

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 [FEE REQUIRED]
FOR THE FISCAL YEAR ENDED JUNE 30, 1994

OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

FOR THE TRANSITION PERIOD FROM ___ TO ___ COMMISSION FILE NO. 0-9992

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

<TABLE>
<S>

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

<C>
04-2564110
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

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

95134
(ZIP CODE)

</TABLE>

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 434-4200

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

<TABLE>

<S> TITLE OF EACH CLASS -----	<C> NAME OF EACH EXCHANGE ON WHICH REGISTERED -----
NONE	NONE

</TABLE>

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 average bid and asked prices of the registrant's
stock, as of August 31, 1994, was \$994,164,000. 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 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 22,974,230 shares of Common Stock outstanding as of
August 31, 1994.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report to Stockholders for the fiscal year ended June
30, 1994 ("1994 Annual Report to Stockholders"), are incorporated by reference
into Parts I, II and IV of this Report.

Portions of the Proxy Statement for the Annual Meeting of Stockholders
("Proxy Statement") to be held on November 16, 1994, and to be filed pursuant
to Regulation 14A within 120 days after registrant's fiscal year ended June 30,
1994, are incorporated by reference into Part III of this Report.

PART I

Item 1. DESCRIPTION OF BUSINESS

The Company was incorporated under the laws of the State of Delaware in July 1975. The Company's headquarters are located at 160 Rio Robles, San Jose, California, 95134, telephone (408) 434-4200. Unless the text requires otherwise, the "Company" or "KLA" refers to KLA Instruments Corporation and its subsidiaries.

KLA is the leader in design, manufacture, marketing and service of yield management and process monitoring systems for the semiconductor industry. KLA believes that it is the world's largest supplier to the wafer, reticle and metrology inspection equipment markets. The Company sells to virtually all of the world's semiconductor manufacturers and has achieved very high market shares in its principal businesses. KLA's systems are used to analyze product and process quality at critical steps in the manufacture of integrated circuits, providing feedback so that fabrication problems can be identified, addressed and contained. This understanding of defect sources and how to contain them enables semiconductor manufacturers to increase yields. Quickly attaining and then maintaining high yields is one of the most important determinants of profitability in the semiconductor industry. The Company believes that its customers typically experience rapid paybacks on their investments in the Company's systems.

The growing complexity of semiconductor devices, including shrinking feature dimensions, has substantially increased the cost to manufacture semiconductors, making yield loss more expensive. This trend has increased semiconductor manufacturers' demand for systems which permit the detection and containment of process problems. The sensitivity of fabrication yields to defect densities increases as devices become more complex. Further, the escalating capital investments necessary for the construction of semiconductor fabrication facilities heighten manufacturers' need for yield enhancing systems which can leverage their returns on these investments.

Several years ago, the Company recognized the industry's need for in-line monitoring to provide real-time process management capability. In response, the Company devoted substantial resources to developing systems with the throughput, reliability and associated data analysis capabilities for in-process inspection. During the past several years, customers' use of the Company's wafer inspection systems began evolving from single system, off-line engineering analysis applications to multiple systems monitoring critical steps directly on advanced fabrication lines. Positive customer evaluation of the Company's in-line production monitoring systems led to record order levels for the Company's 1993 and 1994 fiscal years. The Company believes that the potential market for in-line monitoring systems is several times larger than its traditional market for engineering analysis systems.

YIELD MANAGEMENT

Maximizing yields, or the number of good die per wafer, is a key goal of modern semiconductor manufacturing. Higher yields increase the revenue a manufacturer can obtain for each semiconductor wafer processed. As line width geometries decrease, yields become more sensitive to the size and density of defects. Semiconductor manufacturers use yield management and process monitoring systems to improve yields by identifying defects, by analyzing them to determine process problems, and, after corrective action has been taken, by monitoring subsequent results to ensure that the problem has been contained. Monitoring and analysis may take place at many points in the fabrication process as wafers move through a production cycle consisting of hundreds of separate process steps.

Semiconductor factories are increasingly expensive to build and equip. Yield management and process monitoring systems, which typically represent a fraction of the total investment required to build and equip a fabrication facility, enable integrated circuit manufacturers to leverage these expensive facilities and improve their returns on investment.

The most significant opportunities for yield improvement generally occur when production is started at new factories and when new products are first built. Equipment that helps a manufacturer to increase yields quickly when products are new enables the manufacturer to offer products in volume at the time when they are likely to generate the greatest profits.

The following are some of the methods used to manage yield; they all require the capture and analysis of data gathered through many measurements:

- o Engineering analysis is performed off the manufacturing line to identify and analyze defect sources. Engineering analysis equipment operates with very high sensitivity to enable comprehensive analysis of wafers. Because they operate off-line, engineering analysis systems do not require high speeds of operation.
- o In-line monitoring is used to review the status of circuits during production steps. Information generated is used to determine whether the fabrication process steps are within required tolerances and to make any necessary process adjustments in real-time before wafer lots move to subsequent process stations. Because the information is needed quickly

to be of greatest value, in-line monitoring requires both high throughput and high sensitivity.

- o Pass/fail tests are used at several steps in the manufacturing process to evaluate products. For example, a pass/fail test is used to determine whether reticles used in photolithography are defect-free; electrical pass/fail testing is performed at the end of the manufacturing process to determine whether products meet performance specifications.

KLA STRATEGY

KLA is the premier supplier of yield management and process monitoring systems to the semiconductor manufacturing industry. Key elements of KLA's strategy are as follows:

- o Leadership in Yield Management. The Company believes that yield management requires both the ability to identify defects and the ability to use defect data: (i) to recognize patterns which reveal process problems; and (ii) to resolve and contain process flaws which are causing reduced yields. The Company has developed yield management solutions that consist of sophisticated defect detection sensors located at key steps in the production process, as well as analysis stations with relational database software that enable isolation of defect sources, identification of problem causes and implementation of corrective action.

The Company believes that its world-wide organization of more than 50 applications engineers provides an important competitive advantage. These applications engineers serve

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as yield management consultants to the Company's customers, assisting in applying KLA's systems to accelerate yield improvement and achieve real-time process control.

- o Development of In-Line Monitoring Market. KLA has introduced a family of wafer inspection systems with the wafer throughput and sensitivity necessary for in-line monitoring. Prior to the introduction of KLA's 2100 series, no suppliers' products were capable of both the speed and the sensitivity needed for in-line inspection for all defect types at critical process steps. In-line inspection is a critical yield enhancement and cost reduction technique because it allows defect detection in real-time rather than waiting until after final test results become available to discover problems that have a significant yield impact. As a result of these advantages, the Company believes that its customers will install multiple systems directly monitoring critical steps in the integrated circuit manufacturing process.
- o Technology Leadership. The Company believes that it is the technological leader in integrated circuit yield management and process control monitoring. To maintain its leadership position, KLA is committed to state-of-the-art multidisciplinary technologies. See "-Technology" on page 8.

The Company's long range objective is to develop an integrated yield management network which spans the semiconductor fabrication process.

YIELD MANAGEMENT AND PROCESS MONITORING SYSTEMS

KLA's systems are developed to work together to offer its customers not just tools, but integrated yield management solutions. KLA offers inspection systems for key steps in the semiconductor manufacturing process and analysis systems comprised of database management hardware and software to translate raw inspection data into patterns which reveal process problems. The Company's wafer inspection and metrology systems are used for engineering analysis and in-line monitoring, and its reticle inspection systems and wafer probers are used for pass/fail tests.

WISARD - Wafer Inspection Systems. KLA's WISARD business unit created the market for automated inspection of semiconductor wafers with the introduction of the KLA 2000 series over nine years ago. KLA continues to have a predominant market share with its current generation of wafer inspection systems, the 2100 series.

KLA's 2100 series, combined with a dedicated defect data gathering and analysis workstation, the KLA 2551, and an off-line Review Station, the KLA 2608, provide semiconductor manufacturers with a yield management system sensitive enough for engineering analysis and fast enough for in-line monitoring of the semiconductor manufacturing process. The 2100 series of inspection systems offers an increase in inspection speed of up to 2,000 times over that of KLA's original wafer inspection system. This marked increase in speed and sensitivity allows customers to obtain very prompt feedback on process status by placing wafer inspection systems on the production line.

The selection of the technology architecture for the 2100 series was made to allow the base unit to support a family of products capable of performance enhancements through upgrades of various subsystems. The first model, the KLA 2110, was introduced in 1991 with sufficient speed and sensitivity to enable in-line inspection of repeating arrays typical in memory devices. One year later, in 1992, KLA introduced a new repeating array model, the KLA 2111, which operates at up to five times the speed of the KLA 2110 and has improved

sensitivity.

Shortly thereafter in 1992, KLA introduced the KLA 2130 which is capable of "all pattern" inspection required for microprocessors and other logic devices as well as both the logic and repeating array portions of memory devices. In late 1993, KLA introduced the new 2131 model for all pattern inspection which operates at up to twice the speed of the KLA 2130 and with higher

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sensitivity. The Company believes that there are further opportunities to expand the 2100 series family of systems and has several new models under development.

To manage defect data, KLA offers the KLA 2551 Analysis Station, a multi-user work station using a relational database for storing defect coordinates and digitized images. Defect analysis and image review operates through a WindowsTM-based interface. The KLA 2551 incorporates an open architecture which consolidates data from inspection systems, review stations, wafer sort electrical testers, host computers, and scanning electron microscopes (SEMs). The data analysis software provides statistical process control reports, defect source analysis, and automated correlation of in-line process defects to bit failures. The graphical software combines both data and image to produce wafer maps, trend charts, and video review. When coupled with an optional remote terminal, the KLA 2551 permits process engineers in remote locations to link to the database of defect records and images to perform further analyses or compare data from different wafer fabrication facilities.

The KLA 2608 Review Station provides a platform for reviewing and classifying defects detected on KLA and non-KLA wafer inspection systems. An operator may append classification codes to the defect record, a record which also includes wafer number, die coordinates, defect location, and defect size.

The average selling prices of KLA's 2100 series of wafer inspection systems range from approximately \$1 million to approximately \$2 million.

RAPID - Reticle Inspection Systems. RAPID, KLA's first business unit, created the market for automated inspection of reticles and photomasks for the semiconductor manufacturing industry over 16 years ago, and continues to have a predominant market share. KLA has delivered over 700 reticle and photomask inspection systems worldwide.

During photolithography, a stepper projects a circuit pattern from a reticle onto a wafer. Error-free reticles are the first step in ensuring high yields in the manufacturing process because defects in reticles can translate into millions of ruined die.

In 1992, KLA introduced its new generation of reticle inspection systems, the 300 series. The KLA 301 Reticle Inspection System and the KLA 30 Reference Data Computer together form the KLA 331 Inspection System which represents a major advance in speed, sensitivity and flexibility. The KLA 331 offers the highest inspection sensitivity available in the market place, which the Company believes is vital to meet reticle inspection requirements for today's more complex microprocessors and larger DRAMs.

During fiscal 1993 and 1994, delays in completing all features of the KLA 331 systems caused a decline in RAPID's business as many customers waited for the new model. Certain ease-of-use and performance enhancements to the KLA 331 which are yet to be completed will be required before some customers will order systems.

The average selling prices of KLA's 331 inspection systems range from approximately \$1.7 million to approximately \$2.6 million.

Metrology - Overlay and Critical Dimension Measurement Systems. Lithography for sub-micron semiconductor fabrication requires increasingly stringent overlay and critical dimension tolerances. In particular, decreasing line widths, larger die sizes, and additional layers have made overlay mis-registration errors a crucial cause of yield loss. To address these challenges, KLA offers the KLA 5000 series metrology systems: the 5100 for overlay; and the 5015 for both overlay and critical dimension measurement. KLA estimates that during its fiscal 1993 and 1994, it had the leading share in the worldwide market for overlay registration systems.

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The KLA 5000 series uses a patented coherence probe microscopy technology which permits fast autofocus and precision critical dimension measurements. Applying its expertise in digital image processing, KLA has developed sophisticated measurement algorithms that are tolerant of process variations. With coherence probe microscopy, the system scans the image-forming coherence region through the wafer plane, only gathering information from in-focus surfaces. As a result, measurements are more tolerant of process and substrate reflectivity variations than those from ordinary optical systems.

The precision measurements from the KLA 5000 series identify the magnitude and direction of overlay mis-registration errors arising from the stepping process and from optical distortion inherent in the stepper lens. Based upon

these measurements, users can fine-tune the stepper program to compensate for these errors, and improve process yield.

The average selling prices of KLA's metrology systems for the semiconductor industry range from approximately \$300,000 to approximately \$550,000.

The disk drive manufacturing industry is an emerging market for KLA's metrology systems. Disk drive manufacturers use a semiconductor photolithography process to produce thin film heads. The Company's coherence probe technology is particularly well-suited to handle the complex topography characteristics encountered in the thin film head process. The Company believes that its solution to these requirements has allowed it to achieve the major share of the thin film head metrology market.

Wafer Probing Systems. The ATS division sells and services a family of automated wafer probers and network controllers which position individual semiconductor devices still in wafer form under electrical test probes. The probers work in conjunction with electronic parametric and functional testers to perform fully automated tests of the performance of completed die before the wafers are diced and packaged. The electrical test procedure also identifies failed die, classifies die by performance and generates a database of test results for use in process control.

KLA develops, manufactures and markets these products in cooperation with Tokyo Electron, Limited ("TEL"), the leading distributor of semiconductor equipment in Japan. KLA develops and manufactures the prober's image processing electronics and optical subsystems. TEL manufactures the prober's mechanical chassis and incorporates the KLA electronics and subsystems. The ATS division sells the integrated prober systems in the United States and Europe with its own control software and custom interfaces. TEL sells and services the integrated prober systems in Japan and the rest of Asia.

The WATCHER business unit develops the image processing subsystems used in ATS' and TEL's wafer prober systems. This image processing computer performs a number of steps: (i) optical character recognition (OCR) to identify the wafer; (ii) precise wafer alignment and positioning to the probe head; and (iii) probe process inspection to monitor prober performance.

The average selling prices of KLA's basic wafer prober systems range from approximately \$150,000 to approximately \$350,000.

PRISM-Software Productivity and Analysis Systems. The PRISM division was formed in June 1994 to enter the software market with a family of standard software packages for the global semiconductor industry. PRISM, which stands for PProcess Information Systems, has adopted a charter to offer software products that enhance yield and maximize factory productivity.

PRISM's first products to market are a set of probe floor networking products that provide an open architecture for prober and tester automation. These were originally developed within the ATS division as an enhancement to ATS prober systems. Within PRISM they have been integrated into an architecture called CIMA, or Control and Information Management

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Architecture, and are being marketed as an open architecture probe floor product suite that will integrate with most any prober and tester regardless of manufacturer.

SEMSpec-Scanning Electron Microscope Inspection Systems. As feature sizes of semiconductor circuits continue to decrease for leading edge semiconductor products, the Company believes that conventional optical technologies ultimately will begin to reach physical limits imposed by the wavelength of light and fail to provide the necessary inspection resolution. Working closely with those customers with the most advanced inspection requirements, KLA has developed the world's only fully automatic electron beam inspection systems. These systems, comprised of the world's fastest scanning electron-optical column and a high speed image computer, are used for reticle and wafer inspection. The development of these systems was funded in part by customer-sponsored research and development programs. KLA has sold four of these systems to customers. KLA expects the market for these inspection systems to emerge slowly.

KLA Acrotec Ltd. The Company has an 8% equity investment in KLA Acrotec, a Japanese company that develops optical systems that inspect flat panel displays utilizing technology developed by the Company. The Company has a research and development agreement with KLA Acrotec to provide research, development and engineering, on a best efforts cost reimbursement basis. The Company believes that KLA Acrotec is the leading supplier of flat screen inspection systems.

CUSTOMERS AND APPLICATIONS

The Company believes that it is one of the few suppliers which sells its systems to virtually all of the world's semiconductor manufacturers. In fiscal 1992 and 1994, no single customer accounted for more than 10% of the Company's revenues. During fiscal 1993, Motorola accounted for approximately 11% of the Company's revenues.

SALES, SERVICE AND MARKETING

The Company sells products through a combination of direct sales and distribution channels. The Company believes that the size and location of its field sales, service and applications engineering organization represents a significant competitive advantage in its served markets. In the United States and Europe, the Company has a direct sales force located in major geographical markets. Sales, service and applications facilities throughout the world employ over 400 sales, service and applications engineers.

In Japan, the Company sells systems for the semiconductor market through TEL. TEL has been the Company's distributor to the Japanese semiconductor market since 1978. The sales effort in Japan is supported by KLA Japan, which provides marketing, applications support, technical support and service to Japanese customers. Over the last two years, the Company significantly increased its customer service organization in Japan in order to assume service and support responsibilities from TEL. KLA Japan has over 100 local employees and occupies facilities at Tachikawa, Osaka and Fukuoka.

In Singapore and Taiwan, the Company sells its systems through local sales representatives. In Korea, the Company will convert, in October 1994, from a local sales representative to a direct sales force.

KLA maintains an export compliance program that fully meets the requirements of the U.S. Department of Commerce. KLA has never been denied approval to ship against a purchase order.

For information regarding the Company's revenues from foreign operations for the Company's last three fiscal years, see Note 3 on page 20 of the 1994 Annual Report to Stockholders, incorporated herein by reference.

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TECHNOLOGY

KLA's inspection and metrology systems precisely capture trillions of features on wafers and reticles that are as small as 10 millionths of an inch on a side and analyze each of these features for possible defects through the use of the following technologies:

Image Acquisition. KLA's systems acquire images of sub-micron features on wafers and reticles. The quality and brightness of the images greatly influence the speed and sensitivity of the final inspection system. KLA has developed a wide range of optical imaging systems, such as laser scanners, interference microscope systems, and conventional white light and deep UV optical systems. To satisfy the future sensitivity requirements of advanced lithography, KLA has already developed an electron beam system which incorporates the world's fastest scanning electron-optical column.

Image Conversion. The Company's equipment converts the photon or electron image to an electronic digital format. KLA has pioneered the use of time-delay-integration sensors that convert as many as 100 million pixels (picture elements) to 256-level gray scale images each second. KLA also utilizes other image conversion technologies such as avalanche diode detectors, photo multiplier systems, and fixed frame pickups.

Precision Mechanics. In the most common configuration of an inspection system, the reticle or the wafer is moved at a constant speed through the field of the imaging system. Since areas of interest are as small as 5 millionths of an inch, and vibrations in the scanning system of one-tenth of the area of interest can degrade system performance, the mechanical stage must be extremely smooth and precise. To address these requirements, KLA has eight years experience in the design and manufacture of air-bearing linear drive stages.

Proprietary Algorithms. To perform the inspection or measurement task, the Company's equipment examines the properties of the digitized images using a set of logical steps (algorithms) which measure the desired image property. KLA's engineers develop sets of algorithms that are specifically tailored to obtain optimum performance for its wafer, reticle and metrology systems. These algorithms are largely responsible for the state-of-the-art performance of KLA's systems.

Image Computers. The combination of proprietary algorithms and special purpose computers allows KLA's equipment to have a high performance to cost ratio. While general purpose computers are capable of executing KLA's algorithms, very few computer architectures can sustain the computing speed that is required in KLA's systems (as high as 72,000 MIPS). To address this requirement, KLA develops and builds special purpose image computers designed to execute its algorithms.

Database Analysis. Many of the inspections that KLA reticle inspection systems perform require a digital image representation of the ideal pattern obtained from the data used to manufacture the reticle. This capability allows inspection systems to compare the actual circuit with its design specifications. KLA has been developing database systems for over 14 years to satisfy this objective. Its present generation of special purpose database computers is capable of generating simulated images at the same high speeds at which KLA's image conversion systems generate the digital image from the actual reticle.

Statistical Process Control. Integrated circuit yield management and process monitoring systems generate hundreds of thousands of data items each day. To enhance the utility of these data, KLA has a team of software

engineers who build systems containing statistical process control software to simplify data and present these data in a useful manner. KLA is continuing to work on new software to enhance its statistical process control systems.

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RESEARCH AND DEVELOPMENT

The market for yield management and process monitoring systems is characterized by rapid technological development and product innovation. The Company believes that continued and timely development of new products and enhancements to existing products are necessary to maintain its competitive position. Accordingly, the Company devotes a significant portion of its personnel and financial resources to research and development programs and seeks to maintain close relationships with customers to remain responsive to their needs.

In order to meet continuing developments in the semiconductor industry and to broaden the applications for its image processing technology, the Company is committed to significant engineering efforts for product improvement and new product development. Approximately 18% of the Company's workforce is engaged in engineering, research and development. For information regarding the Company's research and development expense during the last three fiscal years, see page 18 and 21 of the 1994 Annual Report to Stockholders herein incorporated by reference.

KLA typically receives some external funding from customers, from industry groups, and from government sources to augment its engineering, research and development efforts. In addition, KLA capitalizes some software development costs. Although the timing and the level of these external funds cannot be predicted, the level of such funding and capitalization has been approximately 4%, 4% and 2% of sales for fiscal 1992, 1993 and 1994, respectively. The Company reports engineering, research and development expense net of this funding and capitalization. Thus, recorded amounts for engineering, research and development expense were 17%, 10% and 9% of sales in fiscal 1992, 1993 and 1994, respectively.

MANUFACTURING

The Company's principal manufacturing activities take place in San Jose, California; Bevaix, Switzerland; and Migdal Ha'Emek, Israel; and consist primarily of assembling and testing components and subassemblies which are acquired from third party vendors and then integrated into the Company's finished products. Subsequent to June 30, 1994, the Company began planning the construction of one or two additional buildings on undeveloped land at its San Jose campus facility. The Company is also cross-training personnel, so that it can respond to changes in product mix by reallocating personnel in addition to hiring.

The Company has been working with key vendors to improve inventory management. Volume purchase agreements and just-in-time delivery schedules have reduced both inventory levels and costs. The Company's manufacturing engineers, in conjunction with key vendors, are improving the manufacturability and reliability of the new wafer and reticle inspection systems.

Many of the components and subassemblies are standard products, although certain items are made to Company specifications. Certain of the components and subassemblies included in the Company's systems are obtained from a single source or a limited group of suppliers. Those parts subject to single or limited source supply are routinely monitored by management and the Company endeavors to ensure that adequate supplies are available to maintain manufacturing schedules, should supply for any part be interrupted. Although the Company seeks to reduce its dependence on sole and limited source suppliers, in some cases the partial or complete loss of certain of these sources could have at least a temporary adverse effect on the Company's results of operations and damage customer relationships.

COMPETITION

The market for yield management and process control systems is highly competitive. In each of the markets it serves, the Company faces competition from established and potential competitors, some of which may have greater financial, engineering, manufacturing and marketing resources than the Company. Significant competitive factors in the market for yield

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management and process control systems include system performance, ease of use, reliability, installed base and technical service and support.

The Company believes that, while price and delivery are important competitive factors, the customers' overriding requirement is for systems which easily and effectively incorporate automated, highly accurate inspection capabilities into their existing manufacturing processes, thereby enhancing productivity. The Company's yield management and process control systems for the semiconductor industry are generally higher priced than those of its

present competitors and are intended to compete based upon performance and technical capabilities. These systems also compete with less expensive, more labor-intensive manual inspection devices.

