

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended June 30, 2002

OR

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

For the Transition Period from \_\_\_\_\_ To \_\_\_\_\_

Commission File No. 0-9992

KLA-TENCOR CORPORATION  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

04-2564110  
(I.R.S. Employer  
Identification Number)

160 Rio Robles, San Jose, California  
(Address of Principal Executive Offices)

95134  
(Zip Code)

Registrant's Telephone Number, Including Area Code: (408) 875-6000  
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class Name of Each Exchange on Which Registered  
None None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 Par Value  
Common Stock Purchase Rights  
(Title of Class)

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing price of the registrant's stock, as of September 16, 2002, was \$5,822,813,286. 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 189,113,780 shares of common stock outstanding as of September 16, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2002 Annual Meeting of Stockholders ("Proxy Statement") to be held on November 8, 2002, and to be filed pursuant to Regulation 14A within 120 days after registrant's fiscal year ended June 30, 2002, are incorporated by reference into Part III of this Report.

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#### FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements included in or incorporated by reference in this Annual Report on Form 10-K, other than statements of historical fact, are forward-looking statements. Such forward-looking statements include, among others, those statements regarding the future results of our operations; the recovery and upturn in the demand for semiconductors; technological trends in the semiconductor industry; our future product offerings and product features, as well as industry adoption of new technology; customers' results utilizing our products; anticipated revenue from various domestic and international regions; international sales and operations; maintenance of competitive advantage; success of our product offerings; completion of backlog; creation of development and engineering programs for research and development; attraction and retention of employees; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions and development of acquired technologies; the outcome of any litigation to which we are a party; results of our investment in leading edge technologies; enhancements of current products and strategic acquisitions; our future income tax rate; sufficiency of our existing cash balance, investments and cash generated from operations to meet our liquidity and working capital requirements; our use of derivative financial instruments to mitigate certain financial market risks, and the effectiveness of our efforts and the effects of hedging transactions.

Our actual results may differ significantly from those projected in the forward-looking statements in this report. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the "Risk Factors" section in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 1, "Business" in this Annual Report on Form 10-K. You should carefully review these risks and also review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q that we will file in fiscal 2003. You are cautioned not to place undue reliance on these forward-looking statements, and we expressly assume no obligations to update the forward-looking statements in this report which occur after the date hereof.

#### PART I

##### ITEM 1. BUSINESS

###### The Company

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

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

for in-line wafer defect monitoring; reticle and photomask defect inspection; critical dimension scanning electron microscope ("CD SEM") metrology; wafer overlay; film and surface measurement; and overall yield and fab-wide data analysis. These advanced products, coupled with our unique yield technology services, allow us to deliver the complete yield management solutions our customers need to accelerate their yield learning rates, reduce their yield excursion risks and adopt industry-leading yield management practices.

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

## Industry

### General Background

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

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

### Current Trends

Companies that anticipate future market demands by developing and refining new technologies and manufacturing processes, as well as bringing them into production, are better positioned to lead in the semiconductor market. During previous industry cycles, semiconductor manufacturers generally had to contend with one key new technology or market trend, such as a specific design rule shrink. In today's market, the leading semiconductor manufacturers are investing in bringing three key new technologies into production at the same time: copper interconnects; deep-sub-wavelength lithography (0.13-micron design rules and below); and 300 mm (the next larger wafer size, from which more than twice as many ICs can be produced as on 200 mm wafers).

While each of these three technologies has been adopted at the development and pilot production stages, several significant challenges and risks associated with each one have slowed their adoption into full-volume production. For example, as design rules decrease, yields become more sensitive to the size and density of defects, while device performance characteristics become more sensitive to such parameters as linewidth and film-thickness variation, among other factors. Copper introduces both new defects, which are harder to find within the interconnect structure, as well as electrical defects, which cannot be detected using conventional optical inspection systems. 300 mm wafers are more susceptible to damage than 200 mm wafers since they can bend or bow twice as much, creating stress on the wafer that can result in yield loss. Film uniformity is also more difficult to maintain on these larger wafers. Moving all three of these advanced technologies into production at once only adds to the risk that chipmakers face, since technical challenges in bringing any one of these into production could also be a factor in slowing the adoption of the other two.

Our key activities during fiscal year 2002 involved the development of new process control and yield management tools that enable chipmakers to accelerate the adoption of these new technologies into full-volume production, while minimizing their associated risks. With our portfolio of application-focused technologies and our dedicated yield technology expertise, we are in a unique position to be the single source for comprehensive yield management solutions that enable our customers to achieve first-to-market success for their next-generation products.

The continuing evolution of semiconductor devices to smaller linewidth geometries and more complex multi-level circuitry has significantly increased the cost and performance requirements of the capital equipment used to manufacture these devices. Construction of an advanced wafer fabrication facility can cost over \$2 billion, a substantial increase over the cost of

previous-generation facilities. As a result, chipmakers are demanding increased productivity and higher returns from their manufacturing equipment. Because our process control and yield management equipment typically represents only a small percentage of the total investment required to build a fabrication facility, our customers are able to better leverage these increasingly expensive facilities and significantly improve their return on investment ("ROI").

#### Our Process Control and Yield Acceleration Solutions

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

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

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

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

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

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

KLA-Tencor is the leader in the design, manufacture, marketing and service of process monitoring and yield management systems for the semiconductor industry. Our technical expertise and understanding of customer needs enable us to provide unique yield management solutions and one of the broadest lines of process monitoring and yield management function systems available in the semiconductor industry. Our systems are used to analyze product and process quality at critical points in the IC manufacturing process, as well as provide feedback to our customers that can be used to identify, address, contain and eliminate fabrication problems.

#### Products

We market and sell products to all major semiconductor, wafer, photomask and data storage manufacturers worldwide. We combine our hardware--consisting of patterned and unpatterned wafer inspection, optical overlay metrology, e-beam review, reticle and photomask inspection, spectroscopic- and SEM-based CD metrology, and film and surface measurement tools--with our advanced yield analysis and defect classification software, into fab-wide yield management solutions that are optimized for each of the manufacturing process cells used in IC production, including lithography, etch, deposition and chemical mechanical planarization ("CMP"). Our products can be broadly categorized into five groups: Defect Inspection, Metrology, Yield Management Software Solutions, Customer Service and Support, and Data Storage.

#### Defect Inspection

Our defect inspection tools are used to detect, count, classify and characterize particles and pattern defects in off-line engineering applications, as well as in-line at various stages during the wafer, semiconductor and reticle manufacturing processes. We pioneered the market for automated defect inspection of semiconductor wafers and reticles more than two decades ago. Our portfolio includes all the tools necessary for our customers to detect, correlate and analyze defects, as well as determine and correct their cause.

## High-Resolution Imaging Inspection

Our 2xxx wafer inspection series, first introduced in 1992, has set the standard for high-sensitivity patterned wafer inspection through a unique combination of high-speed image processing, an ultra-broadband brightfield illumination source and our Segmented Auto Threshold technology. In 2000, we unveiled our next-generation platform, the 2350, which was the first ultraviolet ("UV") inspection system to feature ultra-broadband brightfield illumination. Delivering a two-fold increase in throughput over the previous generation 2xxx platform, the 2350 enables the resolution of circuit patterns and defects for 0.13-micron and smaller processes. In July of 2001, an upgrade to the 2350 was introduced, the 2351, which offers enhancements in sensitivity, throughput and ease of use.

## High-Speed Laser Scattering Inspection

Our AIT wafer inspection family is designed for high throughput and low cost of ownership ("CoO"), providing fast and accurate feedback on process tool performance, as well as advanced line monitoring for films, CMP, and non-critical etch and photo modules. The AIT series uses patented double-darkfield technology, which is a low-angle illumination technique particularly effective for detecting defects on planar surfaces such as post-CMP wafers. First introduced in 1995, the AIT platform has been continually enhanced over the years with increasing levels of sensitivity and throughput to address the inspection needs for 0.13-micron and smaller design rules.

In June 2001, we unveiled the AIT XP, which took our AIT inspection family to a whole new level of performance. With its ability to dynamically adjust and optimize inspection speed and sensitivity, while filtering out nuisance defects, the AIT XP delivers maximum sensitivity to all die regions in a single pass. The system can scan an entire wafer in as little as 80 seconds with the sensitivity needed to inspect advanced devices incorporating 0.10-micron (100-nm) and smaller design rules.

## E-Beam Inspection

SEMs use an electron beam to image and measure surface features on a semiconductor wafer at a much higher resolution than images captured by optical microscopes. As the industry moves deeper into the sub-0.15-micron copper device realm, SEM-based inspection becomes mandatory for accelerating yield ramps. KLA-Tencor pioneered this market with the introduction of the industry's first e-beam inspection system nearly 10 years ago. In 1999, we unveiled the eS20, the first scanning e-beam wafer inspection system optimized for use in full-volume production. The following year, we introduced the eS20XP, which delivers further improvements in sensitivity while increasing throughput to enable true production line monitoring of sub-0.13-micron semiconductor manufacturing. KLA-Tencor leveraged more than 25 years of experience in wafer inspection to bring this latest tool to market.

## Optical and E-beam Defect Review

Our defect review capability includes optical confocal and e-beam scanning technology. In 1995, we introduced the CRS(TM) optical review system, which enables high-speed defect review and classification on both patterned and unpatterned 200 mm and 300 mm wafers at a low CoO. In 2000, we introduced the eV300 defect review system--an advanced, automated SEM designed to gather and analyze defect excursion information, as well as report the results with the improved sensitivity required at 0.13-micron and smaller design rules. The eV300 supplements optical review by providing topographical information, enabling more accurate defect classification than can be achieved by optical review systems alone.

## In-line Non Contact Electrical Defect Monitoring

The increasing complexity of IC manufacturing has given rise to a greater number of electrical defects, causing device failure. Accelerating yield learning for the back-end-of-line process, especially in the development and early ramp phases, is made more difficult by the task of isolating these yield-killing defects from the thousands of non-relevant defects induced by material anomalies--an extremely time-consuming process that can take from two to eight weeks to complete per yield-learning cycle.

Our breakthrough uLoop(TM) methodology, introduced in October 2001, provides a fab-wide framework of solutions that accelerate time to yield through an aggressive merger of inspection, metrology and electrical test data. eDo, the first product in the uLoop family, combines non-contact electrical test with in-line physical defect inspection to produce the fastest root-cause analysis method available in the industry today. Using eDo, chipmakers can reduce the length of

their yield-learning cycles down to only a few days. This new approach represents an integrated turnkey solution to electrical inspection that increases the speed and effectiveness of root-cause analysis by detecting and imaging electrical defects quickly, while minimizing the engineering resources required to gather and assimilate the root-cause data. eDo comprises: proprietary test structures; KLA-Tencor's eS20XP e-beam inspection system; and the uLoop Controller--an integrated defect characterization, analysis, and reporting system. The test structures are designed to meet the customer's design rule and chip size requirements. Optimized for voltage-contrast inspection using KLA-Tencor's e-beam technology, the test structures enable highly accurate and accelerated electrical defect capture.

#### Unpatterned Wafer Inspection

In 1997, we introduced the Surfscan SP1(TM) for bare wafer qualification, process monitoring and equipment monitoring applications. It provides the high sensitivity, fast throughput and low CoO required in a production environment, and is used in virtually all semiconductor manufacturing processes. The SP1TBI ("Triple Beam Illumination") was introduced in 1998, and was designed with additional optical configurations needed to detect sub-micron defects on metal films and rough surfaces while still providing sensitivity below 100 nm on polished silicon. The SP1TBI is also used for detecting defects on non-uniform films, a critical requirement for CMP applications. In 1999, we introduced a surface nanotopography measurement capability for the SP1 that enhances lithography and CMP process monitoring for 0.13-micron process development. In 2001, we unveiled the SP1DLS, the first 300 mm tool to provide brightfield, darkfield and nanotopography defect information in a single scan. It has the sensitivity to capture the widest variety of defects as small as 50 nm at high throughput speeds of up to 125 wafers per hour.

#### Macro After-Develop Inspection

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

In 2001, we introduced the 2430 macro ADI series, which brought the benefits of the 2401's advanced analysis capabilities, high throughput and advanced detection algorithms to 300 mm production. Macro defects, which can ruin the entire wafer, are especially costly to chipmakers in 300 mm production, since more than twice the number of die are at risk with these larger wafers as compared to 200 mm wafers. The 2430 is the first automated macro ADI system on the market to be fully compliant with I300I standards for complete integration and rapid deployment in 300 mm fabs.

#### Backside Wafer Inspection

In 2002, we unveiled a new Backside Inspection Module ("BSIM") option for the Surfscan SP1 series that provides the industry's first fully automated, non-destructive inspection solution for the backsides of patterned production wafers. Wafer backside defects can have a significant impact on wafer and process uniformity, both of which are critical issues in advanced 300 mm processing. Our field trials indicate that these backside defects can arise at nearly every process step, and account for as much as 10 percent of a fab's baseline yield loss--amounting to millions of dollars annually in lost revenue. The Surfscan SP1 with BSIM enables automated, non-destructive wafer backside inspection to be incorporated as a routine step into every process module in order to recover these yield losses and help chipmakers further realize the economic gains in moving to 300 mm.

#### Reticle Inspection

Our reticle inspection systems look for possible defects that could be transmitted to the design pattern on the wafer. Reticles are high precision quartz plates that contain microscopic images of electronic circuits. Placed into steppers or scanners, these reticles are used to transfer circuit patterns onto wafers to fabricate ICs. Error-free reticles are the first step in ensuring high yields in the manufacturing process since defects in reticles can be replicated on wafers. Reticle inspection is becoming increasingly critical as the industry moves to deep sub-wavelength lithography (0.13 micron and below), where the feature sizes printed on wafers are significantly

smaller than the wavelength of light used in the stepper or scanner. This extension of the lithography process results in the mask error enhancement factor, where reticle defects once too small to print on the wafer become enhanced in the lithography process to create yield-killing wafer defects. We pioneered the market for automated inspection of reticles and photomasks for the semiconductor manufacturing industry over two decades ago, and continue to be a market leader in addressing our customers' evolving inspection requirements.

Our latest-generation reticle inspection system, TeraStar(TM), was unveiled in 2000 and has since proved to be one of the most successful launches in our company's history. With its ability to inspect up to a terapixel (one million by one million pixels) per reticle, TeraStar provides a three-fold increase in throughput compared to previous generation systems, and can detect critical killer defects as small as 100 nm--making it ideal for inspecting advanced multi-die reticles used in high-volume IC production.

## Metrology

Our metrology or process window optimization products provide virtually all of the critical measurements fabs need to manage their advanced manufacturing processes. With our unique combination of overlay, CD, film thickness and reflectivity measurements, IC manufacturers have the capabilities they need to maintain the tightest possible control of their lithography, etch, deposition and CMP processes.

### Optical Overlay

Decreasing linewidths, larger die sizes and increasing numbers of layers in semiconductor devices all affect the tolerances for layer-to-layer matching, or overlay, and can result in overlay misregistration errors--a crucial cause of yield loss. Metrology systems are needed to measure the alignment between different layers of the semiconductor device to ensure overlay parameters are kept within specification.

KLA-Tencor's overlay metrology systems are more tolerant of process and substrate reflectivity variations than other optical systems, and provide the measurements that our customers need to fine-tune their lithography systems to compensate for these errors and improve process yield. In February 2001, we unveiled our latest-generation overlay metrology system, the Archer 10, which enables highly precise and accurate measurements to within 2 nm, while providing one of the industry's most competitive cost-of-ownership overlay tools for sub-0.13 micron and 300 mm production. To augment the performance of the Archer 10, we introduced a new software tool this past July called Archer Analyzer that conducts fully automated, real-time, on-tool overlay metrology analysis. Seamlessly integrated with the Archer 10, Archer Analyzer provides mission-critical information, such as wafer lot dispositioning and stepper correction data, which helps chipmakers eliminate unnecessary wafer rework and quickly address variations in the performance of their lithography tools to minimize yield loss. This results in reduced cycle times, increased yields and optimum device performance.

### Process Window Monitoring

Over time, optimal focus and exposure settings for a given lithography cell and process can drift and change in a variety of ways, such as CD variations during the patterning process, which result in significant yield losses. Knowing not just the optimal process settings, but also the size of the process window and the sensitivity to process variation, is now critical for stable and efficient pattern transfer.

KLA-Tencor's Process Window Monitor(TM) ("PWM") series of CD metrology systems enables chipmakers to monitor and match the process windows of every lithography cell and process in the fab in real time. Building upon the high precision, throughput and sensitivity of KLA-Tencor's CD SEM and optical CD metrology tools, the new 8x50-PWM and SpectraCD(TM)-PWM series of systems enable a variety of exposure tool-based diagnostics to be off-loaded to the metrology tools, increasing production capacity and overall equipment effectiveness of lithography cells. In addition, the focus-exposure process window information provided by the PWM systems enables rapid excursion detection and root-cause analysis.