The Company's wafer and reticle inspection systems have a predominant share of their markets. The Company is the leading provider of overlay registration systems. The Company believes it is the second largest supplier of wafer prober systems in the U.S. and Europe.

Many of the Company's competitors are investing in the development of new products aimed at applications currently served by the Company. The Company's competitors in each product area can be expected to continue to improve the design and performance of their products and to introduce new products with competitive price/performance characteristics. Competitive pressures often necessitate price reductions which can adversely affect operating results. Although the Company believes that it has certain technical and other advantages over its competitors, maintaining such advantages will require a continued high level of investment by the Company in research and development and sales and marketing. There can be no assurance that the Company will have sufficient resources to continue to make such investments or that the Company will be able to make the technological advances necessary to maintain these competitive advantages.

The yield management and process control industry is characterized by rapidly changing technology and a high rate of technological obsolescence. Development of new technologies that have price/performance characteristics superior to the Company's technologies could adversely affect the Company's results of operations. In order to remain competitive, the Company believes that it will be necessary to expend substantial effort on continuing product improvement and new product development. There can be no assurance that the Company will be able to develop and market new products successfully or that the products introduced by others will not render the Company's products or technologies non-competitive or obsolete.

PATENTS AND OTHER PROPRIETARY RIGHTS

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

The Company protects its proprietary technology through a variety of intellectual property laws including patents, copyrights and trade secrets. The Company's source code is protected as a trade secret and as an unpublished copyright work. The Company has a number of United States and foreign patents and patent applications. The Company's effort to protect its intellectual property rights through trade secret and copyright protection may be impaired if third parties are able to copy or otherwise obtain and use the Company's technology without authorization. Effective intellectual property protection may be unavailable or limited in certain foreign countries. In addition, the semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. No assurance can be given that any patent held by the Company will be sufficient to protect the Company.

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BACKLOG

Backlog orders for systems were \$125 million as of June 30, 1994, with 99% shippable in one year, as compared with \$52 million as of June 30, 1993, with 98% shippable in one year. The Company generally ships systems within six months after receipt of a customer's purchase order.

EMPLOYEES

As of August 31, 1994, KLA employed a total of approximately 1,135 persons. None of KLA's employees is represented by a labor union. KLA has experienced no work stoppages and believes that its employee relations are excellent.

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

Item 2. PROPERTIES

KLA owns a corporate facility which houses engineering, manufacturing and administrative functions in San Jose, California, occupying approximately 232,000 square feet. The Company purchased this facility in 1990 at a total cost of approximately \$30 million, including improvements. The Company leases additional office space for manufacturing, engineering, sales and service activities, including seven locations in the U.S., four in Europe, three in Japan, and one each in Malaysia, Korea, Taiwan and Israel. Subsequent to June 30, 1994, the Company entered into two leases, for two year terms commencing August 10, 1994 and November 1, 1994, for two buildings adjacent to its campus facility, consisting of an aggregate of approximately 73,000 square feet. Capital expenditures for fiscal 1995 are expected to approximate depreciation; however, this assessment could change if demand continues to exceed estimates

and additional manufacturing capacity is required. No estimate can be made of the size or cost of any such additional capacity. In addition, subsequent to June 30, 1994, the Company began planning the construction of one or two additional buildings on undeveloped land at its campus facility .

Item 3. LEGAL PROCEEDINGS

In June 1990, the Company filed a lawsuit in the U.S. Federal District Court in San Jose, California, against Orbot Systems Ltd. and Orbot, Inc., now Orbotech ("Orbot") for patent infringement. Orbot has since counter-sued for interference with normal business. If the Company were to lose, Orbot would be allowed to continue to sell products using its present illuminator. The Company believes that the outcome of this suit will most likely be determined based upon the validity of KLA's patent, U.S. Patent No. 4,877,326. The case is scheduled to go to trial in early 1995. Management believes the results of this lawsuit will not have a significant adverse effect on the Company.

In November 1993 KLA filed suit, in U.S. District Court in San Jose, CA, against Orbot Instruments Inc. for infringing a KLA patent on die- to-database inspection. Orbot Instruments filed a cross-complaint alleging interference with business. This case is in the early phase of discovery.

The Company is also the defendant in three suits resulting from the discontinuance of the printed circuit inspection business. In one case the trial court denied the plaintiff's demand for damages. This case is under appeal. The other two cases are in early discovery. Management does not believe that these suits will have a significant adverse effect on the Company.

Beginning in August 1992 Jerome Lemelson, an independent inventor, filed suit in U.S. District Court in Reno, NV, against the three U.S. automobile companies, Motorola and several Mitsubishi subsidiaries for the infringement of Lemelson's patents on machine vision. Recently Motorola settled with Lemelson. However, Lemelson has put other semiconductor companies on

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notice . In the event that Lemelson prevails in his suit against other semiconductor companies, KLA may be liable as a potential indemnitor.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable.

PART II

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

"Common Stock" on page 24 of the 1994 Annual Report to Stockholders is incorporated herein by reference.

Item 6. SELECTED FINANCIAL DATA

"Selected Financial Data" on page 14 of the 1994 Annual Report to Stockholders is incorporated herein by reference.

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

"Management's Financial Commentary" on pages 12 and 13 of the 1994 Annual Report to Stockholders is incorporated herein by reference.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements, together with the report thereon of Price Waterhouse LLP dated July 26, 1994, appearing on pages 14 through 24 of the aforementioned 1994 Annual Report to Stockholders are incorporated herein by reference in this Form 10-K Annual Report. With the exception of the information incorporated by reference in Items 1, 5, 6, 7 and 8, the 1994 Annual Report to Stockholders is not to be deemed filed as part of this Form 10-K Annual Report.

Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

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PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names of the present executive officers of the Company, their ages and positions held with the Company.

Name	Age	Position
Kenneth Levy	51	Chairman of the Board of Directors and Chief Executive Officer
Kenneth L. Schroeder	48	President, Chief Operating Officer and Director
Robert J. Boehlke	53	Vice President of Finance and Administration, Chief Financial Officer, and Assistant Secretary
Ben Tsai	36	Vice President, Chief Technical Officer
Gary E. Dickerson	36	Vice President, Wafer Inspection
Michael D. McCarver	48	Vice President, Corporate Sales
Neil Richardson	39	Vice President, Metrology
Magnus O. W. Ryde	38	Vice President, Customer Support
Arthur P. Schnitzer	51	Group Vice President, Wafer and Reticle Inspection
William Turner	38	Vice President, Corporate Controller
Virginia J. DeMars	52	Vice President, Human Resources
Christopher Stoddart	38	Treasurer
Leo J. Chamberlain	64	Director
Robert E. Lorenzini	57	Director
Yoshio Nishi	54	Director
Samuel Rubinovitz	64	Director
Dag Tellefsen	52	Director

Mr. Levy co-founded the Company in July 1975 and served as President and Chief Executive Officer and a Director of the Company until November 1991, when he became Chairman of the Board of Directors and Chief Executive Officer. Since May 1993, Mr. Levy has been a Director of Ultratech Stepper, Inc., a manufacturer of photolithography equipment, and since April 1993 a director of Network Peripherals, Inc., a supplier of high-performance client-server networking solutions.

Mr. Schroeder rejoined the Company in November 1991 as President, Chief Operating Officer and Director. Mr. Schroeder had worked previously at KLA from 1979 through 1987, during which time he held the positions of Vice President of Operations (1979); Vice President and General Manager, RAPID (1982); Vice President and General Manager, WISARD (1983); and Senior Vice President (1985). In July 1988, he became President and Chief Executive Officer of Photon Dynamics, Inc., a manufacturer of electro-optic test equipment. In mid-1989, he was appointed President, Chief Operating Officer, and Director of Genus, Inc., a manufacturer of CVD chemical vapor deposition and ion implant equipment. He left Genus in October 1991, to rejoin KLA Instruments Corporation.

Mr. Boehlke joined the Company in April 1983 as Vice President and General Manager of the RAPID Division. Subsequently, he was General Manager of several divisions and groups of divisions at KLA. In June 1985, Mr. Boehlke was elected to Senior Vice President and to Executive Vice President in January 1989, and to Chief Operating Officer in August 1989 until July 1990, when he became Chief Financial Officer.

Dr. Tsai joined the Company in June 1984 as a member of the WISARD Technical Staff and was promoted to Manager of Algorithm Development for the WISARD Division. From August 1989 until September 1990 he served as Director of Engineering for WISARD. In October 1990, he

was promoted to Vice President of Engineering for KLA Acrotec, and in July 1994 he was elected Vice President of the Company and promoted to Chief Technical Officer.

Mr. Dickerson joined KLA in January 1986 as a Senior Applications Engineer in the Wafer Inspection Division. In July 1987 he was promoted to Manager of Applications Engineering for the Wafer Inspection Division, followed by Manager of Product Planning in July 1989, Director of Marketing in July 1990, and Vice President of Marketing in July 1992. In July 1993, he was promoted to Vice President and Director of the Wafer Inspection Business Unit. In July 1994, he was elected to Vice President of the Company.

Mr. McCarver joined the Company in October 1985 as Vice President of Sales for the RAPID Division, was promoted to General Manager in July 1987, and was additionally elected to Vice President of the Company in August 1989. In August 1993, he became Vice President of Corporate Sales.

Dr. Richardson joined KLA in June 1993 as Vice President and General Manager of the Metrology Division, and was elected Vice President of the Company in July 1994. He served as Vice President and General Manager of Diagnostic Systems Group of Schlumberger Technologies from September 1985 to November 1991, and was the Corporate Technology Adviser for Schlumberger Ltd., a manufacturer of electronic test equipment, from November 1991 to May 1993.

Mr. Ryde joined KLA in June 1980 as Production Control Manager. In May 1981 he was promoted to Materials Manager, followed by Production Manager in January 1982 and Manager, Advance Manufacturing - KLA208 in May 1984. In March 1985 he became Product Marketing Manager for the RAPID Division. In December 1988, after leaving KLA for 6 months to pursue other interests, he returned as Director of EMMI Business within the ATS Division. In January 1989 he was promoted to Director of Operations - Europe, and in March 1991 became Vice

President of Operations for the ATS Division. He was promoted to Vice President and General Manager of the Customer Support Division in July 1992 and was elected to Vice President of the Company in July 1994.

Mr. Schnitzer joined the Company in July 1978 as Software Engineering Manager and was promoted to Director of Engineering of the RAPID Division in July 1982, and was promoted to Vice President in July 1983. He became Vice President of Technology and Marketing of RAPID in May 1987, and Vice President of Advanced Inspection in January 1989. In October 1989, he was promoted to General Manager of the WISARD Division and, additionally, was elected to Vice President of the Company in July 1990. In July 1993, he became Group Vice President of the Wafer and Reticle Inspection Group ("WRInG"), composed of the former RAPID and WISARD divisions.

Mr. Turner joined the Company in September 1983 as a Corporate Financial Analyst, transferred to be the Field Service Financial Administrator of the RAPID Division in August 1984, was promoted to RAPID Division Controller in February 1986, transferred to International Division Controller in July 1988, was promoted to Corporate Controller in December 1989, and was elected Vice President of the Company in July 1990.

Ms. DeMars joined KLA in 1988 as Director of Human Resources after a 13 year career in Employee Relations at Monolithic Memories, Inc. and Advanced Micro Devices. In November 1991, KLA promoted Ms. DeMars to Vice President of Human Resources, worldwide.

Mr. Stoddart joined the Company in December 1991 as Treasurer. Prior to joining the Company, Mr. Stoddart was Treasurer of General Cellular Corporation, a cellular telephone service provider, from October 1989 to September 1991 and previously with The Cooper Companies, Inc., a manufacturer of pharmaceuticals and medical equipment and implant equipment, as Assistant Treasurer from August 1986 to July 1988, and then Treasurer from July 1988 to September 1989.

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Mr. Chamberlain has served as a Director of the Company since 1982. He has served as a Director of Octel Communications Corporation, a manufacturer of high performance voice processing systems since March 1989.

Mr. Lorenzini has served as a Director of the Company since 1976. He has served since January 1993 as Chairman of SunPower Corporation, a manufacturer of optoelectronic devices, and from October 1988 to January 1993, he served as President and Chief Executive Officer. Since July 1993, he has also been a Principal in Dalton Partners, a turn-around management company. He was a founder and, until December 1986, Chairman of the Board of Siltec Corporation, a manufacturer of semiconductor materials and manufacturing equipment. Since October 1986, Mr. Lorenzini has also served as a Director of FSI International, a semiconductor process equipment manufacturer.

Mr. Nishi has served as a Director of the Company since 1989. He is the Director of ULSI Research Laboratory, Hewlett-Packard Laboratories, and also a consultant professor in the Stanford University Department of Electrical Engineering.

Mr. Rubinovitz previously served as a Director of the Company from October 1979 to January 1989, and rejoined the Company as a Director in 1990. From April 1989 through December 1993, he served as Executive Vice President of EG&G, Inc., a diversified manufacturer of scientific instruments and electronic, optical and mechanical equipment, and previously as Senior Vice President of EG&G, Inc. between April 1986 and April 1989. Since April 1989, Mr. Rubinovitz has served as a Director of EG&G. Since October 1984, he has served as Director of Richardson Electronics, Inc., a manufacturer and distributor of electron tubes and semiconductors and, since October 1986, Director of Kronos, Inc., a manufacturer of electronic time keeping systems.

Mr. Tellefsen has served as a Director of the Company since 1978. He is General Partner of the investment manager of Glenwood Ventures I and II, venture capital funds. Since January 1983, he has served as a Director of Iwerks Entertainment, a producer of movie-based specialty theaters, and since 1982, as a director of Octel Communications Corporation.

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Item 11. EXECUTIVE COMPENSATION

The information regarding Executive Compensation as it appears in the Proxy Statement is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information regarding Security Ownership of Certain Beneficial Owners and Management as it appears in the Proxy Statement is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information regarding Certain Relationships and Related Transactions as

it appears in the Proxy Statement is incorporated herein by reference.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES, AND REPORT ON FORM 8-K

- (a) (1) Financial Statements: See Index to Financial Statements, page 19.
- (2) Financial Statement Schedules: See Index to Financial Statement Schedules, page 19. (3) Exhibits: See Index to Exhibits, pages 23, 24 and 25.
- (b) No reports on Form 8-K were filed during the quarter ended June 30, 1994.

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 in the City of San Jose, State of California, on the 27th day of September 1994.

KLA INSTRUMENTS CORPORATION

By WILLIAM TURNER

 William Turner
 Vice President/Corporate Controller

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

<TABLE> <CAPTION>			
Signature	Title	Date	
<S>		<C>	<C>
----- KENNETH LEVY ----- Kenneth Levy	Director, Chairman of the Board, and Chief Executive Officer	September 27, 1994	
----- KENNETH L. SCHROEDER ----- Kenneth L. Schroeder	Director, President And Chief Operating Officer	September 27, 1994	
----- ROBERT J. BOEHLKE ----- Robert J. Boehlke	Vice President Finance and Administration, Chief Financial Officer, and Assistant Secretary	September 27, 1994	
----- Leo J. Chamberlain	Director	September 27, 1994	
----- ROBERT E. LORENZINI ----- Robert E. Lorenzini	Director	September 27, 1994	
----- DR. YOSHIO NISHI ----- Dr. Yoshio Nishi	Director	September 27, 1994	
----- SAMUEL RUBINOVITZ ----- Samuel Rubinovit	Director	September 27, 1994	
----- DAG TELLEFSEN ----- Dag Tellefsen	Director	September 27, 1994	

</TABLE>

KLA INSTRUMENTS CORPORATION AND SUBSIDIARIES

INDEX TO FINANCIAL STATEMENTS

<TABLE> <CAPTION>	Page(s) in 1994 Annual Report*
<S>	<C>
Consolidated Statement of Operations for the three years ended June 30, 1994	14
Consolidated Balance Sheet at June 30, 1993 and 1994	15
Consolidated Statement of Stockholders' Equity for the three years ended June 30, 1994	16
Consolidated Statement of Cash Flows for the three years ended June 30, 1994	17
Notes to the Consolidated Financial Statements	18-23
Report of Independent Accountants	24

INDEX TO FINANCIAL STATEMENT SCHEDULES

<TABLE> <CAPTION>	Page ----
<S>	<C>
Report of Independent Accountants on Financial Statement Schedules For the three years ended June 30, 1994:	20
Schedule VIII - Valuation and Qualifying Accounts	21
Schedule IX - Short-Term Borrowings	22

</TABLE>
*Incorporated by reference from the indicated pages of the 1994 Annual Report to Stockholders.

Financial Statement Schedules not included in this Form 10-K Annual Report have been omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT ACCOUNTANTS ON
FINANCIAL STATEMENT SCHEDULES

To the Board of Directors
of KLA Instruments Corporation

Our audits of the consolidated financial statements referred to in our report dated July 26, 1994, appearing on page 24 of the 1994 Annual Report to Stockholders of KLA Instruments Corporation (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the Financial Statement Schedules listed in the index on page 19 of this Form 10-K. In our opinion, these Financial Statement Schedules present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

Price Waterhouse LLP

San Jose, California
July 26, 1994

KLA INSTRUMENTS CORPORATION
VALUATION AND QUALIFYING ACCOUNTS

DESCRIPTION -----	BALANCE AT BEGINNING OF PERIOD -----	CHARGED TO COSTS AND EXPENSES -----	DEDUCTIONS -----	BALANCE AT END OF PERIOD -----
<S>	<C>	<C>	<C>	<C>
YEAR ENDED JUNE 30, 1992				
Provision for loss on investments	\$ 3,108,000 =====	\$ 333,000 =====	\$ - =====	\$ 3,441,000 =====
Allowance for doubtful accounts	\$ 641,000 =====	\$ 1,011,000 =====	\$ - =====	\$ 1,652,000 =====
YEAR ENDED JUNE 30, 1993				
Provision for loss on investments	\$ 3,441,000 =====	\$ 94,000 =====	\$ - =====	\$ 3,535,000 =====
Allowance for doubtful accounts	\$ 1,652,000 =====	(\$ 183,000) =====	\$ - =====	\$ 1,469,000 =====
YEAR ENDED JUNE 30, 1994				
Provision for loss on investments	\$ 3,535,000 =====	\$ - =====	\$ - =====	\$ 3,535,000 =====
Allowance for doubtful accounts	\$ 1,469,000 =====	\$ 285,000 =====	\$ - =====	\$ 1,754,000 =====

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SCHEDULE IX

KLA INSTRUMENTS CORPORATION
SHORT TERM BORROWINGS

DESCRIPTION -----	BALANCE AT END OF PERIOD -----	WEIGHTED AVERAGE INTEREST RATE -----	MAXIMUM AMOUNT OUTSTANDING DURING THE PERIOD -----	AVERAGE AMOUNT OUTSTANDING DURING THE PERIOD 1 -----	WEIGHTED AVERAGE INTEREST RATE DURING THE PERIOD 2 -----
<S>	<C>	<C>	<C>	<C>	<C>
YEAR ENDED JUNE 30, 1992					
Notes Payable ³	\$4,957,000 =====	6.72%	\$ 8,345,000 =====	\$5,705,000 =====	7.77%
YEAR ENDED JUNE 30, 1993					
Notes Payable ⁴	\$2,532,000 =====	4.51%	\$ 7,742,000 =====	\$3,651,000 =====	5.82%
YEAR ENDED JUNE 30, 1994					
Notes Payable ⁵	\$4,673,000 =====	4.10%	\$ 6,770,000 =====	\$2,958,000 =====	4.95%

1The average borrowings were determined based on the amounts outstanding at each month-end.

2The weighted average interest rate during the year was computed by dividing the interest expense on these borrowings by the average short-term borrowings outstanding during the year.

3Short-term borrowings at June 30, 1992 include \$1.3 million local currency borrowings by one of the Company's foreign subsidiaries under the Company's \$15 million multicurrency line of credit and \$3.7 million of local currency borrowings by certain of the Company's foreign subsidiaries.

4Short-term borrowings at June 30, 1993 include \$1.2 million local currency borrowings by one of the Company's foreign subsidiaries under the Company's \$15 million multicurrency line of credit and \$1.4 million of local currency borrowings by certain of the Company's foreign subsidiaries.

5Short-term borrowings at June 30, 1994 include \$4.2 million local currency borrowings by one of the Company's foreign subsidiaries under the Company's \$10 million multicurrency line of credit and \$0.5 million of local currency borrowings by certain of the Company's foreign subsidiaries.