### E-Beam CD Metrology

Controlling CD linewidth errors is critical to the IC manufacturing process. Even the tiniest CD variations can affect the speed of the IC, or cause the device to fail completely. Our latest-generation wafer CD SEMs, the 8200 series (for 200 mm wafers) and the 8400 series (for 300 mm wafers), combine high throughput,

advanced imaging, superior measurement precision and enhanced productivity capabilities to enable tight CD control for critical lithography and etch applications. Our pQC(TM) ("Pattern Quality Confirmation") software enables the 8200 and 8400 CD SEMs to provide in-line, real-time monitoring of feature shape integrity during the patterning process--enabling the detection of subtle variations in feature shape that can occur at and below the 0.13 micron node, which are undetected by traditional CD SEM measurements. Our 8250-R reticle CD control system, which is based on the 8200/8400 CD SEM platform, provides extremely precise and high-throughput measurements on advanced reticles used in the production of sub-0.13 micron devices.

#### Spectroscopic CD Metrology

New materials that are used in advanced IC production, such as low-k dielectrics and photoresists for 193 nm lithography, are difficult to control during lithography and etch processes. As a result, they require more comprehensive data to be taken on device features and linewidths in order to identify and correct process variations and remain within process windows. Our SpectraCD(TM) system provides non-destructive simultaneous and extensive CD, feature shape and film-thickness measurements from a single tool, making it one of the industry's lowest cost-of-ownership, production-worthy CD metrology systems for 193-nm lithography applications and sub-100 nm device production.

#### Film Measurement

Our film measurement products measure a variety of optical and electrical properties of thin films. These products are used to control a wide range of wafer fabrication steps, where within-wafer and wafer-to-wafer uniformity of the process is of paramount importance to semiconductor manufacturers--enabling them to achieve high device performance characteristics at the lowest possible cost.

In 1995, we introduced the UV-1250SE, which brought a powerful new technology to production, called spectroscopic ellipsometry ("SE"). KLA-Tencor has shipped more than 500 "UV-SE" systems since the technology was first introduced. Our third generation SE thin-film measurement system tool, the ASET-F5, addressed the difficult film measurement needs that came from the continuing evolution of film development driven by shorter linewidths. In 1999, we introduced an enhanced version of the award-winning ASET-F5, known as the ASET-F5x. It incorporates a single wavelength ellipsometry ("SWE") option to complement the industry-leading SE and dual-beam spectrophotometry ("DBS") technologies incorporated in the ASET-F5 for even greater accuracy, repeatability and system-to-system matching.

In June 2002, we unveiled SpectraFx 100, our latest-generation thin-film metrology system, which delivers the precision, matching and stability required for advanced film-measurement applications for 90-nm device production, including 193-nm deep ultraviolet ("DUV") lithography processes. Designed to fully support next-generation and "operator free" 300 mm fabs with advanced automation and tool-to-tool matching capabilities, SpectraFx 100 enables foundries and other multi-product high-volume chip manufacturers to reduce the process development time for advanced materials and accelerate their adoption into volume production. These materials include 193-nm photoresists, complex copper dual-damascene film stacks, and low-k and high-k dielectrics.

#### Contamination Monitoring

Gate dielectric quality is critical to the speed and reliability of an IC. Below the 0.13-micron node, dielectrics become so thin (less than 20 angstroms, or the equivalent of 0.002 microns) that electrical performance characteristics of the dielectric films become just as critical as physical characteristics in determining overall transistor performance. Our Quantox(TM) product line provides non-contact, in-line electrical performance measurements of all the key parameters that determine the quality of advanced gate dielectric films, including contamination and oxide thickness, as well as electrical capacitance and leakage.

We introduced the latest addition to this product family, called Quantox XP, earlier this year. Quantox XP provides highly accurate and comprehensive information on both the physical and electrical properties of advanced gate dielectric materials in real time. These materials include silicon oxynitride ("SiON") and high-k dielectrics, which are required for sub-0.13-micron IC production. Quantox XP data provides better than 95 percent correlation to device electrical test data, enabling chipmakers to predict transistor performance in-line, rather than having to wait until end-of-line electrical test--a process which normally can take days or weeks to complete.

## In-situ CMP End-Point Detection

In copper deposition, metal film thickness and uniformity can vary significantly from wafer to wafer. To compensate for these variances during CMP, chipmakers have traditionally had to either take copper wafers off line, which dramatically slows the production process, or have had to use optical-only in-situ metrology methods, which provide limited information and unreliable end-point data. In March 2001, we unveiled Precice(TM), the industry's first production-worthy in-situ film thickness and end-point control system for copper CMP that provides highly-accurate measurements in real time. Precice reduces the risk of process errors due to non-uniform polishing, thereby speeding the ramp of new copper processes and maximizing copper yields.

## Surface Metrology

Our Stylus profilers measure the surface topography of films and etched surfaces, and are used in basic research and development as well as semiconductor production and quality control. In 1999, we introduced the HRP-240ETCH, the latest generation of our award-winning HRP(R) high resolution profilers. This system combines the dishing and erosion measurement capabilities of our long-scan profilers with high aspect ratio etched feature measurement capability, which has historically been limited to atomic force microscopes. This allows customers to monitor their critical etch processes such as shallow trench isolation ("STI") and dual-damascene via/trench. We also provide stress measurement systems and capabilities, such as our new wafer bow and wafer stress option for our ASET-F5x thin film metrology tool, which detects reliability-related problems such as film cracking, voiding and lifting.

## Yield Management Software Solutions

Our productivity and analysis software systems translate raw inspection and metrology data into patterns that reveal process problems and help semiconductor manufacturers develop long-term yield improvement strategies.

## Yield/Data Analysis and Management

In 1999, we acquired Taiwan-based ACME Systems, Inc., a leading provider of yield correlation software. Combining the newly-acquired technology from ACME with our own yield management expertise led to the development of our Klarity ACE yield analysis software, which helps our customers quickly identify the source of defects and process problems, as well as correct them. Other acquisitions soon followed that continued to enhance our fab-wide yield management portfolio. With our acquisition of FINLE Technologies in 2000, we developed our Klarity ProDATA lithography data analysis software, which, along with our industry-leading PROLITH lithography and etch simulation software, helps manufacturers reduce their advanced lithography development time and cost. Also in 2000, we acquired Fab Solutions, which added Automated Process Control ("APC") software into our product portfolio. APC allows our customers to employ techniques that can automatically compensate for variances in the IC manufacturing process, and significantly reduce their yield losses.

In 1999, we introduced our IMPACT XP(TM) automated defect classification ("ADC") software, which provides consistent and accurate classification of yield-limiting defects to help our customers accelerate their ramp to higher process yields. IMPACT XP incorporates our SmartGallery(TM) setup tool, which reduces the setup time associated with ADC implementation in fabs by as much as 70 percent. This is a critical requirement, particularly for foundries and application specific integrated circuit ("ASIC") manufacturers, who specialize in short runs of multiple products. Our Real Time Classification(TM) ("RTC") and in-line ADC ("iADC") technologies, which provide classification and binning of defect types in real time during inspection, are critical features on all of our latest-generation e-beam and optical inspection tools.

In 2001, we introduced our new recipe management service, called iRecipe(TM), which allows factory engineers to quickly and easily access existing recipes and associated information that reside on a central database from any personal computer that is connected to the fab intranet. By integrating iRecipe into their fab network, chipmakers can reduce their inspection and metrology tool cost of ownership, as well as improve their overall fab efficiency.

## Customer Service and Support

We enhance the value of our products through our customer service and support programs, which provide comprehensive worldwide service and support across all KLA-Tencor product lines. We also offer yield technology services to

improve our customers' ROI.

#### Global Support Services

Our customer support organization is responsible for much of the support of our customers following the shipment of the equipment and software, including on-site repair, telephone support, system installation, relocation services, and selected post-sales applications.

As part of our customer support program, we offer iSupport(TM), a fast, comprehensive and secure on-line customer support offering that enables our technical support and applications engineers to remotely access data from KLA-Tencor tools and operate them in real time to diagnose and rapidly resolve problems when they occur--all via a secure on-line connection controlled by the customer at all times. With the remote diagnostics capabilities offered by iSupport, customers can achieve such benefits as improved tool productivity and overall equipment effectiveness, as well as lower CoO.

This past June, we unveiled our new iPartner(TM) portfolio of customer support offerings, which leverages a combination of online and on-site resources to cut customer service costs while at the same time boosting tool uptime. Based on our iSupport technology, the iPartner program takes a tiered approach that allows customers to scale at any time to the support level that matches their unique and evolving manufacturing requirements. It is designed to factor in the change in service and support requirements that occur as process and product cycles mature. With 7x24 iPartner online support, customers work with KLA-Tencor's online engineers to resolve common issues, reducing the need for on-site dispatch, thereby reducing costs to the customer and increasing tool uptime. Even when an on-site visit is needed for complex issues, KLA-Tencor online engineers diagnose the problem and then identify and order the necessary parts so that the local customer support engineer arrives on-site with the solution and needed parts in hand to quickly resolve the problem. This approach reduces mean time to repair, further cutting service costs and increasing tool uptime.

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

#### Yield Technology Services

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

#### Data Storage Industry

Outside the semiconductor industry, KLA-Tencor manufactures, sells and services yield management solutions to the data storage market. In 2001, we acquired Phase Metrics, the leading supplier of inspection/certification technologies to the data storage industry. The acquisition marks the latest move in our plan to leverage our core competencies and leadership position in the global semiconductor industry to create similar industry-leading positions in other advanced technology markets.

Phase Metrics' tools and technologies complement the world-class KLA-Tencor systems that already serve as benchmarks for disk and thin film head metrology. Whereas KLA-Tencor's demonstrated technology and expertise focus on front-end data storage metrology and inspection, Phase Metrics' efforts have been focused on data storage back-end inspection and test. By leveraging the naturally synergistic products and services from both companies, in tandem with their joint sales, marketing and customer support channels, the newly combined entity is expected to create the single largest yield management force in the data storage industry.

#### Customers

To support our growing, global customer base, we maintain a significant presence throughout the United States, Europe, Asia-Pacific and Japan, staffed with local sales and applications engineers, customer and field service engineers and yield management consultants. We count among our largest customers

leading semiconductor manufacturers from each of these regions. In fiscal 2002, 2001 and 2000, no single customer accounted for more than 10 percent of our revenues.

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

#### Sales, Service and Marketing

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

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

As of June 30, 2002, we employed over 2,600 sales and related personnel, service engineers and applications engineers. In addition to sales and service offices in U.S., we conduct sales, marketing and services out of wholly-owned subsidiaries or branches of U.S. subsidiaries in a variety of countries, including China, France, Germany, Israel, Italy, Japan, South Korea, Malaysia, Singapore, Taiwan, Thailand and the United Kingdom. International sales accounted for approximately 67%, 66%, and 70% of our revenues in fiscal 2002, 2001, and 2000 respectively. Additional information regarding our revenues from foreign operations for our last three fiscal years is incorporated by reference from Note 10 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

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

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

#### Backlog

Our backlog for system shipments totaled \$599 million at June 30, 2002, compared to \$724 million at June 30, 2001. We include in our backlog only those customer orders for which we have accepted purchase orders and assigned shipment dates within twelve months. In addition, we exclude from backlog any orders for non-released products. We expect to fill the present backlog of orders during fiscal 2003; however, all orders are subject to cancellation or delay by the customer with limited or no penalty. Due to possible customer changes in delivery schedules and to cancellation of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period.

#### Research and Development

The market for yield management and process monitoring systems is characterized by rapid technological development and product innovation. These technical innovations are inherently complex and require long development cycles and appropriate professional staffing. We believe continued and timely

development of new products and enhancements to existing products are necessary to maintain our competitive position. Accordingly, we devote a significant portion of our human and financial resources to research and development programs and seek to maintain close relationships with customers to remain responsive to their needs. As part of our customer relationships, we may enter into certain strategic development and engineering programs whereby our customers offset certain of our research and development costs.

Our key research and development activities during fiscal year 2002 involved development of process control and yield management equipment especially reticle inspection and advanced wafer inspection for smaller feature sizes, copper-based devices and 300mm wafers. For information regarding our research and development expenses during the last three fiscal years, including costs offset by our strategic development and engineering programs, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K.

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

#### Manufacturing, Raw Materials and Supplies

We perform system design, assembly and testing in-house and utilize an outsourcing strategy for the manufacture of components and major subassemblies. Our in-house manufacturing activities consist primarily of assembling and testing components and subassemblies that are acquired through third-party vendors and integrating those subassemblies into our finished products. Our principal manufacturing activities take place in San Jose and Milpitas, California, with additional operations in Bedford, Massachusetts, San Diego, Hayward and Fremont, California, and Migdal Ha'Emek, Israel. As of June 30, 2002, we employed approximately 1,300 manufacturing and 1,200 engineering personnel.

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

Although we seek to reduce our dependence on sole and limited source suppliers, in some cases the partial or complete loss of certain of these sources could disrupt scheduled deliveries to customers and have a material adverse effect on our results of operations and damage customer relationships.

#### Competition

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

Significant competitive factors in the market for process control and yield management systems include system performance, ease of use, reliability, installed base and technical service and support. We believe that, while price and delivery are important competitive factors, the customers' overriding requirement is for systems that easily and effectively incorporate automated and

highly accurate inspection and metrology capabilities into their existing manufacturing processes, thereby enhancing productivity.

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

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

#### Acquisitions

We continue to pursue a course of strategic acquisitions and alliances to expand our technologies, product offerings and distribution capabilities. In fiscal 2002, we acquired substantially all of the assets of QC Optics, Inc. ("QC Optics"), a manufacturer of laser-based inspection systems for semiconductor, flat panel and computer hard disk manufacturing industries.

The financial position and results of operations of this acquisition were immaterial in relation to those of KLA-Tencor and this transaction was accounted for as a purchase. Further details of our acquisitions during the last three fiscal years are included in Note 3 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

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

#### Patents and Other Proprietary Rights

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

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

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

#### Employees

As of June 30, 2002, we employed a total of approximately 5,700 persons. None of our employees are represented by a labor union. We have experienced no work stoppages and believe that our employee relations are good.

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

#### ITEM 2. PROPERTIES

Information regarding our principal properties at June 30, 2002 is set forth below:

<TABLE>  
<CAPTION>

Location	Type	Principal use	Footage	
Ownership				
<S> Phoenix, AZ Leased	<C> Office	<C> Sales and Service	<C> 9,736	<C>
Fremont & Hayward, CA Leased	Office, plant and warehouse	Research, Engineering, Marketing, Manufacturing and Service	85,560	
Livermore, CA Leased	Office	Sales and Service	19,604	
Livermore, CA Owned  (Not yet Occupied)	Office, Plant	Engineering, Manufacturing, and Service	241,252	
Milpitas, CA Leased	Office, plant and warehouse	Research and Engineering, Marketing, Manufacturing, Sales and Service and Sales Administration	728,426	
San Diego, CA Leased	Office, plant and warehouse	Research, Engineering, Marketing, Manufacturing and Service	41,365	
San Jose, CA Leased  Owned	Office, plant and warehouse	Corporate Headquarters, Research and Engineering, Marketing, Manufacturing, Sales and Service and Sales Administration	192,122  603,325	
Scotts Valley, CA Leased	Office, plant	Research and Development	9,945	
Colorado Springs, CO Leased	Office	Sales and Service	6,902	
Bedford, MA Owned	Office, plant	Administration, Manufacturing, Sales and Service	50,000	
Portsmouth, NH Leased	Office	Sales and Service	6,000	
Beaverton, OR Leased	Office	Sales and Service	13,075	
Austin, TX Leased	Office	Sales and Service, Training	62,960	
Richardson, TX Leased	Office	Sales and Service, Training	15,833	
Orlando, FL Terminated  6/30	Office	Sales and Service	5,922	
Boise, ID Leased	Office	Sales and Service	5,965	
Albuquerque, NM Leased	Office	Sales and Service	7,210	
Hopewell Junction, NY Leased	Office	Sales and Service	8,736	
Essex, VT Leased	Office	Sales and Service	5,704	
Basingstoke and Wokingham, Leased England	Office	Sales and Service, Warehouse	16,475	
Slough, England Leased	Office	Research and Engineering	15,404	
Dresden and Pucheim, Germany Leased	Office	Sales and Service, Warehouse	20,912	

Meylan and Evry, and Leased Rousset, France	Office	Sales and Service	18,060
Milan, Avezzano, and Leased Catania, Italy	Office	Sales and Service	9,041
Yokohama, Japan Leased	Office	Sales, Service, and Warehouse	72,186
Kiheung, South Korea Leased	Office	Sales and Service	11,579
Hsinchu, Taiwan Leased	Office	Sales and Service	33,571
Tainan, Taiwan Leased	Office	Sales and Service	6,492
Shanghai, China Leased	Office	Sales, Service, and Warehouse	16,396
Singapore Leased	Office	Sales and Service	27,846
Migdal Ha'Emek and Herzliya, Leased Israel	Office	Research and Engineering, Marketing, Manufacturing and Sales and Service and Sales Administration	53,800

We also lease office space for other, smaller sales and service offices in several locations throughout the world. Our operating leases expire at various times through June 30, 2012 with renewal options at the fair market value for additional periods up to five years. Additional information of these leases is incorporated by reference from Note 7 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K. We believe our properties are adequately maintained and suitable for their intended use and that our production facilities have capacity adequate for our current needs.