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INDEX TO EXHIBITS

- (I) EXHIBITS INCORPORATED BY REFERENCE:
- 3.1 Certificate of Incorporation, as amended¹
 - 3.2 Bylaws, as amended⁸
 - 4.3 Rights Agreement dated as of March 15, 1989, between the Company and First National Bank of Boston, as Rights Agent. The Rights Agreement includes as Exhibit A, the form of Right Certificate, and as Exhibit B, the form of Summary of Rights to Purchase Common Stock²
 - 10.15 Statement of Partnership to Triangle Partners dated April 12, 1983³
 - 10.16 Lease Agreement and Addendum thereto dated January 10, 1983, between BBK Partnership and the Company³
 - 10.18 Purchase and Sale Agreement dated January 10, 1983, between BBK Partnership, Triangle Partners and the Company³
 - 10.23 Research and Development Agreement, Cross License and Technology Transfer Agreement and Agreement for Option to License and Purchase Resulting Technology, all dated February 21, 1985, by and between KLA Development No. 3, Ltd., and the Company⁴
 - 10.24 Research and Development Agreement dated February 21, 1985, by and between KLA Development No. 3, Ltd., and the Company⁴
 - 10.25 Agreement for Option to License and Purchase Resulting Technology dated February 21, 1985, by and between KLA Development No. 3, Ltd., and the Company⁴
 - 10.33 (Research and Development) Agreement dated as of February 1, 1987, by and between IBM Corporation and the Company⁵
 - 10.35 Research and Development Agreement, Cross License and Technology Transfer Agreement and Agreement for Option to License and Purchase Resulting Technology, all dated September 30, 1986 and between KLA Development No. 4, Ltd., and the Company⁵
 - 10.43 Amendment to the Exclusive Marketing Agreement dated February 23, 1989, by and between Micrion Limited Partnership and the Company⁶
 - 10.44 Bank Loan Guarantee dated June 29, 1989, by the Company in favor of The First National Bank of Boston for the Micrion Limited Partnership⁶
 - 10.45 Distribution Agreement, dated July 1990, by and between Tokyo Electron Limited, a Japanese Corporation, and the Company⁷
 - 10.46 Principal facility Purchase Agreement dated July 1990, including all exhibits and amendments; Lease Agreement, Termination of Lease, Lot line adjustment, rights of first refusal, Deeds of Trust⁷
 - 10.47 Joint Venture Agreement between the Company and Nippon Mining Company, Limited, dated September 18, 1990⁸
 - 10.48 Exercise of Option to Purchase Technology made effective as of September 30, 1989, by and between KLA Development No. 3, and the Company⁸
 - 10.49 Exercise of Option to Purchase Technology made effective as of January 1, 1990, by and between KLA Development No. 4, and the Company⁸
 - 10.51 Guarantee Agreement between First National Bank of Boston and the Company, dated June 29, 1989⁸
 - 10.52 Amendment to the Guarantee Agreement between First National Bank of Boston and the Company, dated April 19, 1991⁸
 - 10.53 Secured Installment Note between Micrion and First National Bank of Boston, dated April 19, 1991⁸
 - 10.54 Micrion Corporation Series E Preferred Stock Purchase Agreement, dated September 13, 1991⁸
 - 10.55 Micrion Corporation Guaranty and Warrant Agreement, dated December 8, 1989⁸
 - 10.57 Stock repurchase and option grant agreement between Bob Boehlke and the Company, dated April 22, 1991⁸
 - 10.58 Purchase Agreement between the Company and Ono Sokki Co., Ltd., dated October 18, 1991 with

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- requested, excise⁹
- 10.59 Credit Agreement between Bank of America NT & SA and the Company, dated November 15, 1991, as amended July 29, 1992⁹
 - 10.60 Employment agreement between the Company and Kenneth L. Schroeder dated October 4, 1991⁹
 - 10.61 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated October 28, 1992¹⁰
 - 10.62 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated December 31, 1992¹⁰
 - 10.63 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated February 28, 1993¹⁰
 - 10.64 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated March 31, 1993¹⁰
 - 10.65 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated June 1, 1993¹⁰
 - 10.69 1982 Stock Option Plan, as amended by the Board of Directors on July 20, 1990¹²
 - 10.70 1981 Employee Stock Purchase Plan, as amended by the Board of Directors on July 20, 1990¹³
 - 10.71 1990 Outside Directors Stock Option Plan¹⁴
 - 10.72 1993 Employee Stock Purchase Plan, as amended by the Board of Directors on September 14, 1992.¹⁵

(II) EXHIBITS INCLUDED HEREWITH:

- 10.66 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated December 31, 1993
- 10.67 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated March 31, 1994
- 10.68 Credit Agreement between Bank of America NT & SA and the Company, dated April 30, 1994
- 13 1994 Annual Report to Stockholders. This Annual Report shall not be deemed to be filed except to the extent that the information is specifically incorporated by reference
- 21 List of Subsidiaries of KLA Instruments Corporation
- 23.1 Consent of Independent Accountants

¹Filed as the same exhibit number as set forth herein to Form S-8, File No. 33-15784, effective August 2, 1987

²Filed as exhibit number 1 to Form 8-A, filed effective March 23, 1989

³Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1983

⁴Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1985

⁵Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1987

⁶Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1989

⁷Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1990

⁸Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1991

⁹Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1992

¹⁰Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1993

¹¹Filed as the same exhibit number to Registrant's registration statement no. 33-51819 on Form S-3, dated February 2, 1994

¹²Filed as exhibit number 4.4 as set forth herein to Registrant's Form 10-K for the year ended June 30, 1990

¹³Filed as exhibit number 4.5 as set forth herein to Registrant's Form 10-K for the year ended June 30, 1990

¹⁴Filed as exhibit number 4.6 as set forth herein to Registrant's Form 10-K for the year ended June 30, 1991

¹⁵Filed as exhibit number 4.7 as set forth herein to Registrant's Form 10-K for the year ended June 30, 1993

AMENDMENT OF CREDIT AGREEMENT BETWEEN BANK OF AMERICA
NT & SA AND THE COMPANY DATED DECEMBER 31, 1993

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SEVENTH AMENDMENT TO CREDIT AGREEMENT

This SEVENTH AMENDMENT TO CREDIT AGREEMENT (this Amendment"), dated as of December 31, 1993, is entered into by and between KLA INSTRUMENTS CORPORATION (the "Borrower") and BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION ("the Bank").

Recitals

A. The Bank and the Borrower are parties to a Credit Agreement, dated as of November 15, 1991 (the "Original Credit Agreement"), as amended by a Waiver and First Amendment, dated as of July 29, 1992, by a Second Amendment to Credit Agreement, dated as of October 28, 1992, by a Third Amendment to Credit Agreement, dated as of December 31, 1992, by a Fourth Amendment to Credit Agreement, dated as of February 28, 1993, by a Fifth Amendment to Credit Agreement, dated as of March 31, 1993, and by a Sixth Amendment to Credit Agreement, dated as of June 1, 1993 (the Original Credit Agreement, as so amended, is referred to herein as the "Credit Agreement"), pursuant to which the Bank has extended certain credit facilities to the Borrower and certain of its subsidiaries.

B. The Borrower has requested that the Bank extend this Credit Agreement, as set forth in this Seventh Amendment.

C. The Bank is willing to amend the Credit Agreement subject to the terms and conditions of this Amendment.

NOW, THEREFORE, for valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto hereby agree as follows:

1. Defined Terms. Unless otherwise defined herein, capitalized terms used herein shall have the meanings, if any, assigned to them in the Credit Agreement.

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2. Amendments to Credit Agreement.

(a) The first sentence of Paragraph 1.1 of the Credit Agreement is hereby amended by replacing the phrase "December 31, 1993" with the phrase "March 31, 1994."

(b) The sixth sentence of Paragraph 1.2(b) of the Credit Agreement is hereby amended by replacing the phrase "December 31, 1993" with the phrase "March 31, 1994."

(c) The definition of the term "CD Rate Interest Period" occurring in Paragraph 1.3 (g) of the Credit Agreement is hereby amended by replacing the phrase "beyond June 30, 1994" with the phrase "beyond September 30, 1994."

(d) The definition of the term "Offshore Rate Interest Period" occurring in Paragraph 1.4 (f) of the Credit Agreement is hereby amended by replacing the phrase "beyond June 30, 1994" with the phrase "beyond September 30, 1994".

(e) Paragraph 1.5 (d) of the Credit Agreement is hereby amended by replacing the phrase "June 30, 1994" with the phrase "December 31, 1994".

(f) Section 1.6 (d) of the Credit Agreement is hereby amended to read in full as follows: "No standby letter of credit shall expire later than March 31, 1995."

(g) The first sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "December 31, 1993" with the phrase "March 31, 1994."

(h) The second sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "and the last period which shall end on December 31, 1993" with the phrase "and the last period which shall end on March

31, 1994."

(i) The third sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "December 31, 1993" with the phrase "March 31, 1994."

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3. Representations and Warranties. The Borrower hereby represents and warrants to the Bank as follows:

(a) No Event of Default has occurred and is continuing, and no event has occurred or condition exists which with notice or the passage of time would become an Event of Default..

(b) The execution, delivery, and performance by the Borrower of this Amendment have been duly authorized by all necessary corporate and other action and do not and will not require any registration with, consent or approval of, notice to or action by, any person (including any governmental agency) in order to be effective and enforceable. The Credit Agreement as amended by this Amendment constitutes the legal, valid, and binding obligations of the Borrower, enforceable against it in accordance with its respective terms, without defense, counterclaim or offset.

(c) All representations and warranties of the Borrower contained in the Credit Agreement are true and correct.

(d) The Borrower is entering into this Amendment on the basis of its own investigation and for its own reasons, without reliance upon the Bank or any other person.

4. Effective Date. This Amendment will become effective as of December 31, 1993 (the "Effective Date") provided that each of the following conditions precedent has been satisfied:

(a) The Bank has received from the Borrower a duly executed original of this Amendment.

(b) All representations and warranties contained herein are true and correct as of the Effective Date.

5. Reservation of Rights. The Borrower acknowledges and agrees that the execution and delivery by the Bank of this Amendment shall not be deemed to create a course of dealing or otherwise obligate the Bank to forbear or execute similar amendments under the same or similar circumstances in the future.

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6. Miscellaneous.

(a) Except as herein expressly amended, all terms, covenants, and provisions of the Credit Agreement are and shall remain in full force and effect and all references therein to such Credit Agreement shall henceforth refer to the Credit Agreement as amended by this Amendment. This Amendment shall be deemed incorporated into, and a part of, the Credit Agreement.

(b) This Amendment shall be binding upon and inure to the benefit of the parties hereto and thereto and their respective successors and assigns. No third party beneficiaries are intended in connection with this Amendment.

(c) This Amendment shall be governed by and construed in accordance with the law of the State of California.

(d) This Amendment may be executed in any number of counterparts, each of which shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument.

(e) This Amendment, together with the Credit Agreement, contains the entire and exclusive agreement of the parties hereto with reference to the matters discussed herein and therein. This Amendment supersedes all prior drafts and communications with respect thereto. This Amendment may not

be amended except in writing executed by both of the parties hereto.

(f) If any term or provision of this Amendment shall be deemed prohibited by or invalid under any applicable law, such provision shall be invalidated without affecting the remaining provisions of this Amendment or the Credit Agreement, respectively.

(g) The Borrower covenants to pay to or reimburse the Bank, upon demand, for all costs and expenses (including allocated costs of in-house counsel) incurred in connection with the development, preparation, negotiation, execution and delivery of this Amendment, including without limitation appraisal, audit, search and filing fees incurred in connection therewith.

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IN WITNESS WHEREOF, the parties hereto have executed and delivered this Amendment as of the date first above written.

KLA INSTRUMENTS CORPORATION

By:

Title:

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION

By:

Kevin McMahon, Vice President

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EXHIBIT 10.67

AMENDMENT OF CREDIT AGREEMENT BETWEEN BANK OF AMERICA NT & SA AND THE
COMPANY DATED MARCH 31, 1994

EIGHTH AMENDMENT TO CREDIT AGREEMENT

This EIGHTH AMENDMENT TO CREDIT AGREEMENT (this "Amendment"), dated as of March 31, 1994, is entered into by and between KLA INSTRUMENTS CORPORATION (the "Borrower") and BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION ("the Bank").

Recitals

A. The Bank and the Borrower are parties to a Credit Agreement, dated as of November 15, 1991 (the "Original Credit Agreement"), as amended by a Waiver and First Amendment, dated as of July 29, 1992, by a Second Amendment to Credit Agreement, dated as of October 28, 1992, by a Third Amendment to Credit Agreement, dated as of December 31, 1992, by a Fourth Amendment to Credit Agreement, dated as of February 28, 1993, by a Fifth Amendment to Credit Agreement, dated as of March 31, 1993, by a Sixth Amendment to Credit Agreement, dated as of June 1, 1993 and by a Seventh Amendment to Credit Agreement, dated as of December 31, 1993 (the Original Credit Agreement, as so amended, is referred to herein as the "Credit Agreement") , pursuant to which the Bank has extended certain credit facilities to the Borrower and certain of its subsidiaries.

B. The Borrower has requested that the Bank extend the Credit Agreement, as set forth in this Eighth Amendment.

C. The Bank is willing to amend the Credit Agreement subject to the terms and conditions of this Amendment.

NOW, THEREFORE, for valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto hereby agree as follows:

1. Defined Terms. Unless otherwise defined herein, capitalized terms used herein shall have the meanings, if any, assigned to them in the Credit Agreement.

2. Amendments to Credit Agreement.

(a) The first sentence of Paragraph 1.1 of the Credit Agreement is hereby amended by replacing the phrase "March 31, 1994" with the phrase "April 30, 1994".

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(b) The sixth sentence of Paragraph 1.2(b) of the Credit Agreement is hereby amended by replacing the phrase "March 31, 1994" with the phrase "April 30, 1994".

(c) The first sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "March 31, 1994" with the phrase "April 30, 1994".

(d) The second sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "and the last period which shall end on March 31, 1994" with the phrase "and the last period which shall end on April 30, 1994".

(e) The third sentence of Paragraph 1.9 of the Credit Agreement is hereby amended by replacing the phrase "March 31, 1994" with the phrase "April 30, 1994".

3. Representations and Warranties. The Borrower hereby represents and warrants to the Bank as follows:

(a) No Event of Default has occurred and is continuing, and no event has occurred or condition exists which with notice or the passage of time would become an Event of Default.

(b) The execution, delivery, and performance by the Borrower of this Amendment have been duly authorized by all necessary corporate and other action and do not and will not require any registration with, consent or approval of, notice to or action by, any person (including any governmental agency) in order to be effective and enforceable. The Credit Agreement as amended by this Amendment constitutes the legal, valid, and binding obligations of the Borrower, enforceable against it in accordance with its respective terms, without defense, counterclaim or offset.

(c) All representations and warranties of the Borrower contained in the Credit Agreement are true and correct.

(d) The Borrower is entering into this Amendment on the basis of its own investigation and for its own reasons, without reliance upon the Bank or any other person.

4. Effective Date. This Amendment will become effective as of MARCH 31, 1994 (the "Effective Date") provided that each of the following conditions precedent has been satisfied:

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(a) The Bank has received from the Borrower a duly executed original of this Amendment.

(b) All representations and warranties contained herein are true and correct as of the Effective Date.

5. Reservation of Rights. The Borrower acknowledges and agrees that the execution and delivery by the Bank of this Amendment shall not be deemed to create a course of dealing or otherwise obligate the Bank to forbear or execute similar amendments under the same or similar circumstances in the future.

6. Miscellaneous.

(a) Except as herein expressly amended, all terms, covenants, and provisions of the Credit Agreement are and shall remain in full force and effect and all references therein to such Credit Agreement shall henceforth refer to the Credit Agreement as amended by this Amendment. This Amendment shall be deemed incorporated into, and a part of, the Credit Agreement.

(b) This Amendment shall be binding upon and inure to the benefit of the parties hereto and thereto and their respective successors and assigns. No third party beneficiaries are intended in connection with this Amendment.

(c) This Amendment shall be governed by and construed in accordance with the law of the State of California.

(d) This Amendment may be executed in any number of counterparts, each of which shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument.

(e) This Amendment, together with the Credit Agreement, contains the entire and exclusive agreement of the parties hereto with reference to the matters discussed herein and therein. This Amendment supersedes all prior drafts and communications with respect thereto. This Amendment may not be amended except in writing executed by both of the parties hereto.

(f) If any term or provision of this Amendment shall be deemed prohibited by or invalid under any applicable law, such provision shall be invalidated without affecting the remaining provisions of this Amendment or the Credit Agreement, respectively.

(g) The Borrower covenants to pay to or reimburse the Bank, upon demand, for all costs and expenses (including allocated costs of in-house counsel) incurred in

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connection with the development, preparation, negotiation, execution and delivery of this Amendment, including without limitation appraisal, audit, search and filing fees incurred in connection

therewith.

IN WITNESS WHEREOF, the parties hereto have executed and delivered this Amendment as of the date first above written.

KLA INSTRUMENTS CORPORATION

By: _____

Title:

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION

By: _____
Stephen L Parry, Vice President

EXHIBIT 10.68

CREDIT AGREEMENT BETWEEN BANK OF AMERICA NT & SA AND THE COMPANY DATED APRIL 30, 1994

CREDIT AGREEMENT

DATED AS OF APRIL 30, 1994

BETWEEN

KLA INSTRUMENTS CORPORATION

AND

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION

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CREDIT AGREEMENT

THIS CREDIT AGREEMENT (this "Agreement") is entered into as of April 30, 1994, between KLA INSTRUMENTS CORPORATION (the "Borrower"), and BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION (the "Bank").

In consideration of the mutual covenants and agreements contained herein, the Borrower and the Bank agree as follows:

ARTICLE I

DEFINITIONS AND FINANCIAL REQUIREMENTS.

1.01 Definitions. The following terms (including plural and singular versions thereof) have the meanings indicated:

"Acceptable Subsidiary": a Subsidiary of the Borrower acceptable to the Bank in its sole discretion that (a) is specified as a "Borrower" on a continuing guaranty executed by the Borrower in form and substance satisfactory to the Bank, and (b) has executed such credit and related documentation with and in favor of the Bank as the Bank may request.

"Advance": an advance hereunder.

"Availability Period": the period commencing on the date of this Agreement and ending on the date that is the earlier to occur of (a) 12/31/94, and (b) the date on which the Bank's commitment to extend credit hereunder terminates.

"Business Day": any day other than a Saturday, a Sunday, or other day on which commercial banks in San Francisco, California, are authorized or required by law to close and, if the applicable Business Day relates to any Offshore Rate Advance, means such a day on which dealings are carried on in the applicable offshore interbank market.

"CD Rate": for any CD Rate Interest Period, the rate of interest (rounded upward to the next 1/100th of 1%) determined pursuant to the following formula:

$$\text{CD Rate} = \frac{\text{Certificate of Deposit Rate} + \text{Assessment Rate}}{1.00 - \text{Reserve Percentage}}$$

Where:

"Assessment Rate" means, for any day of such CD Rate Interest Period, the rate determined by the Bank as equal to the annual assessment rate in effect on the first day of such CD Rate Interest Period that is payable to the Federal Deposit Insurance Corporation ("FDIC") by a member of the Bank Insurance Fund that is classified as adequately capitalized and within supervisory subgroup "A" (or a comparable successor assessment risk classification within the meaning of 12 C.F.R. Section 327.3(d)) for insuring time deposits at offices of such member in the United States, or, in the event that the

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FDIC shall at any time hereafter cease to assess time deposits based upon such classifications or successor classifications, equal to the maximum annual assessment rate in effect on such day that is payable to the FDIC by commercial banks (whether or not applicable to the Bank) for insuring time deposits at offices of such banks in the United States.

"Certificate of Deposit Rate" means, for any CD Rate Interest Period, the rate of interest per annum determined by the Bank to be the arithmetic mean (rounded upward to the nearest 1/100th of 1%) of the rates notified to the Bank as the rates of interest bid by two or more certificate of deposit dealers of recognized standing selected by the Bank for the purchase at face value of dollar certificates of deposit issued by major United States banks, for a maturity comparable to the CD Rate Interest Period and in the approximate amount of the CD Rate Advance to be made, at the time selected by the Bank on the first day of such CD Rate Interest Period.

"Reserve Percentage" means, for any CD Rate Interest Period the maximum reserve percentage (expressed as a decimal, rounded upward to the nearest 1/100th of 1%), as determined by the Bank, in effect on the first day of such interest period (including any ordinary, marginal, emergency, supplemental, special and other reserve percentages) prescribed by the FRB for determining the maximum reserves to be maintained by member banks of the Federal Reserve System with deposits exceeding \$1,000,000,000 for new non-personal time deposits for a period comparable to the CD Rate Interest Period and in an amount of \$100,000 or more.

"CD Rate Advance": an Advance that bears interest based on the CD Rate.

"CD Rate Interest Period": for each CD Rate Advance, the period commencing on the date the CD Rate Advance begins to bear interest at a rate based on the CD Rate and ending 30, 60, 90, or 180 days thereafter, as requested by the Borrower; provided, however, that no such CD Rate Interest Period shall extend beyond the Final Maturity Date.

"Closing Date": the date on which all conditions to the initial extension of credit hereunder are satisfied.

"Code": the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder as from time to time in effect.

"Credit Documents": collectively, this Agreement and each other agreement, documents and instrument now or hereafter delivered to the Bank (including any Offshore Credit Provider) in connection with the credits established herein and the transactions contemplated hereby.

"Credit Limit": the amount \$10,000,000 or the Equivalent Amount thereof.

"Default": any event or circumstance which, with the giving of notice, the lapse of time, or both, would (if not cured or otherwise remedied during such time) constitute an Event of Default.

"Dollars", "dollars" and "\$": each, lawful money of the United States.

"Dollar Advances": specified in subsection 2.01(b).

"Environmental Laws": any foreign, federal, state, local, or municipal laws, rules, orders, regulations, statutes, ordinances, codes, decrees, requirements of any governmental authority, any and

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all requirements of law and any and all common law requirements, rules, and bases of liability regulating, relating to, or imposing liability or standards of conduct concerning pollution or protection of human health or the environment, as now or may at any time hereafter may be in effect.

"Equivalent Amount": (a) whenever this Agreement requires or permits a determination on any date of the equivalent in dollars of an amount expressed in a currency other than dollars, the equivalent amount in dollars of any amount expressed in a currency other than dollars as determined by the Bank on such date on the basis of the Spot Rate for the purchase of dollars with such other currency on the relevant date; or (b) whenever this Agreement requires or permits a determination on any date of the equivalent in a currency other than dollars of an amount expressed in dollars, the equivalent amount in a currency other than dollars of an amount expressed in dollars as determined by the Bank on such date on the basis of the Spot Rate for the purchase of such other currency with dollars on the relevant date.

"ERISA": the Employee Retirement Income Security Act of 1974, as amended, and the rules and regulations promulgated thereunder as from time to time in effect.

"ERISA Event": (a) a Reportable Event with respect to a Pension Plan; (b) a withdrawal by the Borrower from a Pension Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer (as defined in Section 4001(a)(2) of ERISA) or a cessation of operations which is treated as such a withdrawal under Section 4062(e) of ERISA; (c) the filing of a notice of intent to terminate, the treatment of a plan amendment as a termination under Section 4041 or 4041A of ERISA or the commencement of proceedings by the PBGC to terminate a Pension Plan subject to Title IV of ERISA; (d) a failure by the Borrower to make required contributions to a Pension Plan or other Plan subject to Section 412 of the Code; (e) an event or condition which might reasonably be expected to constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Pension Plan; (f) the imposition of any liability under Title IV of ERISA, other than PBGC premiums due but not delinquent under Section 4007 of ERISA, upon the Borrower; or (g) an application for a funding waiver or an extension of any amortization period pursuant to Section 412 of the Code with respect to any Pension Plan.

"Event of Default": any event listed in Article VIII of this Agreement.

"FDIC": the Federal Deposit Insurance Corporation, or any entity succeeding to any of its principal functions.

"Final Maturity Date": (a) in respect of any Advances, June 30, 1995; (b) in respect of any commercial letters of credit, June 30, 1995; (c) in respect of any standby letters of credit, December 31, 1995.

"Floating Rate": specified in subsection 2.02(a).

"FRB": the Board of Governors of the Federal Reserve System, or any entity succeeding to any of its principal functions.

"Hazardous Substance": any hazardous or toxic substance, material, or waste, defined, listed, classified, or regulated as such in or under any Environmental Laws, including asbestos, petroleum, or petroleum products (including gasoline, crude oil, or any fraction thereof), polychlorinated biphenyls, and urea-formaldehyde insulation.

"IRS": the Internal Revenue Service or any entity succeeding to any of its principal functions under the Code.

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"L/C Outstanding Amount": at any time, the undrawn amount at such time

of any letter of credit issued hereunder, plus the amount of all drafts or drawings paid or accepted by the Bank which have not yet been reimbursed to the Bank, plus any other obligation or liability of the Borrower or any Acceptable Subsidiary to the Bank with respect to any letter of credit issued under this Agreement.

"Local Currency": specified in subsection 2.01(b).

"Local Currency Advance": specified in subsection 2.01(b).

"Material Adverse Effect": (a) a material adverse change in, or a material adverse effect upon, the operations, business, properties, condition (financial or otherwise) or prospects of the Borrower or the Borrower and its Subsidiaries taken as a whole; (b) a material impairment of the ability of the Borrower or any Acceptable Subsidiary to perform under any Credit Document; or (c) a material adverse effect upon the legality, validity, binding effect or enforceability of any Credit Document.

"Offshore Credit Provider": a foreign office, foreign branch or foreign affiliate of the Bank, acceptable to the Bank.

"Offshore Currency": specified in subsection 2.01(b).

"Offshore Currency Advance": specified in subsection 2.01(b).

"Offshore Rate": for each Offshore Rate Interest Period, the rate of interest (rounded upward to the next 1/16th of 1%) determined pursuant to the following formula:

$$\text{Offshore Rate} = \frac{\text{Offered Rate}}{1.00 - \text{Eurodollar Reserve Percentage}}$$

Where:

"Offered Rate" means the rate of interest at which deposits in the applicable currency in the approximate amount of the Offshore Rate Advance to be made and having a maturity comparable to such Offshore Rate Interest Period would be offered by the Bank's London Branch (or such other office as may be designated for such purpose by the Bank) to major banks in the London interbank market upon request of such banks at approximately 11:00 a.m. (London, England time) two Business Days prior to the first day of such Offshore Rate Interest Period.

"Eurodollar Reserve Percentage" means, for any Offshore Rate Interest Period, the maximum reserve percentage (expressed as a decimal, rounded upward to the next 1/100th of 1%) in effect on the first day of such Offshore Rate Interest Period (whether or not applicable to the Bank) under regulations issued from time to time by the FRB for determining the maximum reserve requirement (including any emergency, supplemental or other marginal reserve requirement) with respect to Eurocurrency funding (currently referred to as "Eurocurrency liabilities") having a term comparable to such Offshore Rate Interest Period.

"Offshore Rate Advance": an Advance for which interest is based on the Offshore Rate.

"Offshore Rate Interest Period": for each Offshore Rate Advance the period commencing on the date the Offshore Rate Advance begins to bear interest at a rate based on the Offshore Rate and ending one, two, three, or six months thereafter, as requested by the Borrower; provided, however, that

the last day of each Offshore Rate Interest Period shall be determined in accordance with the practices of the applicable offshore interbank markets as from time to time in effect, and provided further that no such interest period shall extend beyond the Final Maturity Date.

"PBGC": the Pension Benefit Guaranty Corporation or any entity succeeding to any of its principal functions under ERISA.

"Pension Plan": a pension plan (as defined in Section 3(2) of ERISA) subject to Title IV of ERISA which the Borrower sponsors, maintains, or to which it makes, is making, or is obligated to make contributions, or in the case of a multiple employer plan (as described in Section 4064(a) of ERISA) has made contributions at any time during the immediately preceding five (5) plan years.

"Plan": an employee benefit plan (as defined in Section 3(3) of ERISA) which the Borrower sponsors or maintains or to which the Borrower makes, is

making, or is obligated to make contributions and includes any Pension Plan.

"Reference Rate": for any day, the rate of interest in effect for such day as publicly announced from time to time by the Bank in San Francisco, California, as its "reference rate." It is a rate set by the Bank based upon various factors including the Bank's costs and desired return, general economic conditions and other factors, and is used as a reference point for pricing some loans, which may be priced at, above, or below such announced rate. Any change in the reference rate announced by the Bank shall take effect at the opening of business on the day specified in the public announcement of such change.

"Reference Rate Advance": an Advance that bears interest based on the Reference Rate.

"Reportable Event": any of the events set forth in Section 4043(b) of ERISA or the regulations thereunder, other than any such event for which the 30-day notice requirement under ERISA has been waived in regulations issued by the PBGC.

"Revolving Facility": the line of credit described in Section 2.01.

"Spot Rate": for a currency, the rate quoted by the Bank as the spot rate for the purchase by the Bank of such currency with another currency through its Foreign Exchange Trading Center #5193, San Francisco, California, or such other of the Bank's offices as it may designate from time to time, at approximately 8:00 a.m. (San Francisco time) on the date two Business Days prior to the date as of which the foreign exchange computation is made.

"Subsidiary": of the Borrower, any corporation, association, partnership, joint venture, or other business entity of which more than 50% of the voting stock or other equity interests (in the case of entities other than corporations), is owned or controlled directly or indirectly by the Borrower or one or more Subsidiaries of the Borrower or a combination thereof.

"Unfunded Pension Liability": the excess of a Plan's benefit liabilities under Section 4001(a)(16) of ERISA, over the current value of that Plan's assets, determined in accordance with the assumptions used for funding the Pension Plan pursuant to Section 412 of the Code for the applicable plan year.

1.02 Financial Requirements. Unless otherwise specified in this Agreement, all accounting terms used in this Agreement shall be interpreted, all financial computations required under this Agreement shall be made, and all financial information required under this Agreement shall be prepared, in accordance with generally accepted accounting principles in effect from time to time in the United States, consistently applied.

ARTICLE II

THE CREDIT FACILITIES

2.01 The Revolving Facility. (a) From time to time during the Availability Period, subject to the terms and provisions hereof, the Bank, on a revolving basis, will (i) make Advances to the Borrower or an Acceptable Subsidiary, (ii) create and issue commercial and standby letters of credit for the Borrower's or an Acceptable Subsidiary's account.

(b) Advances hereunder may be made in (i) dollars ("Dollar Advances"), (ii) in a lawful currency other than dollars which is freely transferable and convertible into dollars and is traded in the offshore interbank currency markets at the time of the Advance (an "Offshore Currency" ("Offshore Currency Advances")), or (iii) in a lawful currency other than dollars which is available at a branch or affiliate of the Bank located in a country other than the United States and is the legal tender of that country where the branch or affiliate is located (a "Local Currency") ("Local Currency Advances").

(c) The aggregate of (i) all Dollar Advances, (ii) the Equivalent Amount of all Offshore Currency Advances and Local Currency Advances, and (iii) the L/C Outstanding Amount of all letters of credit, may not exceed at any one time the Credit Limit.

2.02 Advances Under the Revolving Facility. (a) Subject to the other provisions of this Section, Dollar Advances under the Revolving Facility shall bear interest at a rate per annum equal to the Reference Rate plus 0.00 percentage points per annum (the Reference Rate plus 0.00 percentage points per annum is referred to herein as the "Floating Rate"). The Borrower shall pay or cause the applicable Acceptable Subsidiary to pay interest monthly, on the 1st day of each month until the Final Maturity Date, on which date all accrued and

unpaid interest shall be due and payable. The Borrower shall repay or cause the applicable Acceptable Subsidiary to repay the principal amount of each Reference Rate Advance on the date such advance is converted into an Offshore Rate Advance or a CD Rate Advance under subsections (b) or (c) below, and on the Final Maturity Date.

(b) In lieu of the interest rate described above, the Borrower or the applicable Acceptable Subsidiary may elect during the Availability Period to have all or portions of Advances under the Revolving Facility be in dollars or an Offshore Currency and bear interest at the Offshore Rate plus 0.875% per annum during an Offshore Rate Interest Period, subject to the following requirements:

(i) Each Offshore Rate Advance shall be for an amount not less than \$500,000 or the Equivalent Amount thereof if the related Offshore Rate Interest Period is 30 days or longer, and, if the related Offshore Rate Interest Period is less than 30 days, shall be in an amount not less than an amount which, when multiplied by the number of days in the related Offshore Rate Interest Period, is not less than \$15,000,000, or the Equivalent Amount thereof.

(ii) The Borrower shall pay or shall cause the applicable Acceptable Subsidiary to pay interest on each Offshore Rate Advance on the last day of the Offshore Rate Interest Period for such Advance; provided, however, that if any Interest Period for a Offshore Rate Advance exceeds three months, interest shall also be payable on the date which falls three months after the beginning of such Interest Period and on each date which falls three months after any such interest payment date. The Borrower shall repay or shall cause the applicable Acceptable Subsidiary to repay the principal balance of each Offshore Rate Advance on the last day of the Offshore Rate Interest Period for such Advance, and (if sooner occurring) on the Final Maturity Date.

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(iii) Any payment of an Offshore Rate Advance prior to the last day of the Offshore Rate Interest Period for such Advance, whether voluntary, by reason of acceleration or otherwise, including any mandatory payments required under this Agreement and applied by the Bank to an Offshore Rate Advance, shall be accompanied by the amount of accrued interest on the amount repaid and by the amount (if any) required by Section 3.11.

(c) In lieu of the interest rates described above in this Section, the Borrower or the applicable Acceptable Subsidiary may elect during the Availability Period to have all or portions of Advances under the Revolving Facility be in dollars and bear interest at the CD Rate plus 0.875% per annum during a CD Rate Interest Period, subject to the following requirements:

(i) Each CD Rate Advance shall be in an amount not less than a minimum amount satisfactory to the Bank.

(ii) The Borrower shall pay or shall cause the applicable Acceptable Subsidiary to pay interest on each CD Rate Advance on the last day of the CD Rate Interest Period for such Advance; provided, however, that if any Interest Period for a CD Rate Advance exceeds 90 days, interest shall also be payable on the date which falls 90 days after the beginning of such Interest Period and on each date which falls 90 days after any such interest payment date. The Borrower shall repay or shall cause the applicable Acceptable Subsidiary to repay the principal balance of each CD Rate Advance on the last day of the CD Rate Interest Period for such Advance, and (if sooner occurring) on the Final Maturity Date.

(iii) Any payment of a CD Rate Advance prior to the last day of the CD Rate Interest Period for such Advance, whether voluntary, by reason of acceleration or otherwise, including mandatory payments required under this Agreement and applied by the Bank to a CD Rate Advance, shall be accompanied by the amount of accrued interest on the amount repaid and by the amount (if any) required by Section 3.11.

(d) For purposes of determining the Borrower's and any applicable Acceptable Subsidiary's compliance with subsection 2.01(c), the Equivalent Amount of Offshore Currency Advances shall be determined, and redetermined by the Bank as of the applicable borrowing date in respect of such Advance (including the date such Advance was converted into an Offshore Currency Advance under subsection 2.02(b)), and on the last Business Day of each month.

2.03 Commercial Letters of Credit under the Revolving Facility. (a) Each commercial letter of credit shall be denominated in dollars and issued pursuant to the terms and conditions hereof and of a Bank standard form

Application and Security Agreement for Commercial Letter of Credit (or such other form as the Bank may require) executed by the Borrower or an Acceptable Subsidiary.

(b) Each commercial letter of credit shall:

(i) expire on or before 180 days after the date such letter of credit is issued, but in no event later than the Final Maturity Date;

(ii) require drafts payable in dollars at sight or up to 180 days after sight; and

(iii) be otherwise in form and substance and in favor of beneficiaries and for purposes satisfactory to the Bank.

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(c) The Borrower shall pay or cause the applicable Acceptable Subsidiary to pay to the Bank issuance fees, negotiation fees, and other fees at the times and in the amounts the Bank advises the Borrower from time to time as being applicable to the Borrower's or the Acceptable Subsidiary's commercial letters of credit.

(d) Each draft paid by the Bank under a commercial letter of credit issued hereunder shall be reimbursed by the Borrower or the applicable Acceptable Subsidiary to the Bank on the date such draft is paid by the Bank. Any sum owed to the Bank with respect to a commercial letter of credit issued for the Borrower's or any Acceptable Subsidiary's account which is not paid when due shall, at the option of the Bank in each instance, be deemed to be an Advance to the Borrower outstanding under the Revolving Facility and shall thereafter bear interest at the Floating Rate.

(e) At the expiration of the Availability Period, the Bank may require the Borrower to provide cash collateral in the amount of the L/C Outstanding Amount of any commercial letters of credit outstanding under this Agreement, and, in addition to any other rights or remedies which the Bank may have under this Agreement or otherwise, upon the occurrence of an Event of Default, the Bank may require the Borrower to provide cash collateral in the amount of the L/C Outstanding Amount of any commercial letters of credit outstanding under this Agreement.

2.04 Standby Letters of Credit Under the Revolving Facility. (a) Each standby letter of credit shall be denominated in dollars and issued pursuant to the terms and conditions hereof and of a Bank standard form Application and Agreement for Standby Letter of Credit (or such other form as the Bank may require) executed by the Borrower or an Acceptable Subsidiary.

(b) Each standby letter of credit shall: (i) expire on or before 360 days after the date such letter of credit is issued, but in no event later than the Final Maturity Date; and (ii) be otherwise in form and substance and in favor of beneficiaries and for purposes satisfactory to the Bank.

(c) The Borrower shall pay to the Bank a non-refundable fee equal to 0.875% per annum of the outstanding undrawn amount of each financial standby letter of credit and .0625% per annum of the outstanding undrawn amount of each performance standby letter of credit, payable quarterly in advance, and calculated on the basis of the face amount outstanding on the day the fee is calculated. The decision as to whether the standby letter of credit is defined as financial or performance will be the solely determined by the Bank. However, if an Event of Default exists, at the option of the Bank, the amount of the fee shall be increased to 2.00% per annum, commencing on the day the Bank provides notice of the increase to the Borrower. The Borrower shall also pay such other fees and commissions at the times and in the amounts the Bank advises the Borrower from time to time as being applicable to the Borrower's standby letters of credit.

(d) Each draft paid by the Bank under a standby letter of credit issued hereunder shall be reimbursed by the Borrower or the Acceptable Subsidiary to the Bank on the date such draft is paid by the Bank. Any sum owed to the Bank with respect to a standby letter of credit issued for the Borrower's account which is not paid when due shall, at the option of the Bank in each instance, be deemed to be an Advance outstanding under the Revolving Facility and shall thereafter bear interest at the Floating Rate.

(e) In addition to any other rights or remedies which the Bank may have under this Agreement or otherwise, upon the occurrence of an Event of Default, the Bank may require the Borrower to provide cash collateral in the amount of the L/C Outstanding Amount of any standby letters of credit outstanding under this Agreement.

2.05 Local Currency Advances. (a) From time to time during the Availability Period, the Bank or any Offshore Credit Provider may, in its sole discretion, make Local Currency Advances to the Borrower and to Acceptable Subsidiaries.

(b) Neither the Bank nor any Offshore Credit Provider shall have any obligation to make any Local Currency Advance unless the following conditions are satisfied:

(i) The Bank and the Borrower or the relevant Acceptable Subsidiary agree, at the time of Borrower's or such Acceptable Subsidiary's request for a Local Currency Advance, on the currency, the amount, the principal payment date(s), the interest rate and payment date(s), the prepayment and overdue payment terms, and the reserve, tax and other material provisions for such Advance; and

(ii) The Borrower or such Acceptable Subsidiary shall execute such additional documentation as the Bank or such Offshore Credit Provider may require relating to each Local Currency Advance.

2.06 Mandatory Payment. If at any time and for any reason the total amount of credit outstanding under this Agreement exceeds the limitations set forth herein, the Borrower shall pay to the Bank, upon demand, the amount of the excess. Payments under this Section may be applied to the obligations of the Borrower to the Bank in the order and manner as the Bank in its discretion may determine. Payments to be applied to outstanding letters of credit and drafts accepted under letters of credit may, at the Bank's option, be used to prepay, or held as cash collateral to secure, the Borrower's or any Acceptable Subsidiary's obligations to the Bank with respect thereto.

2.07 Facility Fee. The Borrower shall pay to the Bank a facility fee at the rate of .25% per annum on the total amount of the facility. The facility fee shall be computed on a calendar quarter basis, except for the first period which shall commence on the closing date, and end on March 31, 1994, and the last period which shall end on December 31, 1994. The facility fee shall be payable in arrears on March 31, 1994, on the last day of each successive calendar quarter thereafter, and on the last day of the Availability Period.

2.08 Default Rate. Upon the occurrence and during the continuation of any Event of Default, and without constituting a waiver of any such Event of Default, Advances under the Revolving Facility shall at the option of the Bank bear interest at a rate per annum which is 2.00% per annum higher than the rate of interest otherwise provided under this Agreement.

2.09 Early Termination of Commitment. The Borrower may at any time terminate the Bank's (including any Offshore Credit Provider's) commitment to extend credit hereunder by paying in full the entire amount of credit outstanding hereunder (including the L/C Outstanding Amount, together with any sums due under Section 3.11). Payments to be applied to outstanding letters of credit and drafts accepted under letters of credit, may, at the Bank's option, be used to prepay, or held as cash collateral to secure, the Borrower's and Acceptable Subsidiaries' obligations to the Bank with respect thereto.

2.10 Prior Credit Agreement. The Bank and the Borrower entered into a Credit Agreement, dated as of November 15, 1991, as amended by a Waiver and First Amendment, dated as of July 29, 1992, by a Second Amendment to Credit Agreement, dated as of October 28, 1992, by a Third Amendment to Credit Agreement, dated as of December 31, 1992, by a Fourth Amendment to Credit Agreement, dated as of February 28, 1993, by a Fifth Amendment to Credit Agreement, dated as of March 31, 1993, by a Sixth Amendment to Credit Agreement, dated as of June 1, 1993, and by a Seventh Amendment to Credit Agreement, dated as of December 31, 1993 (as so amended the "Prior

Credit Agreement"). The Bank and the Borrower agree that from and after the Closing Date, the Bank's commitment to make extensions of credit and to continue to extend credit under the Prior Credit Agreement to the Borrower and to the Borrower's Subsidiaries shall terminate without necessity of further act by either the Bank or the Borrower. All credit extended under the Prior Credit Agreement to the Borrower and/or to its Subsidiaries shall be deemed to be credit extended under this Agreement and amounts available for borrowing under this Agreement shall be reduced by the amount of the credit extended and

outstanding under the Prior Credit Agreement.

ARTICLE III

EXTENSIONS OF CREDIT, PAYMENTS AND INTEREST CALCULATIONS

3.01 Requests for Credit. Each request for an extension of credit shall be made in writing on a form acceptable to the Bank or in any other manner acceptable to the Bank.

3.02 Disbursements and Payments. Each disbursement by the Bank and each payment by the Borrower under this Agreement shall be made in the funds and at such branch of the Bank as the Bank may from time to time select.

3.03 Branch Accounts. Each extension of credit under this Agreement shall be made for the account of such branch, office, or affiliate of the Bank as the Bank may from time to time select.

3.04 Evidence of Indebtedness. Principal, interest, and all other sums due to the Bank (or any Offshore Credit Provider) under this Agreement shall be evidenced by entries in records maintained by the Bank (or such Offshore Credit Provider), and, if required by the Bank, by a promissory note or notes. Each payment on and any other credits with respect to principal, interest, and all other sums due under this Agreement shall be evidenced by entries to records maintained by the Bank or such Offshore Credit Provider. The loan accounts or records maintained by the Bank or any Offshore Credit Provider shall be conclusive absent manifest error of the amount of the credit extended hereunder and the interest and payments thereon. Any failure to so record or any error in doing so shall not, however, limit or otherwise affect the obligation of the Borrower or any Acceptable Subsidiary hereunder to pay any amount owing.

3.05 Interest Calculation. Interest based on the Reference Rate shall be computed on the basis of a 365/366-day year, actual days elapsed. All other interest and fees payable under this Agreement shall be computed on the basis of a 360 day year and actual days elapsed, which results in more interest or a larger fee than if a 365-366 day year were used.

3.06 Late Payments; Compounding. Any sum payable by the Borrower hereunder (including unpaid interest) if not paid when due shall bear interest (payable on demand) from its due date until payment in full at a rate per annum equal to the Reference Rate plus 2.00% per annum. At the option of the Bank, in each instance, any sum payable hereunder which is not paid when due (including unpaid interest) may be added to principal of the Revolving Facility and shall thereafter bear interest at the rate applicable to principal.

3.07 Business Day. Any sum payable by the Borrower hereunder which becomes due on a day which is not a Business Day shall be due on the next Business Day after such due date, unless, in the case of an Offshore Rate Loan, the result of such extension would be to carry such Offshore Rate Interest Period into another calendar month, in which event such Offshore Rate Interest Period shall end on the immediately preceding Business Day. Any payments received by the Bank on a day which

is not a Business Day shall be deemed to be received on the next Business Day after such date of receipt.

3.08 Taxes and Other Charges. (a) (i) If any taxes (other than taxes on net income (A) imposed by the country or any subdivision of the country in which the Bank's principal office or actual lending office is located and (B) measured by the United States taxable income the Bank would have received if all payments under or in respect of this Agreement and any instrument or agreement required hereunder were exempt from taxes levied by the Borrower's country) are at any time imposed on any payments under or in respect of this Agreement or any instrument or agreement required hereunder including, but not limited to, payments made pursuant to this Section, the Borrower shall pay all such taxes and shall also pay to the Bank, at the time interest is paid, all additional amounts which the Bank specifies as necessary to preserve the after-tax yield the Bank would have received if such taxes had not been imposed.

(ii) The additional amounts necessary to preserve the after-tax yield the Bank would have received if such taxes had not been imposed shall be calculated pursuant to the formula:

$$y = \frac{(w)(t)(i)}{1-w-t}$$

where the terms are defined as follows:

y = additional payment to be made to the Bank

w = withholding tax rate levied by foreign government

t = the Bank's combined Federal and state tax rate

i = amount of interest to be paid on Credit (computed by using the base rate plus quoted spread)

1 = one

(b) The Borrower will provide the Bank with original tax receipts, notarized copies of tax receipts, or such other documentation as will prove payment of tax in a court of law applying the United States Federal Rules of Evidence, for all taxes paid by the Borrower pursuant to subsection (a) above. The Borrower will deliver receipts to the Bank within 30 days after the due date for the related tax.

3.09 Illegality. (a) If the Bank determines that (i) the introduction of any law, rule, regulation, treaty, or determination of an arbitrator or court or other governmental authority or any change in or in the interpretation or administration thereof has made it unlawful, or that any central bank or other governmental authority has asserted that it is unlawful, for the Bank (directly or through any Offshore Credit Provider) to make or extend any Advance or other credit under this Agreement, or (ii) any order, judgment, or decree of any governmental authority or arbitrator purports by its terms to enjoin or restrain the Bank (or any Offshore Credit Provider) from making or extending any Advance or other credit hereunder, then, on notice thereof by the Bank to the Borrower, the obligation of the Bank to make or extend such Advance or other credit (directly or through any Offshore Credit Provider) shall be

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suspended until the Bank shall have notified the Borrower that the circumstances giving rise to such determination no longer exist.

(b) If the Bank determines that it is unlawful for it or any applicable Offshore Credit Provider to maintain any Offshore Rate Advance or Local Currency Advance hereunder, the Borrower shall prepay in full all Offshore Rate Advances or Local Currency Advances, as the case may be then outstanding, together with interest accrued thereon, either on the last day of the applicable Offshore Rate Interest Period or the interest period applicable to the Local Currency Advance if the Bank or such Offshore Credit Provider may lawfully continue to maintain such Advances to such day and such loans have an interest period, or immediately, if the Bank may not lawfully continue to maintain such Advances or such loans have no interest period, together with any amounts required to be paid in connection therewith pursuant to Section 3.11.

3.10 Increased Costs. The Borrower shall pay to the Bank, on demand, the Bank's costs or losses arising from any statute or regulation, or any request or requirement of a regulatory agency which is applicable to all national banks or a class of all national banks. The costs and losses will be allocated to this facility in a manner determined by the Bank, using any reasonable method. The costs include the following:

(a) any reserve or deposit requirements; and

(b) any capital requirements relating to the Bank's assets and commitments for credit.