### ITEM 3. LEGAL PROCEEDINGS

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

#### ADE Corporation

On October 11, 2000, ADE Corporation ("ADE"), a competitor, filed a patent infringement lawsuit against KLA-Tencor in the U.S. District Court in Delaware. ADE claimed damages and sought an injunction under U.S. Patent No. 6,118,525 ('525 patent). We filed a counterclaim in the same court alleging that ADE has infringed four of our patents. We are seeking damages and a permanent injunction against ADE. In addition, we are seeking a declaration from the District Court that ADE's patent is invalid and not infringed by KLA-Tencor. On October 22, 2001, we filed a separate action for declaratory judgment against ADE in the Northern District of California requesting a declaration that U.S. Patent No. 6,292,259 ('259 patent) is invalid and not infringed. That action has now been consolidated with the prior action in the Delaware proceeding, and ADE has amended its complaint in that proceeding to allege that KLA-Tencor is infringing the '259 patent. On August 8, 2002, the magistrate presiding over the action issued a recommendation that the court enter summary judgment in favor of KLA-Tencor on the issue of non-infringement under ADE's '525 patent. On the same day, the magistrate issued recommendations that the court enter summary judgment in favor of ADE on the issue of non-infringement of two of KLA-Tencor's patents. While we cannot predict the outcome, we believe that we have valid defenses and further believe that our counterclaims have merit.

#### Tokyo Seimitsu Co. Ltd.

On June 27, 2001, we sued Tokyo Seimitsu Co. Ltd. and TSK America Inc. ("TSK"), a competitor, in the U.S. District Court in the Northern District of California alleging that TSK infringes on one of the Company's patents. The suit seeks damages and an injunction under U.S. Patent No. 4,805,123 ('123 patent). TSK filed a counterclaim in the same court seeking a declaration that the '123 patent is invalid, unenforceable and not infringed, and also alleged violations of the antitrust and unfair competition laws.

Although we cannot predict the outcome of these claims, we do not

believe that any of these legal matters will have a material adverse effect on KLA-Tencor. Were an unfavorable ruling to occur in one or more of the pending claims, there exists the possibility of a material impact on our operating results for the period in which the ruling occurred.

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

None.

PART II

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

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

<TABLE>  
<CAPTION>

2001	High	Low
<S>	<C>	<C>
First Quarter	\$ 66.81	\$ 39.81
Second Quarter	40.69	26.25
Third Quarter	46.06	34.12
Fourth Quarter	60.65	32.75
2002	High	Low
First Quarter	\$ 59.45	\$ 31.57
Second Quarter	56.96	29.31
Third Quarter	69.47	47.86
Fourth Quarter	68.66	43.40

As of September 16, 2002, there were 1,076 stockholders of record of our common stock.

We have never paid cash dividends to our stockholders and do not presently plan to pay cash dividends in the foreseeable future.

Equity Compensation Plans

The following table summarizes our equity compensation plans as of June 30, 2002(1):

<TABLE>  
<CAPTION>

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plan
<S>	<C>	<C>	<C>
Equity compensation plans approved by stockholders	24,687,999	\$ 27.20	
Equity compensation plans not approved by stockholders(2)	5,401,708	35.75	
Total	30,089,707	\$ 28.60	

(1) In August 2002, the Board of Directors authorized an increase in the number of securities reserved for future issuance under our equity compensation plans (other than our Director Stock Option Plan) of an aggregate of 7,589,102 shares.  
(2) Officers and directors are not eligible to receive options granted under this plan.

ITEM 6. SELECTED FINANCIAL DATA

The following tables reflect selected consolidated summary financial data for each of the last five fiscal years. This data should be read in conjunction with Item 8, "Financial Statements and Supplementary Data", and with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K. The per share data shown below have been restated to reflect KLA-Tencor's two-for-one stock dividend, effective January 19, 2000.

<TABLE>  
<CAPTION>

Year ended June 30,  
(in thousands, except per share data)  
1998

	2002	2001	2000	1999
-----				
Consolidated Statements of Operations:				
<S>	<C>	<C>	<C>	<C>
Revenues	\$ 1,637,282	\$ 2,103,757	\$ 1,498,812	\$ 843,181
1,166,325				
Income (loss) from operations	244,893	458,468	311,541	(10,334)
164,631				
Income before cumulative effect of change in accounting principles	216,166	373,058	253,798	39,212
134,096				
Cumulative effect of change in accounting principle, net of tax	--	(306,375)	--	--
--				
Net income	216,166	66,683	253,798	39,212
134,096				
Earnings per share:				
Income before cumulative effect of change in accounting principle				
Basic	1.15	2.01	1.39	0.22
0.79				
Diluted	1.10	1.93	1.32	0.21
0.76				
Cumulative effect of change in accounting principle, net of tax				
Basic	--	(1.65)	--	--
--				
Diluted	--	(1.59)	--	--
--				
Net income				
Basic	1.15	0.36	1.39	0.22
0.79				
Diluted	1.10	0.34	1.32	0.21
0.76				

</TABLE>

Pro forma amounts for the periods beginning before July 1, 2000 have not been presented as the effect of the change in accounting principle could not be reasonably determined. See Note 1 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data".

<TABLE>  
<CAPTION>

June 30, (in thousands)  
1998

	2002	2001	2000	1999
-----				
<S>	<C>	<C>	<C>	<C>
Consolidated Balance Sheets:				
Cash, cash equivalents and marketable securities	\$ 1,333,583	\$ 1,143,860	\$ 964,383	\$ 755,183
723,481				
Working capital	931,798	912,861	1,056,927	590,024
605,688				
Total assets	2,717,718	2,744,551	2,203,503	1,584,900
1,548,397				
Stockholders' equity	2,030,228	1,760,466	1,708,676	1,232,583
1,197,714				

</TABLE>

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

The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the related notes included in Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K. This discussion contains forward-looking statements, which involve risk and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements as a result of certain factors, including but not limited to those

discussed in "Risk Factors" and elsewhere in this Annual Report on Form 10-K .

#### CRITICAL ACCOUNTING POLICIES AND THE USE OF ESTIMATES

The preparation of our Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We based these estimates and assumptions on historical experience, and evaluate them on an on-going basis to ensure they remain reasonable under current conditions. Actual results could differ from those estimates. We discuss the development and selection of the critical accounting estimates with the audit committee of our board of directors on a quarterly basis, and the audit committee has reviewed the Company's disclosure relating to them in this Annual Report on Form 10-K. The items in our financial statements requiring significant estimates and judgments are as follows:

**Revenue Recognition** We recognize revenue when persuasive evidence of an arrangement exists, the sale price is fixed or determinable, delivery has occurred or services rendered, and collectibility is reasonably assured. We changed our interpretation of "delivery" based on guidance provided in SEC Staff Accounting Bulletin No. 101 (SAB 101) effective July 1, 2000. Prior to adoption of SAB 101, we generally recognized system revenue when title transferred to the customer (mostly upon shipment). System revenue includes hardware and software that is incidental to the product. We now generally recognize system revenue upon positive affirmation by the customer that the system has been installed and is operating according to pre-determined specifications. This positive affirmation is generally evidenced by an acceptance document signed by the customer. This change has the impact of prolonging the cycle time between order placement and revenue recognition. In limited cases, we allow for exceptions where we recognize system revenue upon shipment if acceptance is not required; however, these exceptions have accounted for less than 2.5% of our revenue this year. (See Note 1 of Notes to Consolidated Financial Statements under "Revenue Recognition" for detailed description of exceptions.)

Revenue from software license fees is typically recognized upon shipment if collection of the resulting receivable is probable, the fee is fixed or determinable, and vendor-specific objective evidence exists to allocate a portion of the total fee to any undelivered elements of the arrangement. Such undelivered elements in these arrangements typically consist of services and/or

upgrades. If vendor-specific objective evidence does not exist for the undelivered elements of the arrangement, all revenue is deferred until such evidence does exist, or until all elements are delivered, whichever is earlier. In instances where an arrangement to deliver software requires significant modification or customization, license fees are recognized under the percentage of completion method of contract accounting. Allowances are established for potential product returns and credit losses. To date, revenue from license fees has been less than 10% of total revenue.

Revenue from the sale of spare parts is recognized upon shipment. Service and maintenance revenue is recognized ratably over the term of the maintenance contract.

The deferred system profit balance as of June 30, 2002 was \$194 million. This amount equals the amount of deferred system revenue that was invoiced and due on shipment and deferred under SAB 101 less applicable product and warranty costs. The deferred profit balance decreased from \$422 million at June 30, 2001 primarily because shipments were lower than revenue recognized during fiscal 2002.

We also defer the fair value of non-standard warranty bundled with equipment sales as unearned revenue. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is recognized ratably as revenue when the applicable warranty term period commences. The unearned revenue balance decreased from \$71 million at June 30, 2001 to \$55 million at June 30, 2002 primarily due to the reduction of system revenue from fiscal 2001 to fiscal 2002.

**Inventory Reserves** We review the adequacy of our inventory reserves on a quarterly basis. For production inventory, our methodology involves matching our on-hand and on-order inventory with our build forecast over the next twelve months. The matching is done on a part-by-part basis. We then evaluate the parts found to be in excess of the twelve-month demand and take appropriate reserves to reflect the risk of obsolescence. For spare parts inventory, we match our on-hand inventory against twenty-four months of usage. We then evaluate the parts in excess of the twenty-four month usage and take appropriate reserves to reflect risk of obsolescence. Both methodologies are significantly affected by the usage assumption. The longer the time period of estimated usage the less reserves are required. Based on our past experience, we believe the twelve-month/twenty-four month time periods best reflect the average obsolescence risks. Given the highly cyclical nature and volatility in our product demand and spare parts usage, we occasionally have to adjust our reserves as actual system demand/spare parts usage varies.

Allowance for Doubtful Accounts A majority of our trade receivables are derived from sales to large multinational semiconductor manufacturers throughout the world. In order to monitor potential credit losses, we perform ongoing credit evaluations of our customers' financial condition. An allowance for doubtful accounts is maintained for potential credit losses based upon our assessment of the expected collectibility of all accounts receivable. The allowance for doubtful accounts is reviewed periodically to assess the adequacy of the allowance. We take into consideration (1) any circumstances of which we are aware of a customer's inability to meet its financial obligations; and (2) a certain percentage of the accounts receivable balance which is based on the age of the receivables and our historical experience. If circumstances change, and

the financial condition of our customers were adversely affected resulting in their inability to meet their financial obligations to us, we may need to take additional allowances.

Warranty We provide standard warranty coverage on our systems for twelve months, providing labor and parts necessary to repair the systems during the warranty period. We account for the estimated warranty cost as a charge to cost of sales when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, we calculate the average service hours and parts expense per system and apply the actual labor and overhead rates to determine the estimated warranty charge. We update these estimated charges every six months. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty reserves accordingly. The difference between the estimated and actual warranty costs tends to be larger for new product introductions for which there is limited or no historical product performance on which to base the estimated warranty expense; more mature products with longer product performance histories tend to be more stable in our warranty charge estimates. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is deferred as unearned revenue and is recognized ratably as revenue when the applicable warranty term period commences.

Contingencies and Litigation We are currently named as a party to various legal proceedings, including those outlined in Part I, Item 3, "Legal Proceedings," in this Annual Report on Form 10-K. While we currently believe the ultimate outcome of these proceedings, both individually and in the aggregate, will not have a material adverse effect on our financial position or operating results, the results of complex legal proceedings are difficult to predict. We would accrue the cost of an adverse judgment if, in our estimation, the adverse settlement is probable and we can reasonably estimate the ultimate cost to us. We have made no such accruals as of June 30, 2002.

#### Results of Operations

During fiscal 2002, we continued to face a significant downturn in the semiconductor industry which started early in calendar year 2001. For several quarters, there has been a worldwide softening in demand for semiconductors resulting in excess capacity and reduced demand for semiconductor manufacturing equipment.

#### Revenues and Gross Margin

Product revenue decreased \$479 million, or 25%, to \$1.43 billion in fiscal 2002 from \$1.91 billion in fiscal 2001. Product revenue declines were mostly the result of reduced capital spending as a result of a semiconductor industry downturn. Product revenue in fiscal 2001 increased \$568 million, or 42% to \$1.91 billion, from \$1.34 billion in fiscal 2000, as a result of the continued recovery of new order and net sales over the previous year as major semiconductor manufacturers expanded facilities for additional capacity and new technology. In fiscal 2002, international revenue slightly increased to 69% of revenue, from 67% in the prior year, due to higher demand in Japan and Western Europe, partially offset by lower demand in Taiwan. In fiscal 2001, international revenue decreased to 67% of revenue, from 72% in fiscal 2000, due to lower demand in Western Europe, Taiwan and Japan.

Service revenue is generated from maintenance service contracts, as well as time and material billable service calls made to our customers after the expiration of the warranty period. Service revenues were \$209 million, \$196 million, and \$159 million in fiscal 2002, 2001 and 2000 respectively. Service revenue continued to increase throughout the 3-year-period as our installed base of equipment at our customers' sites continued to grow. The amount of service revenue generated is generally proportional to the number of post-warranty systems installed at our customers' sites and the degree of utilization of those systems.

Gross margins as a percentage of revenues were 50%, 55% and 55% in fiscal 2002, 2001 and 2000, respectively. The decrease in fiscal 2002 compared to fiscal 2001 was primarily due to reduced capacity utilization, resulting from lower business volume and an increased percentage of revenue in the lower margin service business, as well as factory under-absorption and higher excess inventory write-offs due to lower business levels. The gross margin ratio in fiscal 2001 remained flat compared to fiscal 2000.

Engineering, Research and Development

Net engineering, research and development expenses were \$287 million, \$356 million, and \$246 million, or 18%, 17% and 16% of revenues in fiscal 2002, 2001, and 2000, respectively. The dollars decreased in fiscal 2002, compared to fiscal 2001, primarily due to temporary shutdowns, management pay cuts, reductions in temporary labor and discretionary spending as well as other cost saving measures implemented over the last year. The dollar increase in fiscal 2001, compared to fiscal 2000, was primarily attributable to increased investment in new technologies associated with our ongoing efforts to develop products which address new market segments, enhancements to existing products including next-generation 300mm products, and inspection enhancements for sub-quarter micron technology.

Net engineering, research and development expenses were partially offset by \$14 million, \$8 million and \$16 million in external funding received under certain strategic development programs conducted with several of our customers and government grants in fiscal 2002, 2001 and 2000, respectively.

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

Selling, General and Administrative

Selling, general and administrative expenses were \$291 million, \$354 million and \$268 million, or 18%, 17% and 18% of revenues, in fiscal 2002, 2001, and 2000, respectively. The decrease in dollars in fiscal 2002, as compared to fiscal 2001, was primarily due to temporary shutdowns, management pay cuts, reductions in temporary labor and discretionary spending, as well as other cost saving measures implemented over the last year. The increase in dollars in fiscal 2001, as compared to fiscal 2000, was primarily due to increased costs associated with the growth in revenues.

Non-Recurring Acquisition, Restructuring and Other Charges

The following is summary of non-recurring acquisition, restructuring and other charges:

<TABLE>  
<CAPTION>

(in thousands)	2002	2001	2000
Acquired in-process research and development expense	\$ -	\$ 700	\$ 3,200
Facilities	-	4,713	
Severance	-	1,595	
Non-recurring income from iSupport sale	-	(10,029)	
Reserve reversal	-	-	(7,838)
Others	-	1,018	-
	\$ -	\$ (2,003)	\$ (4,638)

</TABLE>

Acquisitions

During the three years ended June 30, 2002, we completed a number of purchase acquisitions. The Consolidated Financial Statements include the operating results of each business from the date of acquisition. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or aggregate basis. For a period of up to twelve months from the acquisition date, we may change our original purchase price allocation for pre-acquisition uncertainties. After twelve months, we record the fair value of such reasonably estimable contingencies.

The amounts allocated to in-process research and development ("in-process R&D") were determined through established valuation techniques in the high-technology equipment industry and were expensed upon acquisition because technology feasibility had not been established and no future alternative uses existed. Amounts allocated to goodwill and purchased intangible assets are amortized on a straight-line basis over periods not exceeding five years.