3.11 Funding Losses. The Borrower shall reimburse the Bank and hold the Bank harmless from any loss or expense which the Bank may sustain or incur as a consequence of the failure of the Borrower (or any Acceptable Subsidiary) to make any payment or prepayment of principal of any Advance hereunder made at a rate of interest related to the Offshore Rate or the CD Rate (including payments made after any acceleration thereof), or to borrow at such a rate, or the prepayment of an Advance which bears interest at such a rate on a day which is not the last day of the interest period with respect thereto (including payments made after any acceleration thereof or because the total amount of credit exceeds the limitations set forth herein), or the redenomination and conversion, upon the occurrence of any Event of Default, of an Advance which bears interest at such a rate; including any such loss or expense arising from the liquidation or reemployment of funds obtained by it to maintain its Advances made at a rate related to the Offshore Rate or the CD Rate hereunder or from fees payable to terminate any deposits from which such funds were obtained or deemed obtained.

3.12 Inability to Determine Rates. The Bank has no obligation to accept an election for an Offshore Rate Advance or a CD Rate Advance if (a) Dollar deposits in the principal amount, and for the period equal to the interest period, for such Advance are not available in the applicable funding market; or (b) the Offshore Rate or CD Rate does not accurately reflect the cost of such Advance. Nothing contained herein shall, however, obligate the Bank to obtain the funds for any Advance in any particular manner.

3.13 Certificate of the Bank. If the Bank claims any reimbursement or compensation pursuant to Section 3.10 or Section 3.11 hereof, then the Bank shall deliver to the Borrower a certificate setting forth in reasonable detail the amount payable to the Bank thereunder and such certificate shall be conclusive and binding on the Borrower in the absence of manifest error.

3.14 Debits to Borrower's Account. The Borrower hereby authorizes the Bank to debit the Borrower's deposit account number 14831-00220 at the Palo Alto High Technology office of the Bank in the amount of principal, interest, fees, or any other amount due under this Agreement or under any instrument or agreement required under this Agreement. The Bank may, at its option, debit the account

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on the date such amounts become due, or, if such due date is not a Business Day, on the next Business Day after such due date. If there are insufficient funds in the account to cover the amount debited to the accounts in accordance with this Section, such debit may be reversed in whole or in part, at the option of the Bank in its sole discretion, and the amount not debited shall be deemed to remain unpaid.

3.15 Survival. The agreements and obligations of the Borrower under Sections 3.08 through 3.11 hereof shall survive the payment of all other obligations of the Borrower hereunder.

ARTICLE IV

CONDITIONS TO AVAILABILITY OF CREDIT.

The Bank's obligation to extend credit under this Agreement is subject to the Bank's receipt of the following, each in form and substance satisfactory to the Bank:

4.01 Conditions to First Extension of Credit. Before the first extension of credit:

(a) This Agreement, executed by the Borrower;

(b) Satisfactory evidence of due authorization of the execution, delivery, and performance by the Borrower and all Acceptable Subsidiary of this Agreement and any other Credit Documents, including certified resolutions, incumbency certificate, articles of incorporation and bylaws;

(c) If requested by the Bank, an opinion of counsel for the Borrower (which counsel must be satisfactory to the Bank) with respect to such legal matters relating hereto as the Bank may request;

(d) Certificates of state officials showing that the Borrower and any Acceptable Subsidiary is in good standing or qualified to conduct business under the laws of the state of its organization and, if requested by the Bank, in any other state in which the Borrower and any Acceptable Subsidiary is required to be so qualified;

(e) A certificate of an appropriate officer of the Borrower as to the matters set forth in Section 4.02(a) and (b);

(f) Payment of any fee or expense required hereunder prior to the first extension of credit;

(g) A continuing guaranty in favor of the Bank, executed by the Borrower, guaranteeing all debts and obligations (whether contingent or otherwise) of any and all Acceptable Subsidiaries arising under or in connection with this Agreement.

4.02 Conditions to Each Extension of Credit. Before each extension or renewal of credit (including pursuant to any election under Section 2.02(b) and Section 2.02(c), including the first:

(a) The representations and warranties of the Borrower contained in this Agreement shall be true on and as of the date of each extension of credit;

(b) Immediately prior to and immediately after giving effect to such extension of credit, no Default or Event of Default shall exist;

(c) Executed originals of all Credit Documents required under Article II shall have been delivered to the Bank.

Each request for an extension of credit hereunder shall constitute a representation and warranty by the Borrower, as of the date of each such request and as of the date of each extension of credit, that the conditions in this Section are satisfied.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants that:

5.01 Corporate Existence and Power. The Borrower, and each Acceptable Subsidiary: (a) is a corporation duly organized and existing under the laws of the state of its organization; (b) has the power and authority and all governmental licenses, authorizations, consents, and approvals to own its assets, carry on its business, and to execute, deliver, and perform its obligations under, the Credit Documents; and (c) is duly qualified and properly licensed and in good standing under the laws of each jurisdiction where its ownership, lease, or operation of property or the conduct of its business requires such license or qualification.

5.02 Authorization. The execution, delivery, and performance by the Borrower and each Acceptable Subsidiary of this Agreement and any other Credit Document to which any of them is a party, have been duly authorized by all necessary corporate action, and do not and will not:

(a) contravene the terms of any organizational or charter documents;

(b) conflict with or result in any breach or contravention of, or the creation of any lien, security interest, or charge under, any agreement, contract, indenture, document, or instrument to which the Borrower or any Acceptable Subsidiary is a party or by which any property is bound, or any order, injunction, writ, or decree of any governmental authority to which the Borrower or any Acceptable Subsidiary or any property is subject; or

(c) violate any law, rule, regulation, or determination of an arbitrator or of a court or other governmental authority, in each case applicable to or binding upon the Borrower or any Acceptable Subsidiary or any property.

5.03 Enforceability. This Agreement is a legal, valid, and binding agreement of the Borrower, enforceable against the Borrower in accordance with its terms, and the other Credit Documents and any other instrument or agreement required under this Agreement, when executed and delivered, will be legal, valid, binding, and enforceable in accordance with its terms against the Borrower or the Acceptable Subsidiary, as applicable.

5.04 Compliance with Laws. The Borrower and the Acceptable Subsidiaries are in compliance with all foreign, federal, state and local laws, rules, regulations and determinations of arbitrators, courts and other governmental authorities materially affecting the business, operations or property of the Borrower and the Acceptable Subsidiaries (including Environmental Laws).

5.05 Permits, Franchises. The Borrower or its Subsidiaries possess all permits, memberships, franchises, contracts, and licenses required and all trademark rights, trade name rights, patent rights, and fictitious name rights necessary to enable the Borrower and its Subsidiaries to conduct the businesses in which they are now engaged.

5.06 Litigation. There is no litigation, tax claim, proceeding, governmental or administrative action, arbitration proceeding or dispute pending, or, to the knowledge of the Borrower, threatened, against or affecting

the Borrower or any of its Subsidiaries or any of their properties, the adverse determination of which would result in a Material Adverse Effect.

5.07 No Event of Default. There exists no Default or Event of Default.

5.08 Other Obligations. As of the Closing Date, the Borrower is not in default under any other agreement involving the borrowing of money, the extension of credit, or the lease of real or personal property, to which the Borrower is a party as borrower, guarantor, installment purchaser, or lessee, except as disclosed in writing to the Bank prior to the Closing Date.

5.09 Tax Returns. The Borrower has no knowledge of any material pending assessments or adjustments with respect to its income tax liabilities for any year, except as disclosed in writing to the Bank prior to the Closing Date.

5.10 Information Submitted. All financial and other information that has been submitted by the Borrower or an Acceptable Subsidiary to the Bank, including the Borrower's financial statement delivered to the Bank most recently prior to the Closing Date: (a) in the case of financial statements, is prepared in accordance with generally accepted accounting principles consistently applied; and (b) is true and correct in all material respects and is complete insofar as may be necessary to give the Bank true and accurate knowledge of the subject matter thereof.

5.11 No Material Adverse Effect. Since September 30, 1993, there has been no Material Adverse Effect.

5.12 ERISA Compliance. Except as specifically disclosed to the Bank in writing prior to the Closing Date: (a) each Plan is in compliance in all material respects with the applicable provisions of ERISA, the Code and other federal or state law; (b) there are no pending, or to the best knowledge of Borrower, threatened claims, actions or lawsuits, or action by any governmental authority, with respect to any Plan which has resulted or could reasonably be expected to result in a Material Adverse Effect; (c) there has been no prohibited transaction or other violation of the fiduciary responsibility rule with respect to any Plan which could reasonably result in a Material Adverse Effect; (d) no ERISA Event has occurred or is reasonably expected to occur with respect to any Pension Plan; (e) no Pension Plan has any Unfunded Pension Liability; (f) the Borrower has not incurred, nor does it reasonably expect to incur, any liability under Title IV of ERISA with respect to any Pension Plan (other than premiums due and not delinquent under Section 4007 of ERISA); (g) no trade or business (whether or not incorporated under common control with the Borrower within the meaning of Section 414(b), (c), (m) or (o) of the Code) maintains or contributes to any Pension Plan or other Plan subject to Section 412 of the Code; and (h) neither the Borrower or entity under common control with the Borrower in the preceding sentence has ever contributed to any multiemployer plan within the meaning of Section 4001(a)(3) of ERISA.

5.13 Environmental Matters. (a) (i) The properties of the Borrower and its Subsidiaries do not contain and have not previously contained (at, under, or about any such property) any Hazardous Substances or other contamination (A) in amounts or concentrations that constitute or constituted a violation of, or could give rise to liability under, any Environmental Laws, (B) which could interfere with

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the continued operation of such property, or (C) which could impair the fair market value thereof; and (ii) there has been no transportation or disposal of Hazardous Substances from, nor any release or threatened release of Hazardous Substances at or from, any property of the Borrower or any of its Subsidiaries in violation of or in any manner which could give rise to liability under any Environmental Laws.

(b) Neither the Borrower nor any of its Subsidiaries has received or is aware of any material claim or notice of material violation, alleged material violation, non-compliance, liability or potential liability regarding environmental matters or compliance with Environmental Laws with regard to the properties or operations of the Borrower or any of its Subsidiaries, nor does the Borrower have knowledge or reason to believe that any such action is being contemplated, considered, or threatened.

ARTICLE VI

AFFIRMATIVE COVENANTS

So long as credit is available under this Agreement and until full and final payment of all of the Borrower's and any Acceptable Subsidiaries' obligations under this Agreement and any other Credit Document:

6.01 Notices of Certain Events. The Borrower shall promptly give written notice to the Bank of:

(a) all litigation, proceedings or actions affecting the Borrower or its Subsidiaries where the amount claimed is \$ 5,000,000 or more;

(b) any substantial dispute which may exist between the Borrower or its Subsidiaries and any governmental regulatory body or law enforcement authority;

(c) any Default or Event of Default;

(d) any of the representations and warranties in Article V ceases to be true and correct; and

(e) any other matter which has resulted or could reasonably be expected to result in a Material Adverse Effect.

6.02 Financial and Other Information. The Borrower shall deliver to the Bank in form and detail satisfactory to the Bank, and in such number of copies as the Bank may request:

(a) Within 90 days after the end of each fiscal year, the Borrower's consolidated financial statements for such year audited by a certified public accountant together with an unqualified opinion of such certified public accountant;

(b) Within 45 days after the end of each quarterly accounting period, the Borrower's consolidated financial statements for such period prepared by the Borrower;

(c) Within 10 days after the date of filing with the Securities and Exchange Commission, copies of any of the Borrower's Form 10-K Annual Reports, Form 10-Q Quarterly Reports and Form 8-K Current Reports;

(d) Promptly upon request, such other materials and information relating to the Borrower or its Subsidiaries as the Bank may request.

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6.03 Books, Records, Audits and Inspections. The Borrower shall, and shall cause its Subsidiaries to, maintain adequate books, accounts and records, and prepare all financial statements required hereunder in accordance with generally accepted accounting principles consistently applied, and in compliance with the regulations of any governmental regulatory body having jurisdiction over the Borrower or its Subsidiaries, or the Borrower's or its Subsidiaries' businesses, and upon prior notice from the Bank permit employees or agents of the Bank at any reasonable time to inspect the Borrower's and its Subsidiaries' properties, and to examine or audit the Borrower's and its Subsidiaries' books, accounts, and records and make copies and memoranda thereof; provided, however, that during any period in which Default or an Event of Default has occurred and is continuing, the Bank need not give prior notice of inspection, examination, or auditing.

6.04 Use of Facility. The Borrower shall use the credit facility provided herein solely for working capital and other general corporate purposes not in contravention of any requirement of law.

6.05 Insurance. The Borrower shall maintain and keep in force insurance of the types and in amounts customarily carried in lines of businesses similar to those of the Borrower, including fire, extended coverage, public liability (including coverage for contractual liability), property damage (including use and occupancy), business interruption, and workers' compensation, all carried by insurers and in amounts satisfactory to the Bank, with loss payable endorsements on such types of insurance as the Bank may request, and deliver to the Bank from time to time, at the Bank's request, a copy of each insurance policy, or if permitted by the Bank, a certificate of insurance setting forth all insurance then in effect.

6.06 Compliance with Laws. The Borrower shall at all times comply with, and cause its Subsidiaries to comply with, all laws, statutes (including any fictitious name statute), rules, regulations, orders, and directions of any governmental authority having jurisdiction over the Borrower or any of its Subsidiaries or the business of the Borrower or any of its Subsidiaries (including all Environmental Laws).

6.07 Change in Name, Structure or Location. The Borrower shall notify the Bank in writing prior to any change in (a) the Borrower's name or the name of any Acceptable Subsidiary, (b) the Borrower's or any Acceptable Subsidiary's business or legal structure, or (c) the Borrower's or any Acceptable Subsidiary's place of business or chief executive office if the Borrower has more than one place of business.

6.08 Existence and Properties. The Borrower and each of its Subsidiaries shall maintain and preserve its existence and all rights, privileges, and franchises now enjoyed, conduct its business in an orderly, efficient, and customary manner, keep all its properties in good working order and condition, and from time to time make all needed repairs, renewals, or replacements thereto and thereof so that the efficiency of such property shall be fully maintained and preserved.

6.09 Additional Acts. The Borrower shall perform, on request of the Bank, such acts as may be necessary or advisable to perfect any lien or security interest contemplated hereby or otherwise to carry out the intent of this Agreement.

ARTICLE VII
NEGATIVE COVENANTS

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So long as credit is available under this Agreement and until full and final payment of all of the Borrower's and any Acceptable Subsidiary's obligations under this Agreement and any other Credit Document:

7.01 Liens. The Borrower shall not, and shall not suffer or permit any of its Subsidiaries to, create, assume, or suffer to exist any security interest, deed of trust, mortgage, lien (including the lien of an attachment, judgment, or execution), or encumbrance, securing a charge or obligation, on or of any of its or their property, real or personal, whether now owned or hereafter acquired, except: (a) security interests and deeds of trust in favor of the Bank; (b) liens, security interests, and encumbrances in existence as of the date of this Agreement and disclosed to the Bank in writing prior to the Closing Date; (c) liens for current taxes, assessments, or other governmental charges which are not delinquent or remain payable without any penalty; (d) liens in connection with workers' compensation, unemployment insurance, or other social security obligations; (e) mechanics', worker's, materialmen's, landlords', carriers', or other like liens arising in the ordinary and normal course of business with respect to obligations which are not due; (f) purchase money security interests in personal property hereafter acquired when the security interest does not extend beyond the property purchased and (g) additional security interests or liens on fixed assets which secure liabilities (other than liabilities for borrowed money) in an aggregate principal amount not exceeding, at any one time, \$10,000,000 .

7.02 Tangible Net Worth. The Borrower shall not permit as of the last day of any fiscal quarter on a consolidated basis its Tangible Net Worth to be less than \$145,000,000 ; where:

"Tangible Net Worth" means the gross book value of the assets of the Borrower and its Subsidiaries on a consolidated basis (exclusive of goodwill, patents, trademarks, trade names, organization expense, treasury stock, unamortized debt discount and expense, deferred charges, and other like intangibles) less (a) reserves applicable thereto, and (b) all liabilities (including accrued and deferred income taxes).

7.03 Quick Ratio. The Borrower shall not permit as of the last day of any fiscal quarter on a consolidated basis, "A" to be less than 1.25 times "B"; provided, however, that as of the last day of each successive fiscal quarter commencing with the last day of the fiscal quarter in which the aggregate cumulative consideration for acquisitions and purchases permitted under Section 7.05 paid by the Borrower and its Subsidiaries exceeds \$40,000,000, "A" shall not be less than 1.50 times "B", on a consolidated basis.

For purposes of this Section:

"A" means the sum of cash, short-term cash investments, marketable securities not classified as long-term investments and accounts receivable; and

"B" equals current liabilities.

7.04 Total Liabilities to Tangible Net Worth. The Borrower shall not permit as of the last day of any fiscal quarter on a consolidated basis the Borrower's total liabilities to exceed its Tangible Net Worth.

7.05 Acquisitions. The Borrower and its Subsidiaries shall not acquire or purchase control of, or the assets or business of, any other person, firm, or corporation for an aggregate consideration, including assumption of existing obligations, cumulatively, in excess of \$60,000,000.

7.06 Dividends. Neither the Borrower nor any of its Subsidiaries that is not wholly-owned by the Borrower shall declare or pay any dividends or

existing, or purchase, redeem or otherwise acquire for value any of its shares, or create any sinking fund in relation thereto, except: (a) dividends payable solely in its capital stock; (b) up to 25% of earnings available therefor and earned during the immediately preceding fiscal year.

7.07 Loans. Neither the Borrower nor any of its Subsidiaries shall make any loans, advances, or other extensions of credit to any of the Borrower's or such Subsidiary's executives, officers, or directors or shareholders (or any relatives of any of the foregoing) other than in the ordinary course of business, or make loans, advances or other extensions of credit to or invest in any other person, firm, corporation, or other entity, other than (a) investments in cash equivalents; (b) extensions of credit in the nature of accounts receivable or notes receivable arising from the sale or lease of goods or services in the ordinary course of business; (c) extensions of credit by the Borrower to any of its Subsidiaries or by any of its Subsidiaries to another of its Subsidiaries; and (d) other investments not to exceed \$10,000,000 over the life of the Credit Agreement.

7.08 Liquidations and Mergers. The Borrower shall not liquidate or dissolve.

7.09 Sale of Assets. Neither the Borrower nor any of its Subsidiaries shall (a) sell, lease, or otherwise dispose of its business or of assets exceeding \$1,000,000 except for full, fair and reasonable consideration; or (b) sell or otherwise dispose of any of its accounts receivable except in connection with the collection of same in the ordinary course of business.

7.10 Consecutive Quarterly Losses; Losses in One Quarter. The Borrower on a consolidated basis shall not incur, (a) any quarterly net or operating loss in any two (2) consecutive fiscal quarters or (b) any quarterly net or operating loss in excess of 5.00% of Tangible Net Worth.

7.11 Business Activities. The Borrower shall not engage in any business activities or operations substantially different from or unrelated to present business activities and operations.

7.12 Regulations G, T, U, and X. The Borrower shall not, and shall not permit any of its Subsidiaries to, use any portion of the proceeds of any Advances or extensions of credit hereunder, directly or indirectly, (i) to purchase or carry margin stock (within the meanings of Regulations G, T, U, and X of the FRB), (ii) to repay or otherwise refinance indebtedness of the Borrower or others incurred to purchase or carry any such margin stock, (iii) to extend credit for the purpose of purchasing or carrying any such margin stock, or (iv) to acquire any security in any transaction that is subject to Section 13 or 14 of the Securities Exchange Act of 1934, as amended.

ARTICLE VIII

EVENTS OF DEFAULT

8.01 Events of Default. The occurrence of any of the following events shall constitute an "Event of Default" under this Agreement:

(a) Failure to Pay. The Borrower or any Acceptable Subsidiary fails to pay, when due, any installment of principal, or within 7 days after the date when due any interest, fee or any other sum due under this Agreement or any other Credit Document in accordance with the terms hereof or thereof.

(b) Breach of Representation or Warranty. Any representation or warranty herein or in any other Credit Document proves to have been false or misleading in any material respect when made.

(c) Specific Defaults. The Borrower fails to perform or observe any term, covenant or agreement contained in Section 6.01, 6.02 or 6.03 or Article VII hereof.

(d) Other Defaults. The Borrower fails to perform or observe any other term or covenant contained in this Agreement or any Credit Document.

(e) Trade Suits. One or more suits are filed against the Borrower or any of its Subsidiaries by a trade creditor or trade creditors of the Borrower or any of its Subsidiaries in the aggregate amount of \$15,000,000 or more.

(f) Judgments. One or more judgments or arbitration awards are entered against the Borrower or any of its Subsidiaries or any guarantor of any of the Borrower's obligations to the Bank, or the Borrower or any of its Subsidiaries or any such guarantor enters into any settlement agreement with respect to any litigation or arbitration, in the aggregate amount of \$5,000,000 or more on a claim or claims not covered by insurance.

(g) Failure to Pay Debts; Voluntary Bankruptcy. The Borrower or any Subsidiary or any guarantor of any of the Borrower's or any Acceptable Subsidiary's obligations to the Bank (i) fails to pay the Borrower's or such Subsidiary's or such guarantor's debts generally as they come due, or (ii) files any petition, proceeding, case, or action for relief under any bankruptcy, reorganization, insolvency, or moratorium law, or any other law or laws for the relief of, or relating to, debtors.

(h) Involuntary Bankruptcy. An involuntary petition is filed under any bankruptcy or similar statute against the Borrower or any Subsidiary or any guarantor of any of the Borrower's or any Acceptable Subsidiary's obligations to the Bank, or a receiver, trustee, liquidator, assignee, custodian, sequestrator, or other similar official is appointed to take possession of the properties of the Borrower or any Subsidiary or such guarantor; provided, however, that such Event of Default shall be deemed cured if such petition or appointment is set aside or withdrawn or ceases to be in effect within 60 days from the date of said filing or appointment.

(i) Default of Other Financial Obligations. Any default occurs under any other agreement involving the borrowing of money or the extension of credit to which the Borrower or any Subsidiary or any guarantor of any of the Borrower's or an Acceptable Subsidiary's obligations to the Bank may be a party as borrower, guarantor, or installment purchaser, if such default consists of the failure to pay any obligation when due or if such default gives to the holder of the obligation concerned the right to accelerate the obligation.

(j) Default under other Credit Documents. Any Credit Document (other than this Agreement), guaranty, subordination agreement, or other agreement or instrument required hereunder or executed in connection herewith is breached or becomes ineffective or any default occurs under any such agreement or instrument.

(k) Default of Other Bank Obligations. Any default occurs under any other obligation of the Borrower or any Subsidiary/Acceptable Subsidiary to the Bank or to any subsidiary or affiliate of the Bank.

(l) Material Adverse Effect. There occurs a Material Adverse Effect.

(m) ERISA. (i) An ERISA Event shall occur with respect to a Pension Plan which has resulted or could reasonably be expected to result in liability of the Borrower under Title IV of ERISA to the Pension Plan or PBGC in an aggregate amount in excess of \$5,000,000; (ii) the commencement or

increase of contributions to, or the adoption of or the amendment of a Pension Plan by the Borrower which has resulted or could reasonably be expected to result in an increase in Unfunded Pension Liability among all Pension Plans in an aggregate amount in excess of \$5,000,000; or (iii) any of the representations and warranties contained in Section V shall cease to be true and correct which, individually or in combination, has resulted or could reasonably be expected to result in a Material Adverse Effect.