A summary of purchase transactions is outlined as follows (in thousands):

<TABLE>  
<CAPTION>

Acquisition year	Acquired Company/Assets	Consideration Including Assumed Liabilities	Acquisition Cost	Goodwill and Purchased Intangible Assets	In-Process R&D Expenses
Fiscal 2002	QC Optics(1)	\$4,000	\$-	\$4,000	\$-
Fiscal 2001	Phase Metrics(2)	\$18,000	\$1,300	\$5,400	\$700
Fiscal 2000	Fab Solutions(3)	\$8,000	\$-	\$7,700	\$800
Fiscal 2000	FINLE Technologies(4)	\$5,000	\$-	\$3,300	\$500
Fiscal 2000	ACME Systems(5)	\$6,900	\$-	\$4,500	\$1,900

(1) With the acquisition of QC Optics, we received certain intellectual property in laser-based inspection systems for the semiconductor, flat panel and computer hard disk manufacturing industries.

(2) We acquired certain assets and technology of Phase Metrics, the leading supplier of inspection/certification products in the data storage industry.

(3) Fab solutions provided us with APC software, allowing our customers to automatically compensate for variances in the IC manufacturing process.

(4) With the Finle acquisition, we developed our Klarity ProDATA lithography data analysis software, which combined with the PROLITH lithography data analysis software, helps our customers reduce their advanced lithography development time and cost.

(5) ACME's technology enabled us to develop the Klarity ACE product which helps our customers quickly identify defects and process problems fab-wide.

</FN>  
</TABLE>

The difference between the purchase price and the goodwill, intangibles and in-process R&D represents amount allocated to the net tangible assets acquired. No deferred stock-based compensation has been recorded for any of the acquisitions.

#### Restructuring and Other Charges

In fiscal 2002, there were no restructuring charges. In fiscal 2001, in response to the downturn in the semiconductor industry, we implemented a restructuring plan to reduce spending. Charges related to our restructuring plan included: facilities of \$4.7 million, severance and benefits of \$1.6 million, and other costs of \$1.0 million. Due to our downsizing and consolidation of certain of our operations, we vacated two of our leased office buildings and included the remaining net book value of the related leasehold improvements as well as the future lease payments, net of anticipated sublease revenue in the charge. We reduced our workforce by approximately 5%, primarily in the manufacturing areas, and recorded severance charges related to these terminations. In addition, during the fourth fiscal quarter of 2001, we sold software and intellectual property associated with our iSupport(TM) on-line customer support technology and recorded \$10.0 million pretax, non-recurring income, which was netted with the other non-recurring charges. As part of the iSupport(TM) transaction, we will record a non-recurring gain of approximately \$15 million in the quarter ending September 30, 2002. During fiscal 2000, we reversed \$8 million of restructuring reserve that would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for our products.

As of June 30, 2002, the remaining balance of the restructuring reserve was \$0.4 million. Restructuring activity for fiscal 2002 was as follows:

<TABLE>  
<CAPTION>

(in thousands)	Facilities	Other	Total
Balance at June 30, 2001	\$2,035	\$200	\$2,235
Cash Paid	(1,630)	(200)	(1,830)
Balance at June 30, 2002	\$405	\$-	\$405

</TABLE>

The semiconductor equipment industry that we operate in is a highly

cyclical industry. This cyclical nature affects our ability to accurately predict future revenue and, thus, future expense levels. We are currently in a down cycle, and if this current down cycle continues to linger, we may need to take appropriate actions to scale operating expenses to our business levels.

#### Interest Income and Other, Net

Interest income and other, net was \$43 million, \$54 million and \$42 million in fiscal 2002, 2001, and 2000, respectively. Interest income and other, net is comprised primarily of gains realized on sales of marketable securities, interest income earned on the investment and cash portfolio and income recognized upon settlement of certain foreign currency contracts. The decrease in fiscal 2002 as compared to fiscal 2001 was primarily due to decreased interest income resulting from declining interest rates. The increase in fiscal 2001 as compared to fiscal 2000 was primarily due to increased interest income resulting from higher interest rate and higher average investment balances.

#### Provision for Income Taxes

KLA-Tencor's effective income tax rate was 25%, 27% and 28% in fiscal 2002, 2001 and 2000, respectively. In general, our effective income tax rate differs from the statutory rate of 35% largely as a function of benefits realized from our Extraterritorial Income ("ETI") exclusion, research and development tax credits and income derived from tax exempt interest.

The overall reduction in our effective income tax rate from fiscal 2001 to fiscal 2002 of 2%, was the result of a combination of factors. Most importantly, more export sales benefits, more tax-exempt interest income and less state tax expense compared relatively to these same items as a percentage of fiscal 2001 pre-tax income, reduced the rate. These reductions were partially offset by more relative foreign tax expense. The overall reduction in our effective income tax rate from fiscal 2000 to fiscal 2001 was primarily due to a shift in the geographic composition of our pre-tax income.

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

#### Liquidity and Capital Resources

Working capital was \$932 million as of June 30, 2002, compared to \$913 million as of June 30, 2001. Cash, cash equivalents and short-term marketable securities at June 30, 2002 decreased to \$673 million from \$697 million at June 30, 2001. In addition, we maintained \$660 million and \$447 million in marketable securities classified as long-term as of June 30, 2002 and 2001, respectively.

KLA-Tencor has historically financed its operations through cash generated from operations. Cash provided by operating activities was \$284 million, \$408 million, and \$253 million in fiscal 2002, 2001 and 2000, respectively. The decrease in cash provided by operating activities in fiscal 2002 compared to fiscal 2001 was primarily due to decreased income before the cumulative effect of accounting change and lower accounts payable, partially offset by lower accounts receivable and inventory balances. Income before cumulative effect of accounting change decreased in fiscal 2002, compared to fiscal 2001, primarily due to declining revenues and gross margins partially offset by decreased engineering, selling, general and administrative expenses associated with cost saving measures in response to the industry slowdown. Accounts payable shrank due to decreased expenditures and lower incoming invoices. Accounts receivable declined primarily due to strong collection efforts, as well as lower shipments. The reduction in inventory was driven primarily in production inventory, where stringent processes have been put in place for managing material procurement. The increase in cash provided by operating activities in fiscal 2001 compared to fiscal 2000 was primarily due to revenue growth and strong collection in accounts receivable, partially offset by increased inventory expenditure and other purchases. During fiscal 2002 and 2001, we sold trade notes and accounts receivable from Japanese customers. At June 30, 2002 and 2001, \$48 million and \$52 million, respectively, of these receivables and notes were outstanding, which have not been included in our consolidated balance sheet as the criteria for sale treatment established by SFAS 140 have been met. Under SFAS 140, after a transfer of financial assets, an entity derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

Cash used in investing activities was \$376 million, \$295 million and \$96 million in fiscal 2002, 2001 and 2000, respectively. Investing activities typically consist of purchases and sales or maturities of marketable securities, purchases of capital assets to support long-term growth and acquisitions of technology or other companies to allow access to new market segments or emerging technologies. Additions of capital assets consist mainly of the planned completion of our Livermore facilities. We anticipate capital expenditures in fiscal 2003 to be significantly lower compared to fiscal 2002 due to the completion of the Livermore facilities in fiscal 2002.

We used \$9 million and \$58 million of cash in financing activities in fiscal 2002 and fiscal 2001, respectively, and generated \$61 million in fiscal 2000. Financing activities typically include sales and repurchases of our common stock, as well as borrowings and repayments of debt. Repurchases of common stock, net of issuance, used \$8 million and \$60 million in fiscal 2002 and fiscal 2001, respectively. Issuance of common stock, net of repurchases, provided \$79 million in fiscal 2000.

We have adopted a plan for the systematic repurchase of shares of our common stock in the open market to reduce the dilution created by our stock-based employee benefit and incentive plans. In fiscal 2002, we repurchased 3,341,000 shares of our common stock at an average price of \$36.89 per share, for a total of \$123 million. In fiscal 2001, we repurchased 4,580,000 shares of our common stock at an average price of \$33.54 per share, for a total of \$154 million. In fiscal 2000, we repurchased 520,000 shares of our common stock at an average price of \$53.80 per share, for a total of \$28 million. Since the inception of the repurchase program in 1997 through June 30, 2002, we have repurchased a total of 11,349,000 shares at an average price of \$32.57 per share. All such shares remain as treasury shares.

Certain of our leased facilities qualify for operating lease accounting treatment under SFAS 13, "Accounting for Leases," and, as such, the facilities are not included on our Consolidated Balance Sheet.

The lease agreement for certain Milpitas and San Jose, California facilities has a term of five years ending in November 2002, with an option to extend up to two more years. Monthly payments under this lease vary based upon the London Interbank Offering Rate (LIBOR) plus 0.42%. Under the terms of the lease, we, at our option, can acquire the properties at their original cost or arrange for the properties to be acquired. Under the terms of the lease, we must maintain compliance with certain financial covenants. As of the date of filing of this 10-K, we were in compliance with all of our bank covenants, including the financial covenants. If we purchase these Milpitas and San Jose, California facilities at the end of the lease term, the purchase transactions would increase land and property value by approximately \$119.3 million and decrease cash by approximately the same amount. Consequently, depreciation expense would increase by approximately \$4.3 million per year, rent expense would decrease by approximately \$2.9 million per year, and interest income would decrease by approximately \$3.6 million per year, based on current interest rates. If we choose not to purchase the facilities, we will be liable to the lessor for residual value guarantees of an aggregate of up to approximately \$100.2 million. Based on current market conditions, we do not believe that we will have to make any significant payments associated with the residual value guarantees.

At June 30, 2002, our principal sources of liquidity consisted of \$1.33 billion of cash, cash equivalents, and investments. Our liquidity is affected by many factors, some of which are based on the normal ongoing operations of the business, and others of which relate to the uncertainties of global economies and the semiconductor and the semiconductor equipment industries. Although cash requirements will fluctuate based on the timing and extent of these factors, our management believes that cash generated from operations, together with the liquidity provided by existing cash balances, will be sufficient to satisfy our liquidity requirements for the next twelve months.

The following is a schedule summarizing KLA-Tencor significant commitments as of June 30, 2002 (in millions):

<TABLE>

<CAPTION>

	Payments Due by Period				
	Total	1 year	2-3 years	3-4 years	Over 5 years
<S>	<C>	<C>	<C>	<C>	<C>
Operating leases	\$ 20.0	\$ 9.4	\$ 8.2	\$ 1.4	\$ 1.0
Lease at maturity	100.2	100.2	-	-	-
	\$ 120.2	\$ 109.6	\$ 8.2	\$ 1.4	\$ 1.0

</TABLE>

Additionally, we maintain certain open inventory purchase commitments with our suppliers to ensure a smooth and continuous supply chain for key components. Our liability in these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecast time-horizon can vary amongst different suppliers. As such, it is difficult to accurately report our true open commitments at any particular point in time. However, we estimate our open inventory purchase commitment as of June 30, 2002 to be no more than \$60 million.

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

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

Our operating results have varied widely in the past, and our future operating results will continue to be subject to quarterly variations based upon

a wide variety of factors, including those listed in this section and throughout this Annual Report on Form 10-K. In addition, future operating results may not follow any past trends. We believe the factors that could make our results fluctuate and difficult to predict include:

- o the cyclical nature of the semiconductor industry;
- o changing global economic conditions;
- o competitive pressure;
- o our ability to develop and implement new technologies and introduction of new products;
- o our ability to manage our manufacturing requirements;
- o intellectual property protection;
- o the shortage of qualified workers in the areas in which we operate; and
- o worldwide political instability.

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

#### Semiconductor Equipment Industry Volatility

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

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

#### International Trade and Economic Conditions

We serve an increasingly global market. A majority of our annual revenues are derived from outside the United States, and we expect that international revenues will continue to represent a substantial percentage of our revenues. Our international revenues and operations are affected by economic conditions specific to each country and region. Because of our significant dependence on international revenues, a decline in the economies of any of the countries or regions in which we do business could negatively affect our operating results.

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

#### Competition

Our industry includes large manufacturers with substantial resources to support customers worldwide. Our future performance depends, in part, upon our ability to continue to compete successfully worldwide. Some of our competitors are diversified companies with greater financial resources and more extensive

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

#### Technological Change and Customer Requirements

Success in the semiconductor equipment industry depends, in part, on continual improvement of existing technologies and rapid innovation of new solutions. For example, the semiconductor industry continues to shrink the size of semiconductor devices which increasing wafer size and has begun to commercialize the process of copper-based interconnects. These and other evolving customer needs require us to respond with continued development programs and to cut back or discontinue older programs, which may no longer have industry-wide support. Technical innovations are inherently complex and require long development cycles and appropriate professional staffing. Our competitive advantage and future business success depend on our ability to accurately predict evolving industry standards, to develop and introduce new products which successfully address changing customer needs, to win market acceptance of these new products and to manufacture these new products in a timely and cost-effective manner. If we do not develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, our business could be seriously harmed.

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

#### Key Suppliers

We use a wide range of materials in the production of our products, including custom electronic and mechanical components, and we use numerous suppliers to supply materials. We generally do not have guaranteed supply arrangements with our suppliers. Because of the variability and uniqueness of customers' orders, we do not maintain an extensive inventory of materials for manufacturing. We seek to minimize the risk of production and service interruptions and/or shortages of key parts by selecting and qualifying alternative suppliers for key parts, monitoring the financial stability of key suppliers and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, key parts may be available only from a single supplier or a limited group of suppliers. Our business would be harmed if we do not receive sufficient parts to meet our production requirements in a timely and cost-effective manner.

#### Manufacturing Disruption

Operations at our primary manufacturing facilities and our assembly subcontractors are subject to disruption for a variety of reasons, including work stoppages, terrorism, fire, earthquake, energy shortages, flooding or other natural disasters. In addition, last year California suffered from a severe energy shortage, causing rolling blackouts throughout the state. In recent months there has also been a marked increase in hostility in the Middle East. Such disruption could cause delays in shipments of products to our customers. We cannot ensure that alternate production capacity would be available if a major disruption were to occur or that, if it were available, it could be obtained on favorable terms. Such a disruption could result in cancellation of orders or loss of customers and could seriously harm our business.

#### Intellectual Property Obsolescence and Infringement

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

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

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

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

As is typical in the semiconductor equipment industry, from time to time we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which they believe cover certain of our products, processes, technologies or information. Our customary practice is to evaluate such assertions and to consider whether to seek licenses where appropriate. However, we cannot ensure that licenses can be obtained or, if obtained, will be on acceptable terms or that costly litigation or other administrative proceedings will not occur. The inability to obtain necessary licenses or other rights on reasonable terms could seriously harm our operating results and financial condition.

#### Key Employees

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

#### Acquisitions

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

#### Litigation

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

#### Terrorism and Political Instability

The threat of terrorism targeted at the regions of the world in which we do business, including the United States, increases the uncertainty in our markets and may delay any recovery in the general economy. Any delay in the recovery of the economy and the semiconductor industry could seriously impact our business.

Increased international political instability, as demonstrated by the September 2001 terrorist attacks, disruption in air transportation and further enhanced security measures as a result of the September 2001 terrorist attacks, the conflict in Afghanistan and the increasing tension in the Middle East, may hinder our ability to do business and may increase our costs of operations. To the extent this instability continues or otherwise increases, we could incur increased costs in transportation, make such transportation unreliable, increase insurance costs, and cause international currency markets to fluctuate. This same instability could have the same effects on our suppliers and their ability to timely deliver their products. If this international political instability continues or increases, our business and results of operations could be harmed.

#### Effects of Recent Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations," which is effective for fiscal years beginning after June 15, 2002. SFAS 143 applies to all entities and addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of a long-lived asset, except for certain obligations of lessees. We do not expect the adoption of SFAS 143 will have a significant impact on our financial position and results of operations.

In October 2001, the FASB issued Statement No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed. SFAS 144 will be effective for fiscal years beginning after December 15, 2001. We are currently evaluating the impact of SFAS 144, but do not expect that our adoption on July 1, 2002 will have a material effect on our financial statements.

In June 2002, the FASB issued Statement No. 146 ("SFAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liabilities Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). This Statement requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. The standard will in certain circumstances change the timing of recognition of restructuring costs.

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

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate these risks, we utilize derivative financial instruments. We do not use derivative financial instruments for speculative or trading purposes. All of the potential changes noted below are based on sensitivity analyses performed on our financial position at June 30, 2002. Actual results may differ materially.

At the end of fiscal 2002, we had an investment portfolio of fixed income securities of \$883 million, excluding those classified as cash and cash equivalents (detail of these securities is included in Note 4 of the Notes to Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K). These securities, as with all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of June 30, 2002, the fair value of the portfolio would have declined by \$6 million.

As of June 30, 2002, we had net forward contracts to sell \$115 million in foreign currency in order to hedge currency exposures (detail of these contracts is incorporated by reference from Note 1 of the Notes to the Consolidated Financial Statements under "Derivative Instruments". If we had entered into these contracts on June 30, 2002, the U.S. dollar equivalent would be \$124 million. A 10% adverse move in currency exchange rates affecting the contracts would decrease the fair value of the contracts by \$15 million. However, if this occurred, the fair value of the underlying exposures hedged by the contracts would increase by a similar amount. Accordingly, we believe that the hedging of our foreign currency exposure should have no material impact on income or cash flows.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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</TABLE>

Consolidated Balance Sheets

<TABLE>

<CAPTION>

June 30, (in thousands, except per share data)	2002	2001
-----		
---		
Assets		
Current assets:		
<S>	<C>	<C>
Cash and cash equivalents	\$ 429,820	\$ 529,674
Marketable securities	243,526	167,421
Accounts receivable, net	277,006	402,013
Inventories	323,016	394,406
Deferred income taxes	315,049	360,079
Other current assets	30,871	43,353
-----		
---		
Total current assets	1,619,288	1,896,946
Land, property and equipment, net	300,560	290,254
Marketable securities	660,237	446,765
Other assets 137,633	110,586	
-----		
Total assets	\$ 2,717,718	\$ 2,744,551
=====		

Liabilities and Stockholders' Equity

Current liabilities:		
Accounts payable	\$ 52,988	\$ 60,740
Deferred system profit	193,852	422,054
Unearned revenue	54,886	70,974
Other current liabilities	385,764	430,317
-----		
---		
Total current liabilities	687,490	984,085
-----		
---		

Commitments and contingencies (Note 7)

Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none outstanding	---	---
Common stock, \$0.001 par value, 500,000 shares authorized, 189,752 and 187,779 shares issued and outstanding	190	188
Capital in excess of par value	765,756	714,145
Retained earnings	1,259,695	1,043,529
Accumulated other comprehensive income	4,587	2,604
-----		
---		
Total stockholders' equity	2,030,228	1,760,466
-----		
---		
Total liabilities and stockholders' equity	\$ 2,717,718	\$ 2,744,551
=====		

</TABLE>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

<TABLE>

<CAPTION>

Year ended June 30, (in thousands, except per share data)	2002	2001	2000
-----			
---			
Revenues:			
<S>	<C>	<C>	<C>
Product	\$ 1,428,107	\$ 1,907,364	\$ 1,339,779
Service	209,175	196,393	159,033

Total revenues	1,637,282	2,103,757	1,498,812
Costs and operating expenses:			
Cost of goods sold	814,393	937,152	677,805
Engineering, research and development	287,408	355,772	246,227
Selling, general and administrative	290,588	354,368	267,877
Non-recurring acquisition, restructuring and other	--	(2,003)	
(4,638)			
Total costs and operating expenses	1,392,389	1,645,289	1,187,271
Income from operations	244,893	458,468	311,541
Interest income and other, net	42,563	54,116	41,536
Income before income taxes and cumulative effect of change in accounting principle	287,456	512,584	353,077
Provision for income taxes	71,290	139,526	99,279
Income before cumulative effect of change in accounting principle	216,166	373,058	253,798
Cumulative effect of change in accounting principle, net of tax	--	(306,375)	--
Net income	\$ 216,166	\$ 66,683	\$ 253,798
Net income per share:			
Basic			
Income before cumulative effect of change in accounting principle	\$ 1.15	\$ 2.01	\$ 1.39
Cumulative effect of change in accounting principle, net of tax	--	(1.65)	--
Basic net income per share	\$ 1.15	\$ 0.36	\$ 1.39
Diluted			
Income before cumulative effect of change in accounting principle	\$ 1.10	\$ 1.93	\$ 1.32
Cumulative effect of change in accounting principle, net of tax	--	(1.59)	--
Diluted net income per share	\$ 1.10	\$ 0.34	\$ 1.32
Weighted average number of shares:			
Basic	187,667	185,860	182,177
Diluted	196,594	193,435	192,564

</TABLE>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

<TABLE>

<CAPTION>

(in thousands)	Common Stock and Capital in Excess of Par Value		Retained Earnings	Accumulated Other Compre- hensive	
	Shares	Amount			
IncomeTotals					
Balances at June 30, 1999	<C> 177,364	<C> \$ 504,352	<C> \$ 723,048	<C> \$ 5,183	<C>
\$1,232,583					
Components of comprehensive income:					
Net income	---	---	253,798	---	
253,798					
Change in unrealized gain on investments	---	---	---	5,580	
5,580					
Currency translation adjustments	---	---	---	2,902	
2,902					
Total comprehensive income	---	---	---	---	

262,280

----				-----
Net issuance under employee stock plans	10,621	109,951	---	---
109,951				
Repurchase of common stock	(520)	(27,978)	---	---
(27,978)				
Tax benefits of stock option transactions	---	131,840	---	---
131,840				
-----				
Balances at June 30, 2000	187,465	718,165	976,846	13,665
1,708,676				
Components of comprehensive income:				
Net income	---	---	66,683	---
66,683				
Change in unrealized loss on investments	---	---	---	(2,485)
(2,485)				
Currency translation adjustments	---	---	---	(12,008)
(12,008)				
Deferred gains on cash flow hedging instruments	---	---	---	3,432
3,432				
-----				
Total comprehensive income	---	---	---	---
55,622				
----				-----
Net issuance under employee stock plans	4,894	93,756	---	---
93,756				
Repurchase of common stock	(4,580)	(153,632)	---	---
(153,632)				
Tax benefits of stock option transactions	---	56,044	---	---
56,044				
-----				
Balances at June 30, 2001	187,779	714,333	1,043,529	2,604
1,760,466				
Components of comprehensive income:				
Net income	---	---	216,166	---
216,166				
Change in unrealized loss on investments	---	---	---	(1,048)
(1,048)				
Currency translation adjustments	---	---	---	7,455
7,455				
Deferred losses on cash flow hedging instruments	---	---	---	(4,424)
(4,424)				
-----				
Total comprehensive income	---	---	---	---
218,149				
----				-----
Net issuance under employee stock plans	5,314	115,136	---	---
115,136				
Repurchase of common stock	(3,341)	(123,220)	---	---
(123,220)				
Tax benefits of stock option transactions	---	59,697	---	---
59,697				
-----				
Balances at June 30, 2002	189,752	\$ 765,946	\$1,259,695	\$ 4,587
\$2,030,228				
=====				

&lt;/TABLE&gt;

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

&lt;TABLE&gt;

&lt;CAPTION&gt;

Year ended June 30, (in thousands)	2002	2001	2000
-----			
Cash flows from operating activities:			
<S>	<C>	<C>	<C>
Net income	\$ 216,166	\$ 66,683	\$ 253,798
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change, net of tax benefit	--	306,375	--
Depreciation and amortization	69,590	55,649	63,338
Restructuring charges	--	(4,297)	(7,838)

In-process research and development	--	698	3,200
Net (gain) loss on sale of marketable securities	6,290	(7,703)	5,306
Deferred income taxes	36,037	(56,939)	(60,522)
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:			
Accounts receivable	125,005	83,761	(185,262)
Inventories	71,430	(101,750)	
(95,780)			
Other assets	(4,974)	(14,522)	
(13,549)			
Accounts payable	(7,754)	5,723	18,969
Deferred profit	(228,202)	(31,835)	--
Other current liabilities	459	106,075	270,857
-----			
Net cash provided by operating activities	284,047	407,918	252,517
-----			
Cash flows from investing activities:			
Acquisitions, net of cash received	(4,035)	(20,818)	(19,925)
Purchase of property and equipment	(68,658)	(162,195)	(78,694)
Purchase of available-for-sale securities	(2,141,323)	(913,096)	(667,887)
Proceeds from sale of available-for-sale securities	1,619,111	731,395	604,969
Proceeds from maturity of available-for-sale securities	218,706	69,606	65,083
-----			
Net cash used in investing activities	(376,199)	(295,108)	(96,454)
-----			
Cash flows from financing activities:			
Issuance of common stock, net	115,136	93,756	106,999
Stock repurchases	(123,220)	(153,632)	(27,978)
Net borrowings (payments) under short term debt obligations	(448)	1,670	(18,316)
-----			
Net cash provided by (used in) financing activities	(8,532)	(58,206)	60,705
-----			
Effect of exchange rate changes on cash and cash equivalents	830	(3,142)	(10,044)
-----			
Net increase (decrease) in cash and cash equivalents	(99,854)	51,462	206,724
Cash and cash equivalents at beginning of period	529,674	478,212	271,488
-----			
Cash and cash equivalents at end of period	\$ 429,820	\$ 529,674	\$ 478,212
=====			
Supplemental cash flow disclosures:			
Income taxes paid (refunded), net of refunds	\$ (19,875)	\$ 133,710	\$ 1,243
Interest paid	\$ 779	\$ 916	\$ 1,131
Supplemental non-cash investing activities:			
Software and technology exchanged for common stock of public company	\$ --	\$ 14,309	\$ --

</TABLE>

See accompanying notes to consolidated financial statements.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

The Consolidated Financial Statements include the accounts of KLA-Tencor and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Management Estimates The preparation of the Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**Fair Value of Financial Instruments** KLA-Tencor has evaluated the estimated fair value of financial instruments using available market information and valuation methodologies. The use of different market assumptions and/or estimation methodologies could have a significant effect on the estimated fair value amounts. The fair value of KLA-Tencor's cash, cash equivalents, accounts receivable, accounts payable and other current liabilities approximate their carrying amounts due to the relatively short maturity of these items.

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

**Marketable Securities** Short-term marketable securities include debt and equity securities acquired with maturities exceeding three months but less than one year from the date of acquisition. Non-current marketable securities include debt and equity securities acquired with maturities exceeding one year from the reporting date. While KLA-Tencor's intent is to hold debt securities to maturity, KLA-Tencor has classified all debt securities and all investments in equity securities that have readily determinable fair values as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. Such securities are reported at fair value determined based on quoted market prices at the reporting date for those instruments, with unrealized gains or losses excluded from earnings and included in "Accumulated other comprehensive income," net of applicable taxes, until realized. The cost of securities sold is based on the specific identification method. Realized gains or losses and declines in value, if any, judged to be other than temporary are reported in "Interest income and other, net" in the Consolidated Statements of Operations.

**Inventories** Inventories are stated at the lower of cost (on a first-in, first-out basis) or market. Demonstration units are stated at their manufacturing cost and reserves are recorded to state the demonstration units at their net realizable value. KLA-Tencor reviews the adequacy of its inventory reserves on a quarterly basis. Its methodology involves matching its on-hand and on-order inventory with its demand forecast on a part-by-part basis. For parts that are in excess of its forecasted demand, KLA-Tencor takes appropriate reserves to reflect risk of obsolescence. If actual demand declined below its forecast, KLA-Tencor may need to take additional inventory reserves.

**Property and Equipment** Property and equipment are recorded at cost. Depreciation of property and equipment is based on the straight-line method over the estimated useful lives of the assets, which are 30 years for buildings, 10 years for building improvements, five to seven years for furniture and fixtures, and three to five years for machinery and equipment. Leasehold improvements are amortized by the straight-line method over the shorter of the life of the related asset or the term of the underlying lease. Construction in process does not depreciate until the assets are placed in service.

**Intangible Assets** Purchased technology, patents, trademarks, favorable leases and goodwill are presented at cost, net of accumulated amortization. Effective July 1, 2001, KLA-Tencor replaced ratable amortization of goodwill with periodic testing of goodwill for impairment in accordance with the provisions of Statement of Financial Accounting Standard No. 142, "Goodwill and Intangible Assets." Intangible assets other than goodwill are amortized over their estimated useful lives using the straight-line method.

**Software Development Costs** Development costs incurred in the research and development of new software products are expensed as incurred until technological feasibility of the product has been established. Software development costs incurred after technological feasibility has been established are capitalized up to the time the product is available for general release to customers. At June 30, 2002 and 2001, there were no amounts capitalized as KLA-Tencor's current development process is essentially completely concurrent with the establishment of technological feasibility.

**Impairment of Long-Lived Assets** KLA-Tencor evaluates the carrying value of its long-lived assets whenever events or changes in circumstances indicate that the carrying value of the asset may be impaired in accordance with the provisions of Statement of Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." An impairment loss is recognized when estimated future cash flows expected to result from the use of the asset including disposition, is less than the carrying value of the asset.

**Concentration of Credit Risk** Financial instruments, which potentially subject KLA-Tencor to credit risk, consist principally of investments, accounts receivable and derivative financial instruments used in hedging activities.

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

A majority of KLA-Tencor's trade receivables are derived from sales to

large multinational semiconductor manufacturers throughout the world. Concentration of credit risk with respect to trade receivables is considered to be limited due to its customer base and the diversity of its geographic sales areas. KLA-Tencor performs ongoing credit evaluations of its customers' financial condition. KLA-Tencor maintains a provision for potential credit losses based upon expected collectibility of all accounts receivable.

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

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

**Derivative Instruments** KLA-Tencor's foreign subsidiaries operate and sell KLA-Tencor's products in various global markets. As a result, KLA-Tencor is exposed to changes in foreign currency exchange rates. KLA-Tencor utilizes foreign currency forward exchange contracts to hedge against certain future movements in foreign exchange rates that affect certain foreign currency denominated sales and purchase transactions. KLA-Tencor attempts to match the forward contracts with the underlying items being hedged in terms of currency, amount, and maturity. KLA-Tencor does not use derivative financial instruments for speculative or trading purposes. Since the impact of movements in currency exchange rates on forward contracts offsets most of the related impact on the exposures hedged, these financial instruments generally do not subject KLA-Tencor to speculative risk that would otherwise result from changes in currency exchange rates.

KLA-Tencor discontinues hedge accounting prospectively when (1) it is determined that a derivative is no longer effective in offsetting changes in the cash flows of a hedged item; (2) the derivative expires or is sold, terminated or exercised; (3) the derivative is discontinued as a hedge instrument because it is unlikely the underlying hedged transaction will occur; (4) because a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the balance sheet, with changes in its fair value recognized in current period earnings. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the related amounts that were accumulated in other comprehensive income are recognized immediately in earnings.

At June 30, 2002, KLA-Tencor had foreign exchange forward contracts maturing throughout fiscal 2003 to sell and purchase \$155 million and \$40 million, respectively, in foreign currency, primarily Japanese yen. At June 30, 2001, KLA-Tencor had foreign exchange forward contracts maturing throughout fiscal 2002 to sell and purchase \$219 million and \$60 million, respectively, in foreign currency, primarily Japanese yen. All foreign exchange forward contracts are carried on the consolidated balance sheets at fair market value. See Note 8 for further information related to derivatives and hedging activities.

**Warranty** KLA-Tencor provides standard warranty coverage on its systems for a period of twelve months, providing labor and parts necessary to repair the systems during the warranty period. The Company accounts for the estimated warranty cost as a charge to cost of goods sold when revenue is recognized. The estimated warranty cost is based on its historical experience with the product's performance in the field. If actual warranty activities differ from its estimates, the Company records revisions to the estimated warranty liability as required. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is deferred as unearned revenue and is recognized ratably as revenue when the applicable warranty term period commences.

**Revenue Recognition** In December 1999, the SEC issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." The SEC Staff addressed several issues in SAB 101, including the timing of revenue recognition for sales that involve contractual customer acceptance provisions and installation of the product if these events occur after shipment and transfer of title. KLA-Tencor implemented the provisions of SAB 101 in the fourth fiscal quarter of 2001, retroactive to July 1, 2000. Prior to adoption of SAB 101, KLA-Tencor's general policy was to recognize revenue on shipment. Accordingly, KLA-Tencor did not have any formal centralized processes for tracking, obtaining and filing customer acceptance reports; therefore, pro forma amounts for the periods before July 1, 2000 have not been presented as the effect of the change in accounting principle could not be reasonably determined.

KLA-Tencor derives revenue from four sources - system sales, spare part sales, service contracts and software license fees. System sales include hardware and software that is incidental to the product. SAB 101 has no impact on KLA-Tencor's revenue recognition policy for spare part sales, service contracts and software license fees.