(n) Change of Control. (i) any person or two or more persons acting in concert shall acquire beneficial ownership, directly or indirectly, of securities of the Borrower (or other securities convertible into such securities) representing 30% or more of the combined voting power of all securities of the Borrower entitled to vote in the election of directors; or (ii) during any period of up to 12 consecutive months, commencing after the Closing Date, individuals who at the beginning of such 12-month period were directors of the Borrower shall cease for any reason to constitute a majority of the Board of Directors of the Borrower unless the persons replacing such individuals were nominated by the Board of Directors of the Borrower; or (iii) any person or two or more persons acting in concert acquiring by contract or otherwise, or entering into a contract or arrangement which upon consummation will result in its or their acquisition of, or control over, securities of the Borrower (or other securities convertible into such securities) representing

30% or more of the combined voting power of all securities of the Borrower entitled to vote in the election of directors.

8.02 Remedies. If any Event of Default occurs,

(a) any indebtedness of the Borrower or of any Acceptable Subsidiary under any of the Credit Documents, any term thereof to the contrary notwithstanding, shall at the Bank's option (but automatically upon the occurrence of an Event of Default described in subsection 8.01(g)(ii) or subsection 8.01(h)) and without notice become immediately due and payable without presentment, demand, protest, or notice of dishonor, or any other notice, all of which are hereby expressly waived by the Borrower to the full extent permitted by law, and the Bank may declare an amount equal to the maximum aggregate amount that is or at any time thereafter may become available for drawing under any then-outstanding letters of credit, (whether or not any beneficiary shall have presented, or be entitled at such time to present, the drafts or other documents required to draw under such letters of credit) to be immediately due and payable;

(b) the obligation, if any, of the Bank (including through any Offshore Credit Provider) to make further loans or extensions of credit hereunder shall immediately cease and terminate, and

(c) the Bank and each Offshore Credit Provider shall have all rights, powers, and remedies available under each of the Credit Documents, or accorded by law, including the right to resort to any or all security for any credit accommodation described herein, and to exercise any or all of the rights of a beneficiary or secured party pursuant to applicable law.

All rights, powers, and remedies of the Bank and each Offshore Credit Provider may be exercised at any time by the Bank or such Offshore Credit Provider and from time to time after the occurrence of an Event of Default. All rights, powers, and remedies of the Bank and any Offshore Credit Provider in connection with each of the Credit Documents are cumulative and not exclusive and shall be in addition to any other rights, powers, or remedies provided by law or equity.

ARTICLE IX

MISCELLANEOUS

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9.01 Successors and Assigns. This Agreement shall bind and inure to the benefit of the parties hereto and their respective successors and assigns; provided, however, that the Borrower shall not assign this Agreement or any other Credit Document or any of the rights, duties or obligations of the Borrower hereunder without the prior written consent of the Bank.

9.02 Consents and Waivers. No failure to exercise and no delay in exercising, on the part of the Bank or any Offshore Credit Provider, any right, remedy, power, or privilege hereunder, shall operate as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power, or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power, or privilege. No consent or waiver under this Agreement shall be effective unless in writing. No waiver of any breach or default shall be deemed a waiver of any breach or default thereafter occurring.

9.03 Governing Law. This Agreement shall be governed by and construed under the laws of the State of California.

9.04 Costs and Attorneys' Fees. The Borrower shall, whether or not the transactions contemplated hereby shall be consummated, pay or reimburse the Bank on demand for all costs and expenses incurred by the Bank in connection with the development, preparation, delivery, administration, and execution of, and any amendment, supplement, waiver or modification to, this Agreement and any other Credit Document and the consummation of the transactions contemplated hereby and thereby, including reasonable attorney fees and disbursements and the allocated cost of internal counsel and disbursements, incurred by the Bank with respect thereto; and in connection with the enforcement, attempted enforcement or preservation of any rights or remedies hereunder or under any Credit Document, including any "workout" or restructuring under this Agreement, including attorney fees and disbursements and the allocated cost of internal counsel and disbursements.

9.05 Integration; Amendment. This Agreement, together with the other Credit Documents, embodies the entire agreement and understanding between the Borrower and the Bank. This Agreement may be amended or modified only in writing, signed by the Borrower and the Bank.

9.06 Borrower's Documents. The Bank shall be under no obligation to

return any schedules, invoices, statements, budgets, forecasts, reports or other papers delivered by the Borrower and shall destroy or otherwise dispose of same at such time as the Bank, in its discretion, deems appropriate.

9.07 Participations. The Bank may at any time sell, assign, grant participations in, or otherwise transfer to any other person, firm, corporation or other entity (a "Participant") all or part of the obligations of the Borrower and any Acceptable Subsidiary under this Agreement and any other Credit Document; provided, however, that the Borrower and /or the Acceptable Subsidiary shall continue to deal solely and directly with the Bank in connection with this Agreement and the other Credit Documents. The Borrower authorizes the Bank and each Participant, upon the occurrence of an Event of Default, to proceed directly by right of setoff, banker's lien, or otherwise, against any assets of the Borrower and any Acceptable Subsidiary which may be in the hands of the Bank or such Participant, respectively. The Borrower authorizes the Bank to disclose to any prospective Participant and any Participant any and all information in the Bank's possession concerning the Borrower and its Subsidiaries, this Agreement or any other Credit Document; provided, however, that any such prospective Participant or Participant shall agree to keep any such information confidential.

9.08 General Indemnification. The Borrower shall pay and indemnify the Bank, the Offshore Credit Providers, the Bank's parent company, and each of their respective officers, directors, employees, counsel, agents and attorneys-in-fact (each, an "Indemnified Person") harmless from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs,

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charges, expenses, or disbursements (including attorneys' fees and disbursements and the allocated costs of internal counsel) of any kind or nature whatsoever with respect to the execution, delivery, enforcement, performance, and administration of this Agreement and any other Credit Documents, or the transactions contemplated hereby and thereby, and with respect to any investigation, litigation, or proceeding related to this Agreement, any violation of any Environmental Law by the Borrower or its Subsidiaries, any release of a Hazardous Substance at or from any property of the Borrower or any of its Subsidiaries, or the loans and other extensions of credit hereunder or the use of the proceeds thereof, whether or not any Indemnified Person is a party thereto (all the foregoing, collectively, the "Indemnified Liabilities"); provided, that the Borrower shall have no obligation hereunder to any Indemnified Person with respect to Indemnified Liabilities arising from the gross negligence or willful misconduct of such Indemnified Person. The agreements in this Section shall survive payment of all other obligations of the Borrower or any Acceptable Subsidiary hereunder or under the other Credit Documents.

9.09 Arbitration; Reference Proceeding. (a) Any controversy or claim between or among the parties, including but not limited to those arising out of or relating to this Agreement or any other Credit Document or other agreements or instruments relating hereto or delivered in connection herewith and any claim based on or arising from an alleged tort, shall at the request of any party be determined by arbitration. The arbitration shall be conducted in accordance with the United States Arbitration Act (Title 9, U.S. Code), notwithstanding any choice of law provision in this Agreement, and under the Commercial Rules of the American Arbitration Association ("AAA"). The arbitrator(s) shall give effect to statutes of limitation in determining any claim. Any controversy concerning whether an issue is arbitrable shall be determined by the arbitrator(s). Judgment upon the arbitration award may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

(b) Notwithstanding the provisions of subsection (a) of this Section, no controversy or claim shall be submitted to arbitration without the consent of all parties if, at the time of the proposed submission, such controversy or claim arises from or relates to an obligation to the Bank which is secured by real property collateral located in California. If all parties do not consent to submission of such a controversy or claim to arbitration, the controversy or claim shall be determined as provided in subsection (c) of this Section.

(c) A controversy or claim which is not submitted to arbitration as provided and limited in subsections (a) and (b) of this Section shall, at the request of any party, be determined by a reference in accordance with California Code of Civil Procedure Sections 638 et seq. If such an election is made, the parties shall designate to the court a referee or referees selected under the auspices of the AAA in the same manner as arbitrators are selected in AAA-sponsored proceedings. The presiding referee

of the panel, or the referee if there is a single referee, shall be an active attorney or retired judge. Judgment upon the award rendered by such referee or referees shall be entered in the court in which such proceeding was commenced in accordance with California Code of Civil Procedure Sections 644 and 645.

(d) No provision of this paragraph shall limit the right of any party to this Agreement to exercise self-help remedies such as setoff, to foreclose against or sell any real or personal property collateral or security, or to obtain provisional or ancillary remedies from a court of competent jurisdiction before, after, or during the pendency of any arbitration or other proceeding. The exercise of a remedy does not waive the right of either party to resort to arbitration or reference. At the Bank's option, foreclosure under a deed of trust or mortgage may be accomplished either by exercise of power of sale under the deed of trust or mortgage or by judicial foreclosure.

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9.10 Notices. (a) All notices, requests and other communications provided for hereunder shall be in writing and mailed or delivered to a party at its address specified on the signature pages hereof, or to such other address as shall be designated by such party in a written notice to the other parties.

(b) All such notices and communications shall, when transmitted by overnight delivery, be effective when delivered for overnight delivery, or if personally delivered, upon such personal delivery, except that notices pursuant to Article II shall not be effective until actually received by the Bank.

(c) The Borrower acknowledges and agrees that any agreement of the Bank pursuant to Article II hereof to receive notices by telephone or facsimile is solely for the convenience and at the request of the Borrower. Telephone requests may be made by any individual identified in writing to the Bank on a form acceptable to the Bank as being authorized to make such requests. The Bank shall be entitled to rely upon any written or telephone request from persons it reasonably believes to be authorized by the Borrower to make such requests without making independent inquiry. The Borrower assumes the full risk of, and the Bank shall not be responsible for, any delays or errors in transmission, and the obligation of the Borrower to repay the loans and other extensions of credit hereunder shall not be affected in any way or to any extent by any failure by the Bank to receive written confirmation of any telephonic or facsimile notice or the receipt by the Bank of a confirmation which is at variance with the terms understood by the Bank to be contained in the telephonic or facsimile notice.

9.11 Headings; Interpretation. Article, section, and paragraph headings are for reference only and shall not affect the interpretation or meaning of any provisions of this Agreement. The meaning of defined terms shall be equally applicable to the singular and plural forms of the defined terms. The words "hereof", "herein", "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement; and subsection, section, schedule and exhibit references are to this Agreement unless otherwise specified. The term "including" is not limiting and means "including without limitation." In the computation of periods of time from a specified date to a later specified date, the word "from" means "from and including"; the words "to" and "until" each mean "to but excluding", and the word "through" means "to and including."

9.12 Severability. The illegality or unenforceability of any provision of this Agreement or any instrument or agreement required hereunder shall not in any way affect or impair the legality or enforceability of the remaining provisions of this Agreement or any instrument or agreement required hereunder.

9.13 Counterparts. This Agreement may be executed in as many counterparts as may be deemed necessary or convenient, and by the different parties hereto on separate counterparts each of which, when so executed, shall be deemed an original but all such counterparts shall constitute but one and the same agreement.

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IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

KLA Instruments Corporation

By: _____

Typed Name: _____

Title: _____

By: _____

Typed Name: _____

Title: _____

Address where notices to
Borrower are to be sent:

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION

By: _____

Typed Name: STEPHEN L. PARRY

Title: VICE PRESIDENT

Address where notices to
Bank are to be sent:

530 LYTTON AVENUE 2ND FLOOR

PALO ALTO, CA. 94301

1994 ANNUAL REPORT TO STOCKHOLDERS

1994 KLA ANNUAL REPORT

 THE YIELD MANAGEMENT COMPANY

SELECTED QUARTERLY FINANCIAL DATA (unaudited)

<TABLE>
 <CAPTION>

Quarter Ended	Fiscal 1993				Fiscal 1994			
	Sept. 30	Dec. 31	March 31	June 30	Sept. 30	Dec. 31	March 31	June 30

(In millions, except per share amounts)								
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
NET SALES	\$ 38.5	\$38.6	\$42.2	\$ 47.9	\$ 51.9	\$ 57.1	\$ 62.6	\$72.1
Gross profit	13.0	13.6	15.6	17.6	20.7	24.7	29.4	35.9
	33.8%	35.2%	37.0%	36.7%	39.9%	43.3%	47.0%	49.8%
Engineering, research and development expense	4.0	4.2	4.4	3.7	4.9	4.8	5.5	7.2
	10.4%	10.9%	10.4%	7.7%	9.4%	8.4%	8.8%	10.0%
Selling, general and administrative expense	7.5	7.7	8.4	9.1	9.9	11.3	12.0	15.0
	19.5%	19.9%	19.9%	19.0%	19.1%	19.8%	19.2%	20.8%
Net income	0.6	1.4 (a)	2.0	3.0	4.2	6.3	9.0	10.7
	1.6%	3.6%	4.7%	6.3%	8.1%	11.0%	14.4%	14.8%
NET INCOME PER SHARE	\$ 0.03	\$ 0.07	\$ 0.10	\$ 0.15	\$ 0.20	\$ 0.30	\$ 0.40	\$ 0.45
Weighted average common shares outstanding	18.9	19.5	20.0	20.5	20.8	20.9	22.7	23.7

</TABLE>

(a) Includes recovery from restructuring of \$0.7 million.

NET SALES [chart]

NET INCOME [chart]

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[ART WORK]

KENNETH LEVY
 Chairman
 Chief Executive Officer

Dear Stockholder:

This past year, your Company recorded the best financial results in its 18-year history, setting new records in bookings, sales and profits. This outstanding performance was primarily the result of a strong, technically advanced product line developed over the past five years and the realization by global semiconductor manufacturers that these products are the key to increased manufacturing yields, resulting in a high return on investment. Other key elements include the exceptional international sales and service network KLA has constructed over the past ten years and a strengthened commitment to excellence, efficiency and profitability by employees throughout the Company.

As impressive as our achievements were in 1994, the KLA team views the year as an intermediate step along the way toward building an even stronger global organization. This report shares with you the key elements which will position KLA to achieve its long-term objectives of high value for our customers, a high rate of return for investors and outstanding career opportunities for our employees.

First, let us look at last year's results. For the year ended June 30, 1994, your Company recorded sales of \$243.7 million, which was 46% higher than 1993 sales of \$167.2 million. Net income was \$30.2 million, which was 331% higher than 1993 income of \$7.0 million. The order rate was 70% higher than in 1993 and backlog at year-end was \$125 million, the largest in the Company's history.

In addition to vastly improved operating results, KLA ended its fiscal year with its strongest balance sheet ever. As a result of an equity offering in February 1994 and \$11 million generated by operations, we ended the year with \$139 million in cash and cash equivalents. This very strong financial position will provide the resources to expand our business as appropriate opportunities present themselves.

While the largest contributor to both sales and earnings was the Wafer Inspection Business Unit -- the focal point of KLA's yield management technology -- we are pleased to report that all divisions contributed to a successful year. New orders in the Reticule Inspection Business Unit reached a two-year high, thanks to increased demand for the KLA 331 Reticule Inspection

System, while the ATS Division achieved a four-year high in new wafer prober orders.

The Metrology Division, now in its third year as the market leader for optical metrology, continued to book orders at a high level, leading KLA to a 50% market share in semiconductors and a 70% share in the important thin-film head industry. In the fourth quarter, this division introduced its next-generation overlay metrology system, the KLA 5100, which meets the speed, throughput and precision requirements needed for sub-half-micron production. This system is expected to have a positive impact on results in 1995.

Geographically, the U.S. and Japan remained the largest components of our business. Each accounted for about one-third of total sales, with the remaining one-third representing Asia Pacific and Europe combined. The Japanese market showed strong improvement this year, and should continue to do so since our many customers in that country are just now exploring the yield management benefits of the KLA 2100 Series. Our KLA Acrotec venture in Japan continued to make progress in the growing flat panel display market. Its products are now on order or in use by all of the major flat panel producers in Japan, Korea and Taiwan.

In our annual report three years ago, KLA first announced to stockholders the goal of networking its data gathering and analysis capability into the industry's first total yield management systems. At the time we stated that "Over the next five years, control of defects and yields will make the difference between profit and loss for semiconductor companies." We began to realize that goal in 1991 by introducing the KLA 2100 Series Defect Monitoring Systems. The introduction of the KLA 2550 followed in 1992 and represented the Company's first data and yield management system capable

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[ARTWORK]

KENNETH L. SCHROEDER
President
Chief Operating Officer

of interfacing with both KLA and non-KLA tools. Together, the 2100 Series and the 2550 create the industry's first on-line yield management capability. The semiconductor industry was quick to respond to the prospect of being able, for the first time, to proactively manage yields through real-time inspection and data analysis right on the production line. This year has seen continued improvements in both product lines with the introduction of the KLA 2551 Analysis Station and, in particular, the KLA 2131 All-pattern Defect Monitoring System.

At first, our customers made single-unit purchases since, without testing, they were understandably reluctant to accept the value of this new concept. By the end of 1993, results indicated major yield improvements, and many customers began to order additional systems. That trend accelerated throughout fiscal 1994, and by the end of the year, 38 wafer fabrication facilities around the globe had multiple KLA monitors either installed or on order.

Wafer fabs using our 2100 series products already average two systems per manufacturing facility, with the most advanced facilities having five or six systems per line. As manufacturers continue to learn how to utilize KLA systems to increase their "rate-of-learning," our KLA 2100 Series business will grow accordingly. As linewidths in semiconductor circuits continue to shrink, more manufacturing lines will use KLA systems, and the average number of systems per line will trend toward the larger number now used by the most advanced customers.

As our business grows, KLA continues to strengthen our management team. This past year, Yasuo Mizokami took over the presidency of KLA Japan, while the newly-created positions of president of KLA Korea and president of KLA Europe were assumed by Hee-June Choi and Dick Conn, respectively. In addition, four new corporate vice presidents were elected in recognition of their excellent contributions and growing organizational responsibilities. Dr. Ben Tsai is now vice president, chief technical officer; Dr. Neil Richardson, vice president and general manager of the Metrology Division; Gary Dickerson, vice president and business unit director of the Wafer Inspection Business Unit; and Magnus Ryde, vice president and general manager of the Customer Support Division.

KLA continues to explore new methods to help customers fill their yield management needs. Just before year-end, your Company announced its entry into the software business with a planned series of standard, open-architecture software packages designed to work in conjunction with KLA equipment as well as other wafer fab systems. The new PRISM (PRocess Information Systems) Division was formed, and Dr. Michael Pliner, a 20-year veteran of the software business, was named general manager of this new venture. The products from this division will further expand KLA's ability to help our customers increase their yields by making better use of the information available on the factory floor.

Since outlining its yield management goal in 1991, KLA has made a key transition from being a supplier of important, but capacity-dependent, inspection tools to being a supplier of enabling technology without which our customers' own design goals cannot be achieved. This reality gives us confidence in the future of your Company, and we hope that you share that confidence with us.

/s/ Kenneth Levy

Kenneth Levy

Chairman
Chief Executive Officer

/s/ Kenneth L. Schroeder

Kenneth L. Schroeder
President
Chief Operating Officer

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[ARTWORK] [ARTWORK]
Thin film, Develop and Etch Monitor Reticle Defect Inspection
and Engineering Analysis
[ARTWORK]
Overlay/Linewidth Metrology

KLA'S ROLE IN INTEGRATED CIRCUIT MANUFACTURING

Semiconductor production is one of the most complex manufacturing processes ever devised by mankind. Yet, for all its technological sophistication, its manufacturing process is still evolving. As this process matures, the industry is relying heavily on advanced process control techniques like those pioneered by KLA.

By monitoring wafers after each critical process step, KLA technology enables early detection, analysis and elimination of process-induced defects. The result is improved process yield and a steadily increasing KLA system presence throughout the wafer fabrication line.

MASK MAKING [ARTWORK]

Expose
Develop/Etch
Linewidth-Overlay Metrology
Defect Inspection
Defect Repair
Clean
Contamination/Particle
Inspection

WAFER FABRICATION [ARTWORK]

Thin Film Deposition
Thin Film Monitor
Resist Coat & Develop
Expose
Overlay Metrology
Photo Monitor
Etch and Clean
Etch Monitor
Linewidth Metrology
Implant

Accomplishing the process steps depicted here requires many highly sophisticated systems which incorporate electronics, optics, mechanics, material handling, software and other technologies.

OFF-LINE ENGINEERING ANALYSIS [ARTWORK]

Optical Defect Detection,
Review and Analysis
SEM-based Defect Detection,
Review and Analysis

NETWORK

Data Analysis and Communication

TEST AND ASSEMBLY [ARTWORK]

Probe
Dice
Die Attach
Wire Bond
Encapsulate
Final Test

4 - 5

Reticle Defect Inspection

[ART WORK]

Overlay and Linewidth Metrology

Reticles and masks are to semiconductor fabrication what negatives are to photography; they contain the master circuit patterns to be transferred to wafers in the lithography process. KLA yield management starts with inspection

of these reticles for defects before the transfer begins. This is followed by evaluation of features on the wafer to assure that the pattern has been accurately transferred, a process which includes overlay and linewidth metrology. The increased complexity of today's multi-layer circuits requires reticle inspection and wafer metrology to be highly sensitive and versatile.

The KLA 331 Reticle Inspection System offers the highest defect sensitivity available and is extendible to advanced lithographic processes such as phase shift masks. Introduced two years ago, the KLA 331 achieved immediate acceptance with manufacturers gearing up for production of 64Mb circuits. In addition, the Company recently introduced an important new reticle inspection capability called STARlight, which uses reflected and transmitted light detection techniques simultaneously to identify reticle contaminants, including airborne particles.

KLA has set the industry standard for wafer metrology following pattern transfer with the KLA 5000 Series systems, and now holds 50% of the global market -- twice that of any other vendor. Using proprietary coherence probe measurement technology, these systems increase lithographic efficiency by providing improved pattern characterization and real-time control. The KLA 5100 Overlay Metrology System, introduced in June 1994, extends these capabilities to advanced wafer fabrication facilities that produce devices with features as small as 0.25 micron with 30% greater throughput than previous systems.

KLA's metrology technology also leads in the characterization of thin-film heads for computer disk drives, with the company now holding approximately 70% of this fast-growing market.

[ART WORK]

Above: Proprietary KLA image computer technology helps KLA reticle inspection systems detect leading-edge phase-shift reticle defects.

Right: Patented KLA coherence probe microscopy enhances the repeatability and accuracy of overlay registration measurements.

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"In the case of leading edge semiconductor technologies, the quality of masks can make the difference between climbing the yield curve or struggling with too narrow a process window."

Geoff Akiki, mask house manager, IBM Corp., Essex Junction, Vermont (At a 1993 BACUS-sponsored meeting in San Francisco)

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" An emerging practice is the use of in-line process measurements to better understand specific die yield limiters. (This) includes the statistical correlation of die yield with process flow tracking and metrology data."