Prior to the implementation of SAB 101, system revenue was generally recognized upon shipment. Effective July 1, 2000, KLA-Tencor changed its method of accounting for system sales to generally recognize revenue upon a positive affirmation by the customer that the system has been installed and is operating according to predetermined specifications. In certain limited cases, KLA-Tencor may deviate from the need for a written acceptance by the customer, as follows:

- o When system sales to independent distributors have no installation, contain no acceptance agreement, and 100% payment is due upon shipment, revenue is recognized on shipment;
- o When the system requires no integration and installation is inconsequential, revenue is recognized on shipment. In these cases KLA-Tencor is required to perform the installation but it considers installation not essential to the functionality of the equipment, and there are no additional tests required to be performed on-site. In addition, third party distributors and customers regularly complete the installation of these tools;
- o When the customer fab has already accepted the same tool, with the same specifications on the same process, for the same application, and it can be objectively demonstrated that it meets all of the required acceptance criteria upon shipment, a portion of revenue may be recognized at the time of shipment. Revenue recognized upon shipment is exclusive of the amount allocable to the installation element. Revenue attributable to the installation element is the higher of the payment amount due upon acceptance or the fair value of installation;
- o When the system is performing in production and meets all published and contractually agreed specifications, but the customer withholds signature on our acceptance document due to warranty or other issues unrelated to product performance.

Total revenue recognized under conditions where KLA-Tencor deviated from the need for a written acceptance by the customer were less than 2.5% of total revenue for fiscal 2002 and fiscal 2001.

In accordance with SAB 101, KLA-Tencor also allows for multiple element revenue arrangement in cases where certain elements of a sales contract are not delivered and accepted at the same time. In such cases, KLA-Tencor defers the fair value of the unaccepted element until that element is delivered to and accepted by the customer. To be considered a separate element, the product or service in question must represent a separate earnings process, and is not essential to the functionality of the delivered and accepted portion of the same sales contract. If the unaccepted element is essential to the functionality of the delivered and accepted portion, the whole amount of the sales contract is deferred until all elements are accepted.

Spare part revenue is recognized when the product has been shipped, risk of loss has passed to the customer and collection of the resulting receivable is probable.

Service and maintenance revenue is recognized ratably over the term of the maintenance contract. If maintenance is included in an arrangement, which includes a software license agreement, amounts related to maintenance are allocated based on vendor specific objective evidence. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is deferred as unearned revenue and is recognized ratably as revenue when the applicable warranty term period commences. Consulting and training revenue is recognized when the related services are performed.

Revenue from software license fees is typically recognized upon shipment if collection of the resulting receivable is probable, the fee is fixed or determinable, and vendor-specific objective evidence exists to allocate a portion of the total fee to any undelivered elements of the arrangement. Such undelivered elements in these arrangements typically consist of services and/or upgrades. If vendor-specific objective evidence does not exist for the undelivered elements of the arrangement, all revenue is deferred until such evidence does exist, or until all elements are delivered, whichever is earlier. In instances where an arrangement to deliver software requires significant modification or customization, license fees are recognized under the percentage of completion method of contract accounting. Allowances are established for potential product returns and credit losses. To date, revenue from license fees have been less than 10% of total revenue.

As a result of implementing SAB 101, KLA-Tencor changed its method of accounting for revenue recognition. This change resulted in cumulative deferred system revenue of \$661 million as of July 1, 2000, which was recorded as a non-cash charge of \$306 million after reduction for product and warranty costs and income taxes. The deferred system profit balance as of June 30, 2002 was \$194 million and equals the amount of system revenue that was invoiced and due on shipment but deferred under SAB 101 less applicable product and warranty

costs.

KLA-Tencor also defers the fair value of non-standard warranty bundled with equipment sales as unearned revenue. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is recognized as revenue ratably when the applicable warranty term period commences. The unearned revenue balance was \$71 million at June 30, 2001 and \$55 million at June 30, 2002.

Advertising Expenses KLA-Tencor expenses advertising costs as incurred. Advertising expenses for fiscal 2002, 2001 and 2000 were approximately \$3 million, \$6 million and \$6 million respectively.

Strategic Development Agreements Net engineering, research and development expenses were partially offset by \$14 million, \$8 million and \$16 million in external funding received under certain strategic development programs conducted with several of KLA-Tencor's customers and government grants in fiscal 2002, 2001 and 2000, respectively.

Income Taxes KLA-Tencor accounts for income taxes under an asset and liability approach. Deferred tax liabilities are recognized for future taxable amounts and deferred tax assets are recognized for future deductions.

Earnings Per Share Basic earnings per share ("EPS") is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by using the weighted average number of common shares outstanding during the period and gives effect to all dilutive potential common shares outstanding during the period. The reconciling difference between the computation of basic and diluted earnings per share for all periods presented is the inclusion of the dilutive effect of stock options issued to employees under employee stock option plans.

Options to purchase 282,746, 4,459,862 and 211,009 shares of KLA-Tencor's common stock were outstanding at June 30, 2002, 2001 and 2000 respectively, but not included in the computation of diluted EPS because the exercise price was greater than the average market price of common shares in each respective year. The exercise price ranges of these options were \$52.75 to \$68.00, \$44.69 to \$68.00 and \$56.31 to \$68.00 at June 30, 2002, 2001 and 2000, respectively.

Stock-Based Compensation Plans KLA-Tencor accounts for its employee stock option plans and employee stock purchase plan in accordance with provisions of APB 25, "Accounting for Stock Issued to Employees." KLA-Tencor provides additional pro forma disclosure required by SFAS 123, "Accounting for Stock-Based Compensation" (see Note 6).

Reclassifications Certain prior period balances have been reclassified to conform to the current financial statement presentation.

Recent Accounting Pronouncements In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations," which is effective for fiscal years beginning after June 15, 2002. SFAS 143 applies to all entities and addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of a long-lived asset, except for certain obligations of lessees. KLA-Tencor does not expect the adoption of SFAS 143 to have a significant impact on its financial position and results of operations.

In October 2001, the FASB issued Statement No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed. SFAS 144 will be effective for fiscal years beginning after December 15, 2001. KLA-Tencor is currently evaluating the impact of SFAS 144, but does not expect that its adoption on July 1, 2002 will have a material effect on its financial statements.

In June 2002, the FASB issued Statement No. 146 ("SFAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liabilities Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS 146 requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. SFAS 146 applies to exit or disposal activities that are initiated after December 31, 2002. This Statement will, in certain circumstances, change the timing of recognition of restructuring costs.

June 30, (in thousands)	2002	2001
Accounts receivable, net		
Accounts receivable, gross	\$ 290,397	\$ 417,025
Allowance for doubtful accounts	(13,391)	(15,012)
	\$ 277,006	\$ 402,013
Inventories:		
Customer service parts	\$ 123,074	\$ 99,099
Raw materials	76,238	140,765
Work-in-process	54,143	61,453
Demonstration equipment	48,564	60,228
Finished goods	20,997	32,861
	\$ 323,016	\$ 394,406
Property and equipment:		
Land	\$ 28,103	\$ 28,103
Buildings and improvements	48,683	49,102
Machinery and equipment	218,977	235,846
Office furniture and fixtures	36,951	35,571
Leasehold improvements	116,787	103,359
Construction in process	74,843	31,184
	524,344	483,165
Less: accumulated depreciation and amortization	(223,784)	(192,911)
	\$ 300,560	\$ 290,254

Other current liabilities:		
Warranty, installation and retrofit	\$ 54,441	\$ 85,300
Compensation and benefits	175,282	186,699
Income taxes payable	84,024	91,239
Restructuring accrual	405	2,235
Other accrued expenses	71,612	64,844
	\$ 385,764	\$ 430,317

<TABLE>  
<CAPTION>

June 30, (in thousands)	2002	2001
Accumulated other comprehensive income:		
<S>	<C>	<C>
Currency translation adjustments	\$ (7,699)	\$ (15,154)
Gains (losses) on cash flow hedging instruments	(992)	3,432
Unrealized gains on investments, net of taxes of \$8,383 in 2002 and \$9,037 in 2001	13,278	14,326
	\$ 4,587	\$ 2,604

</TABLE>

Statements of Operations

<TABLE>  
<CAPTION>

Year ended June 30, (in thousands)	2002	2001	2000
Interest income and other, net			
<S>	<C>	<C>	<C>
Interest income	\$ 46,543	\$ 39,652	\$ 39,335
Interest expense	(594)	(1,057)	(698)
Foreign exchange gain	3,897	8,478	3,791
Realized gain (loss) on sale of available-for-sale securities	(6,290)	7,703	(5,306)
Other	(993)	(660)	4,414
	\$ 42,563	\$ 54,116	\$ 41,536

</TABLE>

NOTE 3 - NON-RECURRING ACQUISITION, RESTRUCTURING AND OTHER CHARGES

The following is summary of non-recurring acquisition, restructuring and other charges.

<TABLE>  
<CAPTION>

(in thousands)	2002	2001	2000
<S>	<C>	<C>	<C>
Acquired in-process research and development expense	\$ -	\$ 700	\$ 3,200
Facilities	-	4,713	-
Severance	-	1,595	-
Non-recurring income from iSupport sale	-	(10,029)	-
Reserve reversal	-	-	(7,838)
Others	-	1,018	-
	\$ -	\$ (2,003)	\$ (4,638)

</TABLE>

Acquisitions

During the three years in the period ended June 30, 2002, KLA-Tencor completed a number of purchase acquisitions. The Consolidated Financial Statements include the operating results of each business from the date of acquisition. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or aggregate basis. For a period of up to twelve months from the acquisition date, KLA-Tencor may change its original purchase price allocation for pre-acquisition uncertainties. After twelve months, KLA-Tencor records the fair value of such reasonably estimable contingencies.

The amounts allocated to in-process research and development ("in-process R&D") were determined through established valuation techniques in the high-technology equipment industry and were expensed upon acquisition because technology feasibility had not been established and no future alternative uses existed. Amounts allocated to goodwill and purchased intangible assets are amortized on a straight-line basis over periods not exceeding five years.

A summary of purchase transactions is outlined as follows (in thousands):

<TABLE>  
<CAPTION>

Acquisition year	Acquired Company/Assets	Consideration Including Assumed Liabilities	Acquisition Cost	Goodwill and Purchased Intangible Assets	In-Process R&D Expenses
<S>		<C>		<C>	<C>
Fiscal 2002	QC Optics(1)	\$4,000	\$-	\$4,000	\$-
Fiscal 2001	Phase Metrics(2)	\$18,000	\$1,300	\$5,400	\$700
Fiscal 2000	Fab Solutions(3)	\$8,000	\$-	\$7,700	\$800
Fiscal 2000	FINLE Technologies(4)	\$5,000	\$-	\$3,300	\$500
Fiscal 2000	ACME Systems(5)	\$6,900	\$-	\$4,500	\$1,900

<FN>

(1) With the acquisition of QC Optics, we received certain intellectual property in laser-based inspection systems for the semiconductor, flat panel and computer hard disk manufacturing industries.

(2) KLA-Tencor acquired certain assets and technology of Phase Metrics, the leading supplier of inspection/certification products in the data storage industry.

(3) Fab solutions provided us with APC software, allowing our customers to automatically compensate for variances in the IC manufacturing process.

(4) With the Finle acquisition, we developed our Klarity ProDATA lithography data analysis software, which combined with the PROLITH lithography data analysis software, help our customers reduce their advanced lithography development time and cost.

(5) ACME's technology enabled us to develop the Klarity ACE product which helps our customers quickly identify the source of

defects and process problems fab-wide.

</FN>  
</TABLE>

The difference between the purchase price and the goodwill, intangibles and in-process R&D represents amount allocated to the net tangible assets acquired. No deferred stock-based compensation has been recorded for any of the acquisitions.

Restructuring and Other Charges

In fiscal 2002, there were no restructuring charges. In fiscal 2001, in response to the downturn in the semiconductor industry, KLA-Tencor implemented a restructuring plan to reduce spending. Charges related to its restructuring plan included: facilities of \$4.7 million, severance and benefits of \$1.6 million, and other costs of \$1.0 million. Due to its downsizing and consolidation of certain of its operations, KLA-Tencor vacated two of its leased office buildings and included the remaining net book value of the related leasehold improvements as well as the future lease payments, net of anticipated sublease revenue in the charge. During fiscal 2002, KLA-Tencor reduced its workforce by approximately 5%, primarily in the manufacturing areas and recorded severance charges related to these terminations. In addition, during the fourth fiscal quarter of 2001, KLA-Tencor sold software and intellectual property associated with its iSupport(TM) on-line customer support technology and recorded \$10.0 million pretax, non-recurring income, which was netted with the other non-recurring charges. As part of the iSupport(TM) transaction, the Company will record a non-recurring gain of approximately \$15 million in the quarter ending September 30, 2002. During fiscal 2000, we reversed \$8 million of restructuring reserve that would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for our products.

As of June 30, 2002, the remaining balance of the restructuring reserve was \$0.4 million. Restructuring activity for fiscal 2002 was as follows:

<TABLE>  
<CAPTION>

(in thousands)	Facilities	Other	Total
<S>	<C>	<C>	<C>
Balance at June 30, 2001	\$2,035	\$200	\$2,235
Cash Paid	(1,630)	(200)	(1,830)
Balance at June 30, 2002	\$405	\$-	\$405

</TABLE>  
NOTE 4 - MARKETABLE SECURITIES

The amortized costs and estimated fair value of securities available-for-sale as of June 30, 2002 and 2001 are as follows:

<TABLE>  
<CAPTION>

June 30, 2002 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<S>	<C>	<C>	<C>	<C>
U.S. Treasuries	\$ 56,996	\$ 406	\$ 18	\$ 57,384
Mortgage-backed securities	46,862	406	8	47,260
Municipal bonds	860,326	6,813	55	867,084
Corporate debt securities	40,548	214	5	40,757
Corporate equity securities	6,784	15,307	1,399	20,692
Other	190,234	---	---	190,234
	1,201,750	23,146	1,485	1,223,411
Less: Cash equivalents	319,505	143	---	319,648
Short-term marketable securities	228,859	16,079	1,412	243,526
Long-term marketable securities	\$ 653,386	\$ 6,924	\$ 73	\$ 660,237
June 30, 2001 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasuries	\$ 56,996	\$ 406	\$ 18	\$ 57,385
Mortgage-backed securities	46,861	406	8	47,260
Municipal bonds	860,326	6,813	56	867,084
Corporate debt securities	25,795	272	24	26,043
Corporate equity securities	24,442	17,273	---	41,715
Other	144,872	---	---	144,872
	1,018,972	23,482	114	1,042,340

Less: Cash equivalents	428,154	---	---	428,154
Short-term marketable securities	149,148	18,273	---	167,421

Long-term marketable securities	\$ 441,670	\$ 5,209	\$ 114	\$ 446,765
---------------------------------	------------	----------	--------	------------

</TABLE>

The contractual maturities of debt securities classified as available-for-sale as of June 30, 2002, regardless of the consolidated balance sheet classification, are as follows:

June 30, 2002 (in thousands)	Estimated Fair Value
Due within one year	\$ 542,482
Due after one year through five years	654,465
Due after five years	5,772
	\$ 1,202,719

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Net realized gains and losses for the years ended June 30, 2002 and 2001 were not material to KLA-Tencor's financial position or results of operations.

NOTE 5 - INCOME TAXES

The components of income before income taxes are as follows:

Year ended June 30, (in thousands)	2002	2001	2000
Domestic income before income taxes	\$ 256,926	\$ 437,329	\$ 311,240
Foreign income before income taxes	30,530	75,255	41,837
Total net income before taxes	\$ 287,456	\$ 512,584	\$ 353,077

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

Year ended June 30, (in thousands)	2002	2001	2000
Current:			
Federal	\$ (1,252)	\$ 162,491	\$ 121,639
State	19,374	15,129	23,187
Foreign	17,131	17,578	14,975
Deferred:			
Federal (44,893)	60,076	(51,782)	
State (13,958)	(20,576)	(4,549)	
Foreign (1,671)	(3,463)	659	
Provision for income taxes	\$ 71,290	\$ 139,526	\$ 99,279

</TABLE>

Actual current tax liabilities are lower than reflected above for fiscal years 2002, 2001 and 2000 by \$60 million, \$56 million and \$132 million, respectively, due to the stock option deduction benefits recorded as credits to capital in excess of par value.

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

<TABLE>

<CAPTION>

June 30, (in thousands)	2002	2001
-----		
Deferred tax assets:		
<S>	<C>	<C>
Federal and state loss and credit carryforwards	\$ 70,794	\$ 19,123
Employee benefits accrual	42,137	34,789
Non-deductible reserves and other	166,365	210,229
Deferred profit	106,959	164,753
-----		
	386,255	\$ 428,894
-----		
Deferred tax liabilities:		
Depreciation	(718)	
(3,638)		
Unremitted earnings of foreign subsidiaries not permanently reinvested	(11,850)	
(12,114)		
Unrealized gain on investments	(8,383)	(9,037)
Other	(16,338)	
(19,756)		
-----		
	(37,289)	
-----		
(44,545)		
-----		
Total net deferred tax assets	\$ 348,966	\$ 384,349
=====		

</TABLE>

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

Year ended June 30,	2002	2001	2000
-----			
<S>	<C>	<C>	<C>
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	(0.3)	1.3	1.7
Effect of foreign operations taxed at various rates	0.3	(1.6)	(0.6)
Export sales benefit	(5.3)	(3.7)	(2.9)
Research and development tax credit	(2.8)	(3.0)	(2.5)
Tax exempt interest	(2.9)	(1.5)	(1.6)
Other	0.8	0.7	(1.0)
-----			
Provision for Income Taxes	24.8%	27.2%	28.1%
=====			

</TABLE>

United States federal income taxes have not been provided for the undistributed earnings of two of KLA-Tencor's foreign subsidiaries. These undistributed earnings aggregated \$37 million at June 30, 2002, and it is the Company's intention that such undistributed earnings be permanently reinvested. The Company has tax credit at June 30, 2002 totaling \$70 million, of which \$23 million will begin to expire in 2021. The Company enjoys tax holidays in Israel where it manufactures certain of its products. These tax holidays are scheduled to expire at varying times within the next ten years. The effect of these tax holidays has not had a material impact on the Company's net income and net income per share.