Report on "Improving Semiconductor Manufacturing Competitiveness," from the Engineering Research Center, University of California, Berkeley

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Wafer Defect Inspection

Electron-beam Defect Inspection

[ART WORK]

During semiconductor wafer fabrication, rapid detection of process-generated yield-limiting defects is crucial. KLA's systems move this detection from off-line analysis into the actual fabrication cycle where immediate corrective action is possible. The KLA 2100 Series, in conjunction with the KLA 2551 Analysis Station, provides a real-time, in-line defect monitor. Throughout the fab, these systems produce statistical information and defect signature maps for easy identification and rapid control of defects and their causes. In addition to these tools, KLA also has partnerships with major universities and sponsors a forum for the development and dissemination of new yield management technology and applications. Held throughout the world, these Yield Management Seminars have had over 700 attendees in their first year, giving KLA a customer interface which assures that system enhancements are in direct, considered anticipation of customer needs, and that customers are constantly aware of the full range of KLA yield management capabilities.

In addition to in-line monitoring, there is still a need for off-line engineering analysis, both to determine corrective actions and to optimize processes. With their all-layer, all-defect-types performance, KLA's 2100 Series optical defect detection systems are the industry standard for addressing these needs. For future technologies, or to complement existing optical inspection, KLA's SEMSpec Electron-beam Inspection System can detect and display defects beyond the capabilities of optical technology. As feature sizes continue to decrease, high-sensitivity SEMSpec inspection will become more and more integral to leading-edge process optimization and device production.

[ART WORK]

Above: KLA's scanning electron-beam inspection technology finds defects like this electrical failure which are beyond the capabilities of optical systems.

Left: High-precision optical systems give the KLA 2131 the ability to find yield limiting defects like this bridge between two wafer features

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Defect Data Analysis

Probe Data Analysis [ART WORK]

Networking Systems

Finding defects, measuring critical dimensions and overlay, and locating bad die are merely data gathering procedures. To truly manage yield, this data must be stored, analyzed, interpreted, and then shared among the fab areas it affects. Open architecture software and networking systems are the tools through which the semiconductor manufacturer's growing reliance on yield data and its analysis can be realized.

In the wafer fab, KLA's Yield Management System depends upon the KLA 2551 Analysis Station, which stores and analyzes in-line defect data and images, calculates the detailed statistical information and defect signature maps that enable corrective actions, and then transmits these results to the appropriate areas over a variety of industry standard networks.

On the test floor, where finished wafers are first tested for electrical functionality, KLA's new networking software products, Navigator Plus, Integrator, and Analyzer, are the direct result of KLA's extensive test floor presence and experience in the sales and support of the ATS Division's highly-regarded automated wafer probers. KLA realized that, for a variety of reasons, there was no easy way to directly correlate test floor results to wafer fab conditions. In response to this and other test floor needs, KLA's networking software packages standardize user interfaces, streamline prober program set-up and storage, monitor test results in real-time, provide data storage and exchange in a standardized data format and analyze test results for early problem detection and correlation with the wafer fab.

On a larger scale, continuous overall process monitoring and improvement requires a way of quickly correlating specific process measurement data with overall fab yield. Recognizing this, KLA recently formed the PRISM (Process Information Systems) Division to continue developing the existing test floor networking products and to develop new stand-alone software packages. PRISM's first major development effort, now nearing completion, is a Yield Management Software System that automatically collects and correlates inputs from major measurement sources in the fab and on the test floor.

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"In the year 2000, computer-assisted analysis will become an absolute requirement (in semiconductor manufacturing)."

Dr. Robert McDonald, Manager, Materials Technology Department, Intel Corp., Santa Clara, California (Quoted in Semiconductor International, January 1994)

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MANAGEMENT'S FINANCIAL COMMENTARY

Annual Results of Operations

Fiscal 1994 was a breakthrough year for KLA. Earnings per share of \$1.37 were almost four times those of fiscal 1993 and were more than double our previous best of \$0.65, in fiscal 1989. This sharp improvement was the result of several factors. First and foremost, the industry leaders increased their understanding of the value of in-line monitoring for improving the yields of their manufacturing operations. As a result, the industry began a more significant adoption of the KLA methodology of using more of the KLA monitors on each of their fabrication lines. Second, the worldwide semiconductor industry, as a whole, continued to expand and invest in scarce leading edge (0.5 micron) semiconductor manufacturing capacity. Third, the cost reductions KLA began in fiscal 1992 and continuing efficiency improvements benefited our bottom line.

During fiscal 1994, the Wafer Inspection Business Unit (WISARD) was engaged in an intensive effort to educate the industry on the emerging science of controlling manufacturing yields. This has resulted in a paradigm shift in our customers' yield management strategy toward employing multiple in-line, real-time wafer defect inspection units, rather than the previous strategy of utilizing a single unit for analysis. The number of fabs worldwide that have multiple 2100 Series systems increased in fiscal 1994 from 17 to 38. Driven largely by the growing demand for the 2100 Series, KLA's bookings grew 70% in fiscal 1994. Backlog rose from \$52 million at June 30, 1993, to \$125 million at June 30, 1994.

Sales increased 46% in fiscal 1994 compared with increases of 7% and 5% in fiscal 1993 and 1992, respectively. Although the dollar sales increase in fiscal 1994 was primarily attributable to WISARD, the revenue increase in the Metrology Division was almost as high in percentage increase. Revenue increases were also recorded in the Reticle and Photomask Business Unit (RAPID) as well as in the ATS and Watcher Divisions. The SEM Division sales declined as the market is just developing for advanced detection capability. The 7% sales increase in fiscal 1993 reflected strength in the ATS and Metrology Divisions, which more than offset a decline in the RAPID Business Unit caused by a delay in completing all the features of its new 300 Series product lines. The 5% sales increase in fiscal 1992 occurred as WISARD successfully launched the 2100 Series product line and because of an increase in Metrology revenues, offset by a decline in RAPID revenues from its record level in fiscal 1991. This decline occurred because of consolidations in the photomask industry and because of the delayed introduction of the 300 Series product line.

International sales were 57%, 62% and 65% in fiscal years 1992, 1993 and 1994,

respectively. The rising share of international revenues occurred to a large extent because Korean semiconductor manufacturers were the first to realize the significance of utilizing multiple process monitors in a single fabrication line and subsequently made significant investments in adopting this KLA methodology. Additionally, in 1994, the Japanese semiconductor industry completed a recovery to levels of profitability and investment approximating those of 1990 and 1991.

Gross margins were 36%, 36%, and 45% in fiscal years 1992, 1993 and 1994, respectively. The sharp improvement in fiscal 1994 was due primarily to an increase in WISARD's share of overall KLA revenues as well as to an increase in WISARD's gross margins. Additionally, there were gross margin improvements in the Customer Support Division coinciding with KLA's assumption of service responsibilities in Japan. The rise in WISARD's gross margins was due to very favorable manufacturing efficiencies as unit volumes increased dramatically and the organization gained experience with the 2100 Series product line. Lower installation and warranty costs were also achieved as the 2100 Series became increasingly stable. Finally, the Company benefited in aggregate by a favorable yen/dollar exchange rate. Gross margins in both fiscal years 1992 and 1993 were adversely impacted by new product transitions in all divisions which generated large scrap, rework and overhead variance costs. In RAPID, these transitions, unlike others in KLA's history, involved redesigns of every significant subsystem.

Engineering, research and development expenses were 17%, 10% and 9% of revenue in fiscal 1992, 1993 and 1994, respectively. In absolute dollars, these expenses rose by \$6.1 million or 38% in fiscal 1994. The dollar increase occurred primarily in WISARD and, secondarily, in Metrology. The decline in the percent of sales to 9% was due to the fact that WISARD was able to add engineering staff only half as fast as its revenues were increasing.

Engineering, research and development expenses are shown net of funds KLA receives from customers, industry groups and government sources. Any capitalization of software costs also reduces the gross spending. In fiscal 1994, KLA's gross R&D expenses were reduced by 2% from these sources versus about 4% in fiscal 1992 and 1993. The reduction in percentage was due about equally to a decline in contract engineering for flat panel inspection products and to a reduction in the amount of software capitalized by KLA.

Selling, general and administrative costs were 23%, 20% and 20% in fiscal years 1992, 1993 and 1994, respectively. In fiscal 1994, as a percent of sales, both sales and administration expenses fell slightly. Representative commissions, as a percent of sales, rose modestly due to an increase in the share of revenue derived from Japan, Korea and Taiwan, where the bulk of representative commissions are incurred. Profit-sharing expenses increased substantially, reflecting the improvement in KLA's financial performance. The reduction in selling, general and administrative expenses in fiscal 1993 was due to the restructuring actions and the continuing effects of the reduction in headcount implemented at the end of fiscal 1992.

Interest income and other, net, increased in fiscal 1994 due to higher average cash balances of approximately \$48 million. Interest income and other, net, did not vary significantly between fiscal 1992 and fiscal 1993.

Interest expense declined in fiscal 1994 due primarily to the resetting in August 1993 of the interest rate on KLA's mortgage loan for its principal facility from 10.3% to 5.63%. Interest expense declined in fiscal 1993 primarily due to lower interest rates.

Effective July 1, 1992, the Company adopted Statement of Financial Accounting Standards No. 109 (FAS 109) "Accounting for Income Taxes." The adoption of FAS 109 changed the Company's method of accounting for

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income taxes from the deferred method (APB 11) to an asset and liability approach. The asset and liability approach requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of other assets and liabilities. Adoption of FAS 109 did not have a significant effect on the consolidated financial statements.

The deferred tax assets valuation allowance at July 1, 1992, and at June 30, 1993 and 1994, is attributed to U.S. federal and state deferred tax assets. The Company has \$13.3 million of net deferred tax assets in the U.S. at June 30, 1994. Management believes sufficient uncertainty exists such that a valuation allowance of \$11.1 million against these net deferred tax assets is required. When these reserved deferred tax assets are ultimately realized, \$6.0 million will reduce the Company's federal and state tax provisions and \$5.1 million will be credited to paid-in capital (related to stock option deductions). The Company's net deferred tax assets in the U.S. at July 1, 1992, and June 30, 1993 were fully reserved.

Net deferred tax liabilities at June 30, 1994, reflect foreign liabilities of \$3.3 million offset by \$2.2 million of U.S. assets. The net deferred tax liability at July 1, 1992, and at June 30, 1993, relates to foreign operations.

The provision for income taxes on pretax income from continuing operations was 2%, 25% and 25% in fiscal 1992, 1993 and 1994, respectively. In fiscal 1992, the income tax provision of 2% on pretax loss was due primarily to limited loss carryback availability in the United States, combined with the effect of foreign income taxes on the Company's European and Asian operations. In fiscal 1993 and 1994, the income tax rate was lower than the statutory U.S. tax rate because of tax advantages in Switzerland which lowered the net foreign tax rate and because of the realization of deferred tax assets previously reserved. Additionally, the fiscal 1994 rate was reduced by the utilization of \$1.9

million in foreign tax credits.

The IRS is currently auditing the Company's federal income tax returns for fiscal years 1985-1992. Management believes sufficient taxes have been provided in prior years and that the ultimate outcome of this review will not have a material adverse impact on the Company's financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by \$87 million in fiscal 1994 with \$69 million from KLA's secondary public offering in February 1994, \$11 million from continuing operations and \$9 million from KLA's stock option and stock purchase plans. Cash provided by operations was reduced somewhat by investments in working capital to support the 46% rise in revenues.

Capital expenditures totaled approximately \$6 million in fiscal 1994, compared with depreciation charges of approximately \$11 million in fiscal 1994. Capital expenditures for fiscal 1995 are expected to approximate depreciation; however, this assessment could change if demand continues to exceed estimates and additional manufacturing capacity is required. No estimate can be made of the size or cost of any such additional capacity. The Company has begun planning the construction of one or two additional buildings on undeveloped land at its campus facility.

KLA currently has a \$10 million multicurrency line of credit through Bank of America. Borrowings under this line of credit were \$4.2 million at June 30, 1994. KLA's overseas entities use this facility from time to time for short-term cash management purposes. In addition, certain of KLA's overseas entities have local currency borrowings totaling \$0.5 million at June 30, 1994.

KLA believes that its current level of liquid assets, working capital and cash expected to be generated from operations will be sufficient to fund its growth through at least fiscal 1995. The current policy of KLA is not to pay dividends. Management believes that it is in the best interests of the stockholders to continue to reinvest KLA's earnings in the business.

BUSINESS RISKS AND UNCERTAINTIES

The Company's future results will depend on its ability to continuously introduce new products and enhancements to its customers as demands for higher productivity and specifications of semiconductor test equipment change or increase. Due to the risks inherent in transitioning to new products, the Company must accurately forecast demand in both volume and configuration and also manage the transition from older products. The Company's results could be affected by the ability of competitors to introduce new products which have technological and/or pricing advantages. The Company's results also will be affected by strategic decisions made by management regarding whether to continue particular product lines, and by volume, mix and timing of orders received during a period, fluctuations in foreign exchange rates, and changing conditions in both the semiconductor industry and key semiconductor markets around the world. As a result, the Company's operating results may fluctuate, especially when measured on a quarterly basis.

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SELECTED FINANCIAL DATA (unaudited)

<TABLE>

<CAPTION>

	1990	1991	1992	1993	1994
	(In thousands, except per share amounts)				
<S>	<C>	<C>	<C>	<C>	<C>
YEARS ENDED JUNE 30,					
Net sales	\$161,642	\$148,432	\$155,963	\$167,236	\$243,737
Restructuring charges (recovery)	-	-	8,158	(718)	-
Income (loss) from continuing operations	12,174	2,415	(16,610)	6,961	30,188
Net income (loss)	9,380	(10,585)	(13,810)	6,961	30,188
Income (loss) per share from continuing operations	0.67	0.13	(0.90)	0.35	1.37
Net income (loss) per share	0.52	(0.57)	(0.75)	0.35	1.37
Weighted average common and dilutive common equivalent shares outstanding	18,038	18,552	18,451	19,707	22,044
AT JUNE 30,					
Cash and cash equivalents	32,263	31,254	23,711	52,362	139,126
Working capital	99,151	91,116	83,961	93,611	212,873
Total assets	179,276	198,023	188,457	199,089	321,570
Long-term debt	-	24,000	24,000	20,000	20,000
Stockholders' equity	122,136	113,161	103,032	114,050	227,382

</TABLE>

CONSOLIDATED STATEMENT OF OPERATIONS

<TABLE>

<CAPTION>

	1992	1993	1994
	(In thousands, except per share amounts)		
<S>	<C>	<C>	<C>
YEARS ENDED JUNE 30,			
Net sales	\$155,963	\$167,236	\$243,737

Costs and expenses:			
Cost of sales	99,993	107,466	133,028
Engineering, research and development	25,860	16,314	22,435
Selling, general and administrative	35,537	32,684	48,192
Restructuring charges (recovery)	8,158	(718)	-
	169,548	155,746	203,655

Income (loss) from operations	(13,585)	11,490	40,082
Interest income and other, net	1,170	1,217	2,174
Interest expense	(3,877)	(3,426)	(2,005)

Income (loss) from continuing operations before income taxes	(16,292)	9,281	40,251
Provision for income taxes	318	2,320	10,063

Income (loss) from continuing operations	(16,610)	6,961	30,188

Discontinued operations:			
Recovery of loss on 1991 discontinuance of PCB business	2,800	-	-

Net income (loss)	\$ (13,810)	\$ 6,961	\$ 30,188

Income (loss) per share from continuing operations	\$ (0.90)	\$ 0.35	\$ 1.37
Income per share from discontinued PCB business	0.15	-	-

Net income (loss) per share	\$ (0.75)	\$ 0.35	\$ 1.37

Weighted average common and dilutive common equivalent shares outstanding	18,451	19,707	22,044

See accompanying notes to consolidated financial statements.			
</TABLE>			

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CONSOLIDATED BALANCE SHEET

<TABLE>			
<CAPTION>			
ASSETS			
AT JUNE 30,	1993	1994	

		(In thousands)	
<S>	<C>	<C>	
Current assets:			
Cash and cash equivalents	\$ 52,362	\$ 139,126	
Accounts receivable, net of allowances of \$1,469 and \$1,754	48,077	74,226	
Inventories	42,489	53,265	
Deferred income taxes	3,917	7,495	
Other current assets	4,724	4,343	

Total current assets	151,569	278,455	

Land, property and equipment, net	39,384	37,149	
Other assets	8,136	5,966	

Total assets	\$ 199,089	\$ 321,570	

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Notes payable and current portion of long-term debt	\$ 6,532	\$ 4,673	
Accounts payable	8,953	11,890	
Income taxes payable	9,403	12,466	
Other current liabilities	33,070	36,553	

Total current liabilities	57,958	65,582	

Deferred income taxes	7,081	8,606	
Long-term debt	20,000	20,000	
Commitments and contingencies			
Stockholders' equity:			
Preferred Stock \$.001 par value, 1,000 shares authorized, none outstanding	-	-	
Common shares, \$.001 par value, 75,000 shares authorized, 19,503 and 22,864 shares issued and outstanding	20	23	
Capital in excess of par value	64,638	147,358	
Retained earnings	50,087	80,275	
Treasury stock	(581)	(581)	
Cumulative translation adjustment	(114)	307	

Total stockholders' equity	114,050	227,382	

Total liabilities and stockholders' equity	\$ 199,089	\$ 321,570	

</TABLE>			
See accompanying notes to consolidated financial statements.			

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

<TABLE>

<CAPTION>

	Common Stock and Capital in excess of par value		Retained Earnings	Treasury Stock		Translation Adjustments
	Shares	Amount		Shares	Amount	
(In thousands)						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at June 30, 1991	18,298	\$ 56,094	56,936	(55)	\$(581)	\$ 712
Exercise of stock options	203	1,431				
Shares sold in stock purchase plan	195	1,432				
Net loss			(13,810)			
Translation adjustments						818
Balance at June 30, 1992	18,696	58,957	43,126	(55)	(581)	1,530
Exercise of stock options	604	4,277				
Shares sold in stock purchase plan	203	1,424				
Net income			6,961			
Translation adjustments						(1,644)
Balance at June 30, 1993	19,503	64,658	50,087	(55)	(581)	(114)
Exercise of stock options	854	6,960				
Tax benefit on exercise of stock options		5,232				
Shares sold in stock purchase plan	207	1,965				
Shares sold in stock offering	2,300	68,566				
Net income			30,188			
Translation adjustments						421
Balance at June 30, 1994	22,864	\$147,381	80,275	(55)	\$(581)	\$ 307

</TABLE>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

<TABLE>

<CAPTION>

YEARS ENDED JUNE 30,	1992	1993	1994
(In thousands)			
<S>	<C>	<C>	<C>
Cash flows from continuing operating activities:			
Income (loss) from continuing operations	\$ (16,610)	\$ 6,961	\$ 30,188
Adjustments required to reconcile income (loss) from continuing operations to cash provided by (used for) continuing operations:			
Depreciation and amortization	10,732	9,646	10,734
Deferred income taxes	142	(466)	(2,053)
Changes in assets and liabilities:			
Accounts receivable	(2,583)	947	(26,149)
Inventories	70	6,048	(10,776)
Other current assets	(766)	2,062	381
Accounts payable	(1,970)	3,375	2,937
Income taxes payable	(820)	(429)	3,063
Other current liabilities	6,840	2,655	3,483
Other assets	526	(492)	(520)
Cash provided by (used for) continuing operations	(4,439)	30,307	11,288
Cash flows from investing activities:			
Capital expenditures	(5,085)	(3,226)	(5,809)
Other	(1,280)	(357)	-
Cash (used for) investing activities	(6,365)	(3,583)	(5,809)
Cash flows from financing activities:			
Short-term borrowings, net	125	(2,881)	2,141
Payment of current portion of long term debt	-	-	(4,000)
Sales of common stock	2,863	5,701	82,723
Cash provided by financing activities	2,988	2,820	80,864
Effect of exchange rate changes	273	(893)	421

Increase (decrease) in cash and cash equivalents	(7,543)	28,651	86,764
Cash and cash equivalents at beginning of year	31,254	23,711	52,362

Cash and cash equivalents at end of year	\$ 23,711	\$ 52,362	\$ 139,126

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

YEARS ENDED JUNE 30,	1992	1993	1994

Cash paid during the year for:			
Interest	\$ 3,778	\$ 3,515	\$ 2,007
Income taxes	1,361	1,914	3,369

See accompanying notes to consolidated financial statements.

</TABLE>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated. Subsidiaries with accounts denominated in foreign currencies have been translated principally using the local currencies as the functional currencies. Accordingly, the assets and liabilities of these subsidiaries are translated at the rates of exchange on the balance sheet date, income and expense items are translated at average rates of exchange for the year, and the resulting translation gains or losses are included in stockholders' equity. Foreign currency transaction gains and losses have not been material and are included in interest income and other, net.

REVENUE RECOGNITION - The Company recognizes sales of wafer inspection, metrology, reticle and photomask inspection systems upon acceptance at the Company's plant, which is when title transfers. Customers may observe and approve satisfactory completion of the tests. Sales of other systems are recognized upon shipment. A provision for the estimated future cost of system installation and warranty is recorded at the time revenue is recognized. Revenues from service contracts are recognized during the terms of the contracts on a straight-line basis.

INCOME PER SHARE - Income per common and common equivalent share is computed using the weighted average number of common and common equivalent shares outstanding during the respective periods, including the assumed net shares issuable upon exercise of stock options, when dilutive.

RESEARCH AND DEVELOPMENT - The Company is actively engaged in significant product improvement and new product development efforts. Research and development expenses relating to possible future products aggregated approximately \$19.3, \$13.4 and \$16.8 million for fiscal 1992, 1993 and 1994, respectively.

SOFTWARE DEVELOPMENT COSTS - The Company capitalizes software development costs in accordance with Statement of Financial Accounting Standards No. 86. For the years 1992, 1993 and 1994, the Company capitalized \$1.3, \$1.2 million and none, respectively, of software development costs in connection with the development of new products and new features and functions on existing products. Such costs are amortized on a straight-line basis over the estimated useful life of three years or the ratio of current revenue to the total of current and anticipated future revenue, whichever is greater. Amortization charged to expense during the fiscal years ended 1992, 1993 and 1994 was \$2.1, \$1.9 and \$2.8 million, respectively. Capitalized software, net of software amortization, totaled \$5.0, \$4.3 and \$1.5 million at June 30, 1992, 1993 and 1994, respectively.

INCOME TAXES - Effective July 1, 1992, the Company adopted Statement of Financial Accounting Standards No. 109 (FAS 109), "Accounting for Income Taxes." The adoption of FAS 109 changed the Company's method of accounting for income taxes from the deferred method (APB 11) to an asset and liability approach. The asset and liability approach requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of other assets and liabilities. Adoption of FAS 109 did not have a significant effect on the consolidated financial statements. Undistributed earnings of certain of the Company's foreign subsidiaries, for which no U.S. income taxes have been provided, aggregated approximately \$6.0 million at June 30, 1994. The amount of the unrecognized deferred tax liability related to this investment is estimated at approximately \$2.2 million at June 30, 1994.