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

Stockholders' Rights Plan In March 1989, KLA-Tencor implemented a plan to protect stockholders' rights in the event of a proposed takeover of KLA-Tencor. Each stockholder under the plan is entitled to one right per common stock owned. The Plan was amended in April 1996. The Plan provides that if any person or group acquires 15% or more of KLA-Tencor's common stock, each right not owned by such person or group will entitle its holder to purchase, at the then-current exercise price, KLA-Tencor's common stock at a value of twice that exercise price. As amended to date, under the Plan, the rights are redeemable at KLA-Tencor's option for \$0.01 per right and expire in April 2006.

Stock Repurchase Program In July 1997, the Board of Directors authorized KLA-Tencor to systematically repurchase shares of its common stock in the open market. This plan was entered into to reduce the dilution from KLA-Tencor's employee benefit and incentive plans such as the stock option and employee stock purchase plans. In fiscal years 2002, 2001 and 2000, KLA-Tencor repurchased 3,341,000, 4,580,000 and 520,000 shares at an average price of

\$36.89, \$33.54 and \$53.80 per share, respectively. Since the inception of the repurchase program in 1997 through June 30, 2002, KLA-Tencor has repurchased a total of 11,349,000 shares at an average price of \$32.57 per share. All such shares remain as treasury shares.

Stock Split For stockholders of record on January 4, 2000, KLA-Tencor effected a two-for-one stock split of its common stock in the form of a 100 percent stock dividend. The stock dividend was paid on January 19, 2000. All prior-period share and per share amounts have been adjusted to reflect this transaction retroactively.

Employee Stock Purchase Plan KLA-Tencor's employee stock purchase plan provides that eligible employees may contribute up to 10% of their eligible earnings toward the semi-annual purchase of KLA-Tencor's common stock. The employee's purchase price is derived from a formula based on the fair market value of the common stock at the time of enrollment into the Offering period versus the fair market value on the date of purchase. Offering periods are generally two years in length. As the plan is non-compensatory under APB 25, no compensation expense is recorded in connection with the plan. In fiscal years 2002, 2001 and 2000, employees purchased 1,155,213, 1,275,837 and 1,935,031 of shares issued at a weighted average fair value of \$29.72, \$28.59 and \$13.28, respectively. The plan shares are replenished annually on the first day of each fiscal year by virtue of an evergreen provision. The provision allows for a share replenishment equal to the lesser of 2,000,000 shares or the number of shares which the Company estimates will be required to issue under the plan during the forthcoming fiscal year. At June 30, 2002, 1,602,401 shares were reserved and available for issuance under this plan.

Stock Option and Incentive Plans KLA-Tencor's stock option program is a broad-based, long-term retention program that is intended to attract and retain qualified management and technical employees ("knowledge employees"), and align stockholder and employee interests. The plans provide for awards in the form of stock options, stock appreciation rights, stock purchase rights, and performance shares. As of June 30, 2002, only stock options have been awarded under the plans. Under KLA-Tencor's stock option plans, options generally have vesting periods of four or five years, are exercisable for a period not to exceed ten years from the date of issuance and are granted at prices not less than the fair market value of KLA-Tencor's common stock at the grant date. This program consists of three plans: one under which non-employee directors may be granted options to purchase shares of our stock, another in which officers, key employees, consultants and all other employees may be granted options and one other in which consultants and all employees other than directors and officers may be granted options to purchase shares of our stock. Substantially all of our employees that meet established performance goals and that qualify as knowledge employees participate in one of our stock option plans. Options granted to employees from fiscal year 1999 through June 30, 2002 are summarized as follows:

	2002	2001	2000	1999
<S>	<C>	<C>	<C>	<C>
Total Options Granted During the period 15,311	9,760	10,274	8,166	
Less Options Forfeited (11,084)	(1,786)	(2,418)	(1,484)	
Net Options Granted 4,227	7,974	7,856	6,682	
Net grants during the period as % of total shares 2.4% outstanding	4.2%	4.2%	3.6%	
Grants to top 5 officers during the period as a % of 0.2% total shares outstanding	0.3%	0.2%	0.2%	
Grants to top 5 officers during the period as a % of 3.0% total options granted	6.0%	4.0%	5.0%	

During fiscal 2002, the Company granted options to purchase approximately 9.8 million shares of stock to employees, which was a net grant of options for 8.0 million shares after deducting options forfeited. The net options granted after forfeiture represented 4.2% of total outstanding shares of approximately 189.8 million as of June 30, 2002.

Options granted to the top five officers as a percentage of the total options granted to all employees vary from year to year. In 2002, they were a higher percentage of the total grants than in the other years shown as they

included Board of Director approved additional grants to Mr. Schroeder in recognition of his future potential to lead the corporation. The additional grants to Mr. Schroeder total 227,400 options with vesting on said grants extended out for up to an eight-year period. These additional grants are not made every year. For additional information about the compensation of our executive officers and stock option grants to our top five executive officers, please refer to our proxy statement dated September 20, 2002.

All stock option grants to officers are made with a review by, and with the approval of the Compensation Committee of the Board of Directors. All members of the Compensation Committee are independent directors, as defined in the applicable rules for issuers traded on the NASDAQ Stock Market. See the "Report of the Compensation Committee on Executive Compensation" appearing in KLA-Tencor's proxy statement dated September 20, 2002, for further information concerning the policies and procedures of KLA-Tencor and the Compensation Committee regarding the use of stock options.

The following table summarizes KLA-Tencor's stock option plans as of June 30, 2002(1):

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under stock option plan
<S>	<C>	<C>	<C>
Stock option plan approved by stockholders	24,687,999	\$ 27.20	6,062,215
Stock option plan not approved by stockholders(2)	5,401,708	35.75	7,671,705(1)
Total	30,089,707	\$ 28.60	13,733,920

</TABLE>

- (1) In August 2002, the Board of Directors authorized an increase in the number of securities reserved for additional future issuance under the Company's stock option plans (other than the Company's [Director Stock Option Plan]) of an aggregate of 7,589,102 shares.
- (2) Officers and directors are not eligible to receive options granted under this plan.

In December 2000, employees of KLA-Tencor were offered the opportunity to exchange their stock options with exercise prices over \$55.00 per share and all subsequently issued options for a promise to issue new options no sooner than six months and two days after the cancellation of the forfeited options. If an employee elected to participate in the exchange program, they were required to exchange all options issued during the period six months prior to December 2000 as well as six months subsequent to December 2000. The new options were granted on July 10, 2001 at an exercise price of \$46.67, the price equal to the NASDAQ closing price of KLA-Tencor's common stock on the same day. The terms of the new option replicated the surrendered option. A total of 278 employees canceled an aggregate of 722,814 options with exercise prices ranging from \$26.25 to \$68.00 per share.

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

	Available For Grant	Options Outstanding	Weighted-Average Price
<S>	<C>	<C>	<C>
Balances at June 30, 1999	6,508,066	24,428,304	10.92
Additional shares reserved	5,320,924	---	---
Options granted	(8,165,856)	8,165,856	37.35
Options canceled/expired	1,483,568	(1,551,794)	18.62
Options exercised	---	(8,686,654)	9.50
Balances at June 30, 2000	5,146,702	22,355,712	20.23
Additional shares reserved	11,216,391	---	---
Options granted	(10,273,504)	10,273,504	37.09
Options canceled/expired	2,418,485	(2,418,485)	36.15
Options exercised	---	(3,921,145)	14.71
Balances at June 30, 2001	8,508,074	26,289,586	\$ 26.18
Additional shares reserved	5,610,752	---	---
Options granted	(9,760,303)	9,760,303	31.83
Options canceled/expired	1,786,295	(1,786,295)	32.55
Options exercised	---	(4,173,887)	19.36

Balances at June 30, 2002 6,144,818 30,089,707 \$ 28.60

</TABLE>

The options outstanding at June 30, 2002 have been segregated into ranges for additional disclosure as follows:

<TABLE>

<CAPTION>

Options Outstanding				Options Vested and Exercisable	
Range of Exercise Prices	Number of Shares Outstanding at June 30, 2002	Weighted-Average Remaining Contract Life (in years)	Weighted-Average Exercise Price at June 30, 2002	Number Vested and Exercisable	Weighted-Average Exercise Price at June 30, 2002
<S>	<C>	<C>	<C>	<C>	<C>
\$1.88-\$ 9.31	881,132	2.31	\$ 8.48	881,132	\$ 8.48
\$9.53-\$10.63	4,760,868	6.12	\$ 10.60	4,396,460	\$ 10.60
\$10.81-\$26.25	4,047,576	6.84	\$ 20.70	2,555,874	\$ 18.00
\$27.38-\$29.00	382,034	7.91	\$ 28.09	177,301	\$ 28.10
\$29.31-\$29.31	8,114,994	9.26	\$ 29.31	1,000	\$ 29.31
\$30.28-\$32.75	2,356,680	8.60	\$ 32.54	624,490	\$ 32.39
\$33.75-\$33.75	3,783,851	7.33	\$ 33.75	2,296,858	\$ 33.75
\$34.94-\$68.00	5,762,572	8.36	\$ 46.14	2,503,040	\$ 45.96
\$ 1.88-\$68.00	30,089,707	7.75	\$ 28.60	13,436,155	\$ 23.66

</TABLE>

The weighted average fair value of options granted in fiscal years 2002, 2001 and 2000 was \$21.87, \$25.93 and \$24.15, respectively. Options exercisable were 13,436,155, 9,807,250 and 6,777,749 as of June 30, 2002, 2001 and 2000, respectively.

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

<TABLE>

<CAPTION>

June 30,	2002	2001	2000
Stock option plan:			
<S>	<C>	<C>	<C>
Expected stock price volatility	80.0%	80.0%	70.0%
Risk free interest rate	4.4%	5.5%	6.3%
Expected life of options (in years)	5.4	5.4	5.3
Stock purchase plan:			
Expected stock price volatility	80.0%	80.0%	70.0%
Risk free interest rate	2.2%	4.3%	6.3%
Expected life of options (in years)	1-2	1-2	1-2

</TABLE>

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

For purposes of pro forma disclosures required by SFAS 123, the estimated fair value of the options is amortized to expense over the options' vesting periods using straight-line method. KLA-Tencor's pro forma information is as follows:

<TABLE>

<CAPTION>

Year ended June 30,  
(in thousands, except per share data) 2002 2001 2000

Net Income				
<S>	<C>	<C>	<C>	<C>
As Reported	\$ 216,166	\$ 66,683	\$ 253,798	
Pro forma	\$ 92,364	(\$ 27,013)	\$ 197,610	
Earnings per share:				
As reported				
Basic	\$ 1.15	\$ 0.36	\$ 1.39	
Diluted	\$ 1.10	\$ 0.34	\$ 1.32	
Pro forma				
Basic	\$ 0.49	(\$ 0.15)	\$ 1.08	
Diluted	\$ 0.47	(\$ 0.15)	\$ 1.05	

</TABLE>

Other Employee Benefit Plans KLA-Tencor has a profit sharing program for eligible employees which distributes, on a quarterly basis, a percentage of pretax profits. In addition, KLA-Tencor has an employee savings plan that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Starting fiscal year 2000, KLA-Tencor has matched up to a maximum of \$1,000 or 50% of the first \$2000 of an eligible employee's contribution, with \$500 of the amount funded from the profit sharing program. The total charge to operations under the profit sharing and 401(k) programs aggregated \$3 million, \$57 million and \$38 million in fiscal years 2002, 2001 and 2000, respectively.

KLA-Tencor has a non-qualified deferred compensation plan whereby certain key executives may defer a portion of their salary and bonus. Participants are credited with returns based on their allocation of their account balances among mutual funds. The Company controls the investment of these funds and the participants remain general creditors of the Company. Distributions from the plan commence the quarter following a participant's retirement or termination of employment. At June 30, 2002, KLA-Tencor had a deferred compensation liability under the plan of \$69 million included as a component of other current liabilities on the consolidated balance sheet.

#### NOTE 7 - COMMITMENTS AND CONTINGENCIES

Factoring KLA-Tencor has agreements with a bank to sell certain of its trade receivables and promissory notes without recourse. During fiscal 2002, approximately \$98 million of receivables were sold under these arrangements. As of June 30, 2002, approximately \$48 million were outstanding. The total amount available under the facility is the Japanese yen equivalent of \$50 million based upon exchange rates as of June 30, 2002. KLA-Tencor does not believe it is materially at risk for any losses as a result of these agreements.

Facilities KLA-Tencor leases certain of its facilities under operating leases, which qualify for operating lease accounting treatment under SFAS 13, "Accounting for Leases," and, as such, these facilities are not included on its Condensed Consolidated Balance Sheet.

The following is a schedule of operating leases payments (in thousands):

Fiscal year ended June 30,	Amount
2003	\$ 9,386
2004	5,188
2005	2,985
2006	1,367
Thereafter	1,048
-----	
Total minimum lease payments	\$ 19,974
=====	

The lease agreement for certain Milpitas and San Jose, California facilities has a term of five years ending in November 2002, with an option to extend up to two more years. Monthly payments under this lease vary based upon the London Interbank Offering Rate (LIBOR) plus 0.42%. Under the terms of the lease, KLA-Tencor, at its option, can acquire the properties at their original cost or arrange for the properties to be acquired. Under the terms of the lease, KLA-Tencor must maintain compliance with certain financial covenants. As of June 30, 2002, KLA-Tencor was in compliance with all of its covenants. If the Company purchases the Milpitas and San Jose, California facilities at the end of the lease term, the purchase transactions would increase land and property by approximately \$119.3 million and decrease cash by approximately the same amount. If the Company chooses not to purchase the facilities, it will be liable to the lessor for residual value guarantees of an aggregate of up to approximately \$100.2 million.

Legal Matters From time to time KLA-Tencor is named as a party to lawsuits in the normal course of its business. Litigation, in general, and intellectual property litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. KLA-Tencor believes that it has defenses

in each of the cases set forth below and is vigorously contesting each of these matters.

#### ADE Corporation

On October 11, 2000, ADE Corporation ("ADE"), a competitor, filed a patent infringement lawsuit against KLA-Tencor in the U.S. District Court in Delaware. ADE claimed damages and sought an injunction under U.S. Patent No. 6,118,525 ('525 patent). We filed a counterclaim in the same court alleging that ADE has infringed four of our patents. We are seeking damages and a permanent injunction against ADE. In addition, we are seeking a declaration from the District Court that ADE's patent is invalid and not infringed by KLA-Tencor. On October 22, 2001, the Company filed a separate action for declaratory judgment against ADE in the Northern District of California requesting a declaration that U.S. Patent No. 6,292,259 ('259 patent) is invalid and not infringed. That action has now been consolidated with the prior action in the Delaware proceeding, and ADE has amended its complaint in that proceeding to allege that KLA-Tencor is infringing the '259 patent. On August 8, 2002, the magistrate presiding over the action issued a recommendation that the court enter summary judgment in favor of KLA-Tencor on the issue of non-infringement under ADE's '525 patent. On the same day, the magistrate issued recommendations that the court enter summary judgment in favor of ADE on the issue of non-infringement of two of KLA-Tencor's patents. While we cannot predict the outcome, we believe that we have valid defenses and further believe that our counterclaims have merit.

#### Tokyo Seimitsu Co. Ltd.

On June 27, 2001, the Company sued Tokyo Seimitsu Co. Ltd. and TSK America Inc. ("TSK"), a competitor, in the U.S. District Court in the Northern District of California alleging that TSK infringes on one of the Company's patents. The suit seeks damages and an injunction under U.S. Patent No. 4,805,123 ('123 patent). TSK filed a counterclaim in the same court seeking a declaration that the '123 patent is invalid, unenforceable and not infringed, and also alleged violations of the antitrust and unfair competition laws.

Although KLA-Tencor cannot predict the outcome of these claims, it does not believe that any of these legal matters will have a material adverse effect on KLA-Tencor. However, were an unfavorable ruling to occur in one or more of the pending claims, there exists the possibility of a material impact on

KLA-Tencor's operating results and financial position for the period in which the ruling occurred.

#### NOTE 8 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Under its foreign-currency risk management strategy, KLA-Tencor utilizes derivative instruments to protect its interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates. This financial exposure is monitored and managed by KLA-Tencor as an integral part of its overall risk management program which focuses on the unpredictability of financial markets and seeks to reduce the potentially adverse effects that the volatility of these markets may have on its operating results. KLA-Tencor continues its policy of hedging its current and anticipated foreign currency exposures with hedging instruments having tenors of up to twelve months.

On July 1, 2001, KLA-Tencor adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). SFAS 133 requires that all derivatives be recorded on the balance sheet at fair value. Changes in the fair value of derivatives which do not qualify, or are not effective as hedges must be recognized currently in earnings. Upon adoption KLA-Tencor recognized the fair value of foreign currency forward contracts, previously held off balance sheet, and reflected their fair value on the balance sheet. These were principally offset by recording on the balance sheet the change in value of the hedged item, generally forecasted shipments. KLA-Tencor did not separately report a cumulative transition adjustment to earnings upon adoption of the standard as the impact was immaterial. All derivatives were reflected at fair value on the balance sheet at that date.

#### Cashflow Hedges

KLA-Tencor's international sales are primarily denominated in U.S. dollars. For foreign currency denominated sales, however, the volatility of the foreign currency markets represents risk to KLA-Tencor's margins. KLA-Tencor defines its exposure as the risk of changes in the functional-currency-equivalent cash flows (generally U.S. dollar) attributable to changes in the related foreign currency exchange rates. Upon forecasting the exposure, KLA-Tencor hedges with forward sales contracts whose critical terms are designed to match those of the underlying exposure. These hedges are evaluated for effectiveness at least quarterly using regression analysis. Ineffectiveness is measured by comparing the change in value of the forward contracts to the change in value of the underlying transaction, with the effective portion of the hedge accumulated in Other Comprehensive Income (OCI). Any measured ineffectiveness is included immediately in "Interest income and

other, net" in the Consolidated Statements of Operations. An immaterial amount of ineffectiveness was recognized during the year. Deferred hedge gains and losses and OCI associated with hedges of foreign currency sales are reclassified to revenue upon recognition in income of the underlying hedged exposure. All amounts reported in OCI at June 30, 2002 are anticipated to be reclassified to revenue within twelve months. The following table summarizes hedging activity in the OCI account during the years ended June 30, (in thousands):

	2002	2001
	-----	-----
<S>	<C>	
Beginning Balance	\$ 3,432	--
Effective portion of cash flow hedging instruments	(2,045)	3,643
Reclassified to revenue	(2,379)	(211)
	-----	-----
Ending Balance	(\$ 992)	\$ 3,432
	=====	=====

</TABLE>

Other Foreign Currency Hedges

KLA-Tencor hedges its monetary non-functional assets and liabilities, and those of its subsidiaries. SFAS 52 requires that such monetary assets and liabilities be remeasured periodically for changes in the rate of exchange against the entities' functional currency. Changes in value of these assets and liabilities are recorded in "Interest income and other, net" in the Consolidated Statements of Operations. The volatility of the non-functional currencies together with the requirement to remeasure non-functional assets and liabilities may result in some volatility to KLA-Tencor's Consolidated Statements of Operations if left unhedged. In order to mitigate these effects, KLA-Tencor enters into remeasurement hedges which are forward contracts used to offset the foreign currency positions represented by non-functional monetary assets and liabilities. Remeasurement hedges are not SFAS 133 designated hedges, thus changes in value of the remeasurement hedges are recorded currently in earnings.

NOTE 9 - GOODWILL AND OTHER INTANGIBLE ASSETS

Effective July 1, 2001, KLA-Tencor adopted Statement of Financial Accounting Standards No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." Under these new accounting standards, KLA-Tencor ceased amortization of goodwill recorded for business combinations consummated prior to July 1, 2001, and reclassified amounts attributed to workforce in acquisitions made prior to July 1, 2001 that did not meet the criteria for separate recognition as an intangible asset under SFAS 141 to goodwill. The net carrying value of goodwill recorded through acquisitions is \$15.1 million as of June 30, 2002. In accordance with SFAS 142, KLA-Tencor concluded there was no impairment of goodwill.

The following table reflects the consolidated results adjusted as though the adoption of SFAS 141 and SFAS 142 occurred as of the beginning of the year ended June 30, 2001 (in thousands, except per share amounts):

	2002		2001	
	-----	-----	-----	-----
	As Reported	As Reported	As Adjusted	
<S>	<C>	<C>	<C>	
Operating income	\$ 244,893	\$ 458,468	\$ 461,039	
Net income	216,166	66,683	68,277	
Basic earnings per share	1.15	0.36	0.37	
Diluted earnings per share	1.10	0.34	0.35	

The following table reflects the components of other intangible assets as of June 30, 2002 (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Amount
	-----	-----	-----
<S>	<C>	<C>	<C>
Existing technology	\$ 6,062	\$ 2,453	\$ 3,609
Patents	4,021	667	3,354
Trademark	625	167	458
Favorable leases and other	270	121	149
	-----	-----	-----
Subtotal	\$ 10,978	\$ 3,408	\$ 7,570
	=====	=====	=====

</TABLE>

Other intangible assets are amortized on a straight-line basis over their estimated useful lives. For the years ended June 30, 2002 and 2001, amortization expense for other intangible assets was \$2.1 million and \$1.0 million, respectively. Estimated amortization expense for each of the four

succeeding fiscal years is as follows (in thousands):

Fiscal year ended June 30:	Amount
2003	\$ 2,396
2004	2,396
2005	2,137
2006	641
Subtotal	\$ 7,570

NOTE 10 -- SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

In fiscal 1999, KLA-Tencor adopted SFAS 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS 131 establishes standards for reporting information about operating segments in annual financial statements and requires that certain selected information about operating segments be reported in interim financial reports. It also establishes standards for related disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. KLA-Tencor's chief operating decision makers are the Chief Executive Officer and the Chief Operating Officer.

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

KLA-Tencor's significant operations outside the United States include a manufacturing facility in Israel and sales, marketing and service offices in Western Europe, Japan, and the Asia Pacific region. For geographical reporting, revenues are attributed to the geographic location in which the customer is located. No single customer accounted for 10% or more of net revenues or accounts receivable in any of the periods presented. Long-lived assets consist of net property and equipment, goodwill, capitalized software and other intangibles, and other long-term assets, excluding long-term deferred tax assets and are attributed to the geographic location in which they are located. The following is a summary of operations by entities located within the indicated geographic areas for fiscal years 2002, 2001 and 2000.

<TABLE>  
<CAPTION>

Year ended June 30, (in thousands)	2002	2001	2000
Revenues:			
<S>	<C>	<C>	<C>
United States	\$ 539,952	\$ 714,517	\$ 448,022
Western Europe	238,897	257,560	222,186
Japan	350,668	401,764	309,062
Taiwan	268,492	402,440	299,442
Asia Pacific	239,273	327,476	220,100
Total	\$ 1,637,282	\$ 2,103,757	\$ 1,498,812

</TABLE>

<TABLE>  
<CAPTION>

June 30, (in thousands)	2002	2001	2000
Long-lived assets:			
<S>	<C>	<C>	<C>
United States	\$375,600	\$344,444	\$240,148
Western Europe	8,079	9,257	8,059
Japan	8,878	8,874	11,012
Taiwan	5,435	2,596	2,469
Asia Pacific	3,732	5,551	5,703
Total	\$401,724	\$370,722	\$267,391

</TABLE>

The following is a summary of revenues by major products for fiscal years 2002, 2001 and 2000 (as a percentage of total revenue).

	2002	2001	2000
Defect Inspection	66%	65%	61%
Metrology	15%	21%	21%

Service	13%	9%	11%
Software and other	6%	6%	7%
	100%	100%	100%

NOTE 11 - QUARTERLY CONSOLIDATED RESULTS OF OPERATIONS (UNAUDITED)

The following table presents certain unaudited consolidated quarterly financial information for the eight quarters ended June 30, 2002. In management's opinion, this information has been prepared on the same basis as the audited Consolidated Financial Statements appearing elsewhere in this Form 10-K and includes all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the unaudited quarterly results of operations set forth herein.

	September 30	December 31	March 31	June 30
Fiscal 2002:				
	<C>	<C>	<C>	<C>
Revenues	\$ 502,832	\$ 404,148	\$ 357,108	\$ 373,194
Gross profit	258,464	202,337	175,006	187,082
Income from operations	104,293	56,280	37,097	47,223
Net income	86,465	49,048	34,149	46,504
Net income per share:				
Basic	\$ 0.46	\$ 0.26	\$ 0.18	\$ 0.25
Diluted	\$ 0.44	\$ 0.25	\$ 0.17	\$ 0.23
Fiscal 2001:				
Revenues				
As previously reported	\$ 534,590	\$ 573,056	\$ 528,790	\$ 602,642
Effect of change in accounting principle	(151,875)	(72,223)	88,777	--
As restated in first three quarters and reported in fourth quarter	382,715	500,833	617,567	602,642
Gross profit				
As previously reported	306,514	328,620	286,097	333,473
Effect of change in accounting principle	(106,808)	(43,687)	62,396	--
As restated in first three quarters and reported in fourth quarter	199,706	284,933	348,493	333,473
Income from operations				
As previously reported	134,969	137,883	112,353	161,362
Effect of change in accounting principle	(106,808)	(43,687)	62,396	--
As restated in first three quarters and reported in fourth quarter	28,161	94,196	174,749	161,362
Net income (loss)				
As previously reported	105,818	109,306	91,410	129,954
Effect of change in accounting principle	(76,901)	(31,455)	44,926	--
Cumulative effect of change in accounting principle	(306,375)	--	--	--
As restated in first three quarters and reported in fourth quarter	\$ (277,458)	\$ 77,851	\$ 136,336	\$ 129,954
Earnings (loss) per basic share:				
Income before cumulative effect of change in accounting principle				
As previously reported	\$ 0.57	\$ 0.59	\$ 0.50	\$ 0.70
Effect of change in accounting principle	(\$ 0.42)	(\$ 0.17)	\$ 0.24	--

-	As restated in first three quarters and reported in fourth quarter	\$ 0.15	\$ 0.42	\$ 0.74	\$ 0.70
	Cumulative effect of change in accounting principle	(\$ 1.63)	\$ --	\$ --	\$ --
-	Net income (loss)	(\$ 1.48)	\$ 0.42	\$ 0.74	\$ 0.70
	Earnings (loss) per diluted share:				
	Income before cumulative effect of change in accounting principles				
	As previously reported	\$ 0.54	\$ 0.57	\$ 0.48	\$ 0.67
	Effect of change in accounting principle	(\$ 0.39)	(\$ 0.16)	\$ 0.23	\$ --
-	As restated in first three quarters and reported in fourth quarter	\$ 0.15	\$ 0.41	\$ 0.71	\$ 0.67
	Cumulative effect of change in accounting principle	(\$ 1.56)	\$ --	\$ --	\$ --
-	Net income (loss)	(\$ 1.41)	\$ 0.41	\$ 0.71	\$ 0.67

</TABLE>

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of KLA-Tencor Corporation and its subsidiaries at June 30, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

San Jose, California  
July 31, 2002

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names of the present directors and executive officers of KLA-Tencor as of September 21, 2002, their ages and positions held. Additional information required by Item 405 of Regulation S-K of the Securities Act of 1933, as amended, is incorporated herein by reference to our Proxy Statement.

<TABLE>

<CAPTION>

Name	Age	Position
-----	-----	-----
<S>	<C>	<C>
Kenneth Levy	59	Chairman of the Board
Kenneth L. Schroeder	57	Chief Executive Officer
Gary E. Dickerson	45	President and Chief Operating Officer
John H. Kispert	38	Executive Vice President, and Chief Financial Officer
Dennis J. Fortino	56	Executive Vice President, Lithography & Parametric

&lt;/TABLE&gt;

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

Kenneth L. Schroeder joined KLA Instruments in 1979 and left in 1987 to pursue personal and other business interests. He returned to KLA-Instruments in 1991. Mr. Schroeder has been Chief Executive Officer and a Director of KLA-Tencor since July 1, 1999 and was our President as well until August 2002. From November 1991 until June 1999, he was President and Chief Operating Officer and a Director. He currently serves on the board of directors of SEMI.

Gary E. Dickerson has been President since July 2002 and Chief Operating Officer since July 1999. Mr. Dickerson has held a series of management positions since he joined KLA-Tencor in January 1986. From July 1997 until June 30, 1999, he was Executive Vice President of the Customer Group. In January 1996, he was promoted to Group Vice President for the Wafer Inspection Group. In July 1994 he became the General Manager of the Wisard Division.

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

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

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

For additional information required by this item see "Compliance with Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement, which is incorporated herein by reference.

#### ITEM 11. EXECUTIVE COMPENSATION

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

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

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

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

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

### PART IV

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

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

1. Financial Statements:

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

Consolidated Balance Sheets at June 30, 2002 and 2001  
 Consolidated Statements of Operations for each of the  
     three years in the period ended June 30, 2002  
 Consolidated Statements of Stockholders' Equity for  
     each of the three years in the period ended  
     June 30, 2002  
 Consolidated Statements of Cash Flows for each of the  
     three years in the period ended June 30, 2002  
 Notes to Consolidated Financial Statements  
 Report of Independent Accountants

2. Financial Statement Schedules:

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

Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are either not applicable or the required information is shown in the Consolidated Financial Statements or notes thereto.

3. Exhibits

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation (1)
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation (2)
3.3	Bylaws, as amended November 17, 1998 (3)
4.1	Amended and Restated Rights Agreement dated as of August 25, 1996 between the Company and First National Bank of Boston, as Rights Agent. The Agreement includes the Form of Right Certificate as Exhibit A and the Summary of Terms of Rights as Exhibit B (4)
10.1	1998 Outside Director Option Plan (5)
10.2	1990 Outside Directors Stock Option Plan (6)
10.3	Tencor Instruments 1993 Nonemployee Directors Stock Option Plan (7)
10.4	1997 Employee Stock Purchase Plan (8)
10.5	Second Amended and Restated 1981 Employee Stock Purchase Plan (9)
10.6	Tencor Instruments Amended and Restated 1993 Equity Incentive Plan (10)
10.7	1993 Employee Incentive Stock Option Plan of Prometrix Corporation (11)
10.8	Tencor Instruments Second Amended and Restated 1984 Stock Option Plan (12)
10.9	1983 Employee Incentive Stock Option Plan of Prometrix Corporation (13)
10.10	Restated 1982 Stock Option Plan, as amended November 18, 1996 (14)
10.11	Excess Profit Stock Plan (15)
10.12	Form of KLA-Tencor Corporation Corporate Officers Retention Plan (16)
10.13	Form of Retention and Non-Competition Agreement (17)
10.14	Form of Indemnification Agreement (18)
10.15	Livermore Land Purchase and Sale Agreement (19)
21.1	List of Subsidiaries
23.1	Consent of Independent Accountants
99.1	Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Notes

- (1) Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997
- (2) Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2000
- (3) Filed as Exhibit 3.2 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68415.
- (4) Filed as Exhibit 1 to the Company's report on form 8-A/A, Amendment No. 2 to the Registration Statement on Form 8-A filed September 24, 1996, SEC File No. 0-9992.
- (5) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68423.
- (6) Filed as Exhibit 4.6 to the Company's Annual Report on Form 10-K for the year ended June 30, 1991.
- (7) Filed as Exhibit 10.3 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (8) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (9) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (10) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (11) Filed as Exhibit 10.7 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (12) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (13) Filed as Exhibit 10.6 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (14) Filed as Exhibit 10.74 to the Company's Registration Statement on Form S-8 filed March 7, 1997, SEC File No. 333-22941.
- (15) Filed as Exhibit 10.15 to the Company's Registration Statement on Form S-8 filed August 7, 1998, SEC File No. 333-60887.
- (16) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (17) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (18) Filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended June 30, 1997.
- (19) Filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended June 30, 2000.

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on September 21, 2002.

By: /s/ KENNETH LEVY

-----  
Kenneth Levy  
Chairman of the Board

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

Signature	Title	Date
<S> ----- /s/ KENNETH LEVY ----- Kenneth Levy	<C> Chairman of the Board and Director	<C> September 20, 2002
/s/ KENNETH L. SCHROEDER ----- Kenneth L. Schroeder	Chief Executive Officer and Director (Principal Executive Officer)	September 20, 2002
/s/ JOHN H. KISPERT ----- John H. Kispert	Executive Vice President and Chief Financial Officer (Principal Accounting Officer)	September 20, 2002
/s/ EDWARD W. BARNHOLT ----- Edward W. Barnholt