CASH EQUIVALENTS - Cash equivalents consist of highly liquid investments with a maturity date at acquisition of three months or less. Cash and cash equivalents are stated at cost, plus accrued interest, which approximates market value. During 1993 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 115 (FAS 115), "Accounting for Certain Investments in Debt and Equity Securities," which requires a change in the method used to account for certain investments. FAS 115 will be effective for the Company's fiscal 1995. The Company does not believe that the adoption of this statement will have a material impact on its financial position or results of operations.

INVENTORIES - Inventories are stated at the lower of cost or market, cost being determined using standard costs which approximate actual costs on a first-in, first-out basis.

PROPERTY AND EQUIPMENT - Property and equipment are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which are 30 years for buildings and building improvements, five years for furniture and fixtures, and range from three to five years for machinery and equipment. The life of the lease or the useful life, whichever is shorter, is used for the amortization of leasehold improvements.

FOREIGN EXCHANGE HEDGING - The Company purchases forward exchange contracts and options to hedge against currency fluctuations which affect certain foreign currency denominated sales and purchase transactions. Because the impact of movements in currency exchange rates on foreign exchange contracts offsets the related impact on the underlying items being hedged, these financial instruments do not subject the Company to speculative risk that would otherwise result from changes in currency exchange rates. Unrealized gains and losses on these contracts are deferred and accounted for as part of the hedged transactions. Cash flows from these contracts are classified in the Statement of Cash Flows in the same category as the hedged transactions.

At June 30, 1993, the Company had foreign exchange contracts maturing throughout fiscal 1994 to sell approximately \$19.2 million in foreign currency, primarily Japanese yen, and to purchase approximately \$0.7 million of Japanese yen. At June 30, 1994, the Company had foreign exchange contracts maturing during fiscal 1995 to sell approximately \$48.1 million in foreign currency, primarily Japanese yen, and to purchase approximately \$5.8 million of Japanese yen. Of these contracts, approximately \$35.2 million of foreign currency contracts hedge foreign currency payables and receivables carried on the balance sheet as of June 30, 1994, and

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NOTE 1 (continued)

consequently, the financial statements reflect the fair market value of the contracts and their underlying transactions. Approximately \$16.5 million and \$2.2 million of the contracts hedge firm commitments for future sales and purchases, respectively, denominated in foreign currency. The fair market value of these contracts at June 30, 1994, based upon prevailing market rates at that date, was approximately \$16.7 million and \$2.2 million, respectively.

CONCENTRATION OF CREDIT RISK - Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, trade accounts receivable and financial instruments used in hedging activities.

The Company places its cash equivalents in a variety of financial instruments such as certificates of deposit, commercial paper, municipal debt and U.S. Government agency debt. Company policy limits the amount of credit exposure to any one financial institution or commercial issuer.

The Company sells its systems to semiconductor manufacturers throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company maintains an allowance for uncollectible accounts receivable 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 any of these counterparties.

NOTE 2 DETAILS OF FINANCIAL STATEMENT COMPONENTS
<TABLE>

	1993	1994
<S>	<C>	<C>
Inventories:		(In thousands)
Customer service spares	13,530	12,220
Systems raw materials	8,389	12,597
Work-in-process	10,004	13,348
Demonstration equipment	10,566	15,100
	42,489	53,265
Land, property and equipment:		
Land	\$10,502	10,502
Buildings and improvements	20,361	21,928
Machinery and equipment	30,780	33,143
Furniture and fixtures	4,625	4,549
Leasehold improvements	6,321	4,029
	72,589	74,151
Less accumulated depreciation and amortization	(33,205)	(37,002)
	39,384	37,149
Other current liabilities:		
Accrued compensation and benefits	\$11,682	16,328
Accrued warranty and installation	12,188	14,367
Unearned service contract revenue	2,854	3,054
Other	6,346	2,804
	33,070	36,553

</TABLE>

NOTE 3 GEOGRAPHIC REPORTING

The Company is a leading manufacturer of yield monitoring and process control systems for the semiconductor manufacturing industry. For geographic reporting, sales are attributed to the geographic location of the sales and service organizations and costs directly and indirectly incurred in generating sales are similarly assigned. During fiscal 1993, one customer accounted for 11% of net sales. During fiscal 1992 and 1994, no customer accounted for more than 10% of sales. The following is a summary of operations by geographical territories:

	1992	1993	1994
(In thousands)			
<S>	<C>	<C>	<C>
Net sales from unaffiliated customers:			
United States	\$ 67,240	\$ 62,802	\$ 84,493
Western Europe	22,484	34,141	37,854
Japan	48,825	46,914	79,820
Asia Pacific	17,414	23,379	41,570
	\$155,963	\$167,236	\$243,737
Operating results:			
United States	\$ (5,570)	\$ 7,558	\$ 15,407
Western Europe	608	6,262	9,234
Japan	(5,214)	(1,783)	11,166
Asia Pacific	2,204	3,896	14,544
	(7,972)	15,933	50,351
General corporate expenses	(5,613)	(4,443)	(10,269)
Operating profit (loss)	\$ (13,585)	\$ 11,490	\$ 40,082
Identifiable assets:			
United States	\$103,960	\$ 96,383	\$ 95,041
Western Europe	15,272	22,631	19,853
Japan	27,026	18,627	38,444
Asia Pacific	18,581	13,487	24,264
	164,839	151,128	177,602
General corporate assets	23,618	47,961	143,968
Total assets	\$188,457	\$199,089	\$321,570

</TABLE>

Intercompany transfers of products from the United States to other regions, based on cost of products transferred, were approximately \$34.2, \$39.7 and \$52.1 million in fiscal years 1992, 1993 and 1994, respectively. Transfers from other regions were not significant in fiscal 1992 and 1993. During fiscal 1994, transfers to the U.S. from other regions were \$9.7 million. Corporate assets consist primarily of cash and cash equivalents and other investments. Corporate expenses consist primarily of general, administrative and other expenses not attributable to geographical regions. Capital expenditures and depreciation expense have been primarily in the United States.

NOTE 4 EMPLOYEE BENEFIT PLANS

The Company has a profit sharing program, wherein a percentage of pretax profits, as determined by the Board of Directors, is accumulated and distributed quarterly to all employees who have completed a stipulated employment period. In addition, the Board may approve matching contributions to the Company's savings and investment plan, a qualified salary reduction plan under section 401(k) of the Internal Revenue Code. The total charge to operations under the profit sharing and 401(k) programs aggregated approximately \$0.4, \$0.7 and \$3.3 million in fiscal 1992, 1993 and 1994, respectively.

Under the 1982 Stock Option Plan, as amended, 4,750,000 shares have been reserved for issuance to eligible employees and directors as either Incentive Stock Options (ISO's) or non-qualified options. Options under this plan are granted at prices determined by the Board of Directors, but not less than the fair market value on the date of grant, and expire ten years after the date of grant. Generally, options become exercisable within five years of the date of grant, vesting monthly after a waiting period of six to thirty months.

In October 1990, the Company adopted the 1990 Outside Directors Stock Option Plan to grant options to non-employee directors. This plan calls for an annual grant of 2,500 options, at fair market value, to each outside director. The options become exercisable at one fifty-fourth per month beginning six months from date of grant and expire ten years from grant date. A total of 100,000 shares have been reserved for issuance under this plan.

In August 1992, the Company allowed all holders of outstanding options, with the exception of holders who were officers or directors of the Company during all of fiscal 1992, to exchange higher priced options for new non-qualified options at \$7.50 per share, the fair market value on the date of the Board's action; 412,000 options were exchanged.

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NOTE 4 (CONTINUED)

Following is a summary of stock option transactions:

<S>	OPTION PRICE	STOCK OPTIONS OUTSTANDING	RESERVED SHARES AVAILABLE
<S>	<C>	<C>	<C>
Balance at June 30, 1991	\$ 3.17-21.25	3,109,109	907,286
Options granted	8.63-11.88	264,050	(264,050)
Options cancelled	3.17-20.25	(231,665)	231,665
Options exercised	3.17-13.00	(202,902)	
Balance at June 30, 1992	\$ 6.13-21.25	2,938,592	874,901
Options granted	7.50-12.38	1,048,246	(1,048,246)
Options cancelled	6.13-20.50	(594,311)	594,311
Options exercised	6.13-14.00	(603,912)	
Balance at June 30, 1993	\$ 7.00-21.25	2,788,615	420,966
Options granted	19.13-41.63	235,050	(235,050)
Options cancelled	7.00-31.75	(113,749)	113,749
Options exercised	7.00-31.75	(853,509)	
Balance at June 30, 1994	\$ 7.00-41.63	2,056,407	299,665

</TABLE>

At June 30, 1994, options to purchase 736,686 shares of stock were exercisable under all option plans.

The Company has reserved 1,700,000 shares of common stock to be issued under the 1981 Employee Stock Purchase Plan. The Plan permits eligible employees to purchase common stock, through payroll deductions, at 85% of the lower of the fair market value of the common stock on the date at the beginning of the two-year offering period or the last day of the purchase period. Substantially all employees are eligible to participate in the Plan. At June 30, 1994, 204,393 shares were available for future issuance under the Plan.

NOTE 5 FINANCING ARRANGEMENTS

At June 30, 1994, the Company had a \$20 million interest-only mortgage on its principal facility due August 1995 bearing interest of 5.63% per annum through August 1994. Under the terms of the loan, the interest rate will be reset in August 1994 to 7.62%. The mortgage, which is secured by \$32.4 million in land, buildings and building improvements at June 30, 1994, requires the Company to maintain, among other things, minimum working capital and tangible net worth.

As of June 30, 1994, the Company had a \$10 million multicurrency line of credit with a bank, expiring December 31, 1994. The line of credit has a facility fee of 0.25% per annum. Interest on domestic and foreign borrowings is charged at the bank's reference rate and at the bank's offshore reference rate plus 0.875%, respectively. The agreement requires the Company to maintain, among other things, minimum quick ratio, tangible net worth and profitability. At June 30, 1994, the Company was in compliance with all of these covenants. As of June 30, 1994, approximately \$4.2 million had been borrowed at the related offshore interest rate of 3.91% per annum.

In addition, certain of the Company's foreign subsidiaries had short-term local currency borrowings of approximately \$0.5 million at an average interest rate of 4.62% at June 30, 1994.

Based upon interest rates available to the Company for issuance of debt with similar terms and remaining maturities, the fair value of the long-term mortgage debt and notes payable was approximately equal to the recorded value.

NOTE 6 RESEARCH AND DEVELOPMENT ARRANGEMENTS

The Company has entered into research and development arrangements with certain key customers and other entities to partially fund the development of new technology on a best efforts basis. The financial risks of these research and development arrangements are substantively and genuinely those of the funding entities. In fiscal 1992, 1993 and 1994, revenues of \$6.1, \$6.8 and \$5.7 million, respectively, have been recognized on these research and development contracts on the percentage of completion basis. These revenues are offset against gross engineering, research and development expenses.

NOTE 7 INVESTMENT IN ACROTEC

During fiscal 1991, the Company invested approximately \$0.2 million cash for an 8% equity investment in Acrotec, a Japanese company developing an automated optical inspection device for flat panel displays utilizing base technology provided by the Company. In addition, the Company has a research and development arrangement with Acrotec to provide research, development and engineering on a best efforts cost reimbursement basis. The Company received \$2.5, \$2.1 and \$1.6 million in fiscal 1992, 1993 and 1994, respectively, under this research and development arrangement, and has recorded these amounts as a reduction of sales, administrative, engineering, research and development expenses (see Note 6).

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NOTE 8 INCOME TAXES

The components of income (loss) from continuing operations before income taxes were as follows:

	1992	1993	1994
	(In thousands)		
Domestic	\$ (22,582)	\$1,828	\$31,515
Foreign	6,290	7,453	8,736
	\$ (16,292)	\$9,281	\$40,251

The provisions for income taxes charged to continuing operations were as follows:

	1992	1993	1994
	(In thousands)		
Federal:			
Currently payable (refundable)	\$ (1,698)	\$ 495	\$ 7,587
Deferred	204	-	(2,195)
	(1,494)	495	5,392
State:			
Currently payable	175	321	2,222
Deferred	(175)	-	-
	-	321	2,222
Foreign:			
Currently payable	867	2,679	2,307
Deferred	945	(1,175)	142
	1,812	1,504	2,449
Provision for income taxes from continuing operations	\$ 318	\$ 2,320	\$ 10,063

The following is a reconciliation of the effective income tax rates from continuing operations and the United States statutory federal income tax rate:

	1992	1993	1994
Statutory federal income tax rate	(34.0)%	34.0%	35.0%
State income taxes, net of federal tax benefits	-	2.3	3.6
Effect of foreign operations at lower tax rates	(2.0)	(11.1)	(1.7)
Non-taxable FSC income	-	-	(1.5)
Financial statement operating loss carryforward not recognized because realization is uncertain	35.3	-	-
Foreign tax credit	-	-	(4.8)
Realized deferred tax assets previously reserved	-	(3.8)	(5.8)
Other	2.7	3.6	0.2
Effective tax rate	2.0%	25.0%	25.0%

Deferred tax liabilities (assets) at July 1, 1992, June 30, 1993 and 1994 are comprised of the following:

<TABLE>
<CAPTION>

	July 1, 1992	June 30, 1993	June 30, 1994
	(In thousands)		

<S>	<C>	<C>	<C>
Deferred tax liabilities:			
Depreciation	\$ 4,342	\$ 4,317	5,157
Unremitted earnings of foreign subsidiaries not permanently reinvested	3,902	2,726	6,327
Capitalized software	1,963	1,679	641
Other	963	1,596	1,255

	11,170	10,318	13,380

Deferred tax assets:			
Inventory reserves and basis differences	(9,357)	(9,876)	(11,483)
Federal and state loss and credit carryforwards	(5,279)	(4,816)	(4,696)
Other asset valuation reserves	(2,079)	(1,874)	(2,008)
Reserves for restructured and discontinued operations	(1,749)	(668)	(331)
Employee benefit accruals	(1,026)	(1,528)	(1,885)
Warranty and installation accruals	(674)	(934)	(1,880)
Other	(984)	(853)	(1,064)

	(21,148)	(20,549)	(23,347)

Deferred tax assets valuation allowance	13,746	13,395	11,078

Total net deferred tax liabilities	\$ 3,768	\$ 3,164	1,111

</TABLE>

NOTE 8 (CONTINUED)

The deferred tax assets valuation allowance at June 30, 1993 and 1994, is attributed to U.S. federal and state deferred tax assets. The Company has \$13.3 million of net deferred tax assets in the U.S. at June 30, 1994. Management believes sufficient uncertainty exists such that a valuation allowance of \$11.1 million against these net deferred tax assets is required. When these reserved deferred tax assets are ultimately realized, \$6.0 million will reduce the Company's federal and state tax provisions and \$5.1 million will be credited to paid-in capital (related to stock option deductions). The Company's deferred tax assets in the U.S. at July 1, 1992, and June 30, 1993, were fully reserved. During fiscal 1993 and 1994, the Company realized \$0.4 and \$2.3 million, respectively, of deferred tax assets previously reserved, reducing the valuation allowance by corresponding amounts.

In accordance with FAS 109, the valuation allowance is allocated pro-rata to federal and state current and non-current deferred tax assets. Net deferred tax liabilities at June 30, 1994, of \$1.1 million, reflect foreign liabilities of \$3.3 million offset by \$2.2 million of U.S. assets. The net deferred tax liability at July 1, 1992 and June 30, 1993 relates to foreign operations.

The Company has federal research and development and other tax credit carryovers of approximately \$4.6 million that will expire primarily in fiscal 1998 through 2009.

The Company's manufacturing operations in Switzerland are exempt from taxes through 2001. The effect of this tax exemption was to increase net income in fiscal 1993 and 1994 by approximately \$0.6 million for each year.

The IRS is currently auditing the Company's federal income tax returns for fiscal years 1985 to 1992. Management believes sufficient taxes have been provided in prior years and that the ultimate outcome of these reviews will not have a material adverse impact on the Company's financial position or results of operations.

NOTE 9 COMMITMENTS AND CONTINGENCIES

The Company leases several facilities under operating leases expiring at various dates through fiscal 2025 with renewal options at fair market value for additional periods ranging up to ten years. The aggregate minimum rental commitment under these lease agreements as of June 30, 1994, excluding property taxes, insurance and certain other costs to be paid by the Company, are approximately \$2.3, \$1.4, \$1.0, \$1.0, \$0.5 and \$1.3 million in fiscal 1995 through 1999 and thereafter, respectively. Total rental expense under all operating leases was \$3.2, \$2.9 and \$2.5 million in fiscal 1992, 1993 and 1994, respectively.

The Company is the plaintiff in two patent infringement suits in which the defendants filed counterclaims alleging interference with business. In

addition the Company has also filed suit against two of its vendors for defective merchandise delivered by them. One of these resulted in a counterclaim. The Company is also a defendant in three suits arising out of the discontinued printed circuit board inspection business. In one of them the trial court ruled in favor of the Company on all causes of action asserted against it. This case is presently under appeal. The remaining cases are in the early discovery stage. The Company also filed a complaint against another semiconductor equipment manufacturer in which the Company holds a minority interest. The Company alleges that its ownership was unjustly diluted by the defendant. In addition to the above, the Company from time to time is put on notice by its customers regarding possible patent infringement. Management does not believe that any of these matters will have an adverse material effect on the Company's financial position or results of operations.

NOTE 10 STOCKHOLDERS' EQUITY

In February 1994, the Company sold 2,300,000 shares of common stock at \$ 31.50 per share in a public offering resulting in \$68.6 million of proceeds to the Company, net of offering expenses.

In March 1989, the Company implemented a plan to protect stockholders' rights in the event of a proposed takeover of the Company. Under the plan, each share of the Company's outstanding common stock carries one Common Stock Purchase Right (Right). The Right entitles the holder, under certain circumstances, to purchase common stock of the Company or its acquirer at a discounted price. The Rights are redeemable by the Company and expire in 1999.

NOTE 11 FISCAL 1992 RESTRUCTURING

Restructuring charges in fiscal 1992 of \$8.2 million include \$2.4 million for costs associated with the discontinuance of the EMMI product line, \$1.6 million of expenses for eliminating one corporate facility, \$0.9 million in severance costs, and \$3.3 million for costs associated with a redefinition of certain product strategies. During fiscal 1993, a \$0.7 million recovery was recognized on the sale of the EMMI product line.

NOTE 12 DISCONTINUED PCB BUSINESS

In December 1990, the Company divested its printed circuit board (PCB) inspection business and recorded a \$15 million pretax charge as a result. In October 1991, the Company entered into an agreement to sell substantially all of the assets and related technology of the PCB business for approximately \$4.3 million plus future royalties. The agreement required the Company to transfer the technology, provide training and develop certain software to enhance the product. The Company recognized a \$2.8 million recovery of the fiscal 1991 provision in the third quarter of fiscal 1992 upon substantial completion of its obligations under the sale agreement.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and
Board of Directors of
KLA Instruments Corporation

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of KLA Instruments Corporation and its subsidiaries at June 30, 1993 and 1994, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1994, in conformity with generally accepted accounting principles. 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 generally accepted auditing standards 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.

PRICE WATERHOUSE LLP

San Jose, California
July 26, 1994

<TABLE>
<CAPTION>

Common Stock	1993		1994	
	High	Low	High	Low
<S>	<C>	<C>	<C>	<C>
First Quarter	9	7 1/8	26 1/2	17
Second Quarter	12 1/4	7 3/4	28	19
Third Quarter	14 3/4	10 5/8	43	25 7/8
Fourth Quarter	19 1/2	11 1/4	43 1/4	32 1/4

</TABLE>

The Company's common stock is traded on the NASDAQ National Market System under the symbol "KLAC." All common stock prices reflect closing prices per the NASDAQ National Market System.

The Company has not paid cash dividends on its common stock and does not plan to pay cash dividends to its stockholders in the near future. The Company presently intends to retain its earnings to finance further growth of its business. As of June 30, 1994, the Company had approximately 1,014 stockholders of record.

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CORPORATE DIRECTORY

OFFICERS

Kenneth Levy
Chairman of the Board
Chief Executive Officer

Kenneth L. Schroeder
President
Chief Operating Officer

Robert J. Boehlke
Vice President Finance
and Administration,
Chief Financial Officer

Gary E. Dickerson
Vice President

Michael D. McCarver
Vice President

Neil Richardson, Ph. D.
Vice President

Magnus O. W. Ryde
Vice President

Arthur P. Schnitzer
Vice President

Ben Tsai, Ph. D.
Vice President
Chief Technical Officer

Virginia DeMars
Vice President,
Human Resources

Christopher Stoddart
Treasurer

William Turner
Vice President,
Controller

Paul E. Kreutz, Esq.
Secretary

DIRECTORS

Kenneth Levy
Chairman of the Board
Chief Executive Officer

Kenneth L. Schroeder
President
Chief Operating Officer

Leo J. Chamberlain
Private Investor

Robert E. Lorenzini
Private Investor

Yoshio Nishi
Director
Research & Development Center
Hewlett-Packard

Samuel Rubinovitz
Retired
Executive Vice President
EG&G, Inc.

Dag Tellefsen
General Partner
Glenwood Venture Management

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886-35-335163

INDEPENDENT ACCOUNTANTS

Price Waterhouse LLP
San Jose, California

GENERAL LEGAL COUNSEL
Gray Cary Ware & Freidenrich
Palo Alto, California

REGISTRAR AND TRANSFER AGENT
First National Bank of Boston
Boston, Massachusetts

Additional copies of this report, as well as copies of SEC Form 10K, for the year ended June 30, 1994, may be obtained from the Company without charge by writing to:

KLA Instruments Corporation
Attn: Investor Relations
P.O. Box 49055
San Jose, CA 95161-9055

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KLA

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Printed in U.S.A. 1094-15M

EXHIBIT 21

LIST OF SUBSIDIARIES OF
KLA INSTRUMENTS CORPORATION

<TABLE>
<CAPTION>

NAME - - - - -	STATE OR OTHER JURISDICTION OF INCORPORATION -----
<S> KLA Building Corporation	<C> California
KLA Instruments International Corporation	California
KLA Management Corporation	Delaware
KLA Instruments PCBI Corporation	California
KLA Instruments Limited	United Kingdom
KLA Instruments GmbH	Germany
KLA Instruments France S.A.	France
KLA Japan Limited	Japan
KLA Instruments Sales Corporation	U.S. Virgin Islands
KLA Instruments (Israel) Corporation	Israel
KLA Holding Company Limited	Israel
KLA (Israel) Service Limited	Israel
KLA Instruments (Cayman) Limited	Cayman Islands
KLA Instruments KLINNIK Corporation	California
KLA Instruments S.A.	Switzerland
KLA Instruments (Malaysia) SdnBdh	Malaysia

</TABLE>

The aforesaid subsidiaries do business only under their own names.

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 33-15784, 2-71584, 2-75314 , 33-26002, 33-42973, 33-42982, 33-42975 and 33-55362) of KLA Instruments Corporation of our report dated July 26, 1994, appearing on page 24 of the 1994 Annual Report to Stockholders which is incorporated in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report on the Financial Statement Schedules, which appears on page 20 of this Form 10-K.

Price Waterhouse LLP

San Jose, California

September 27, 1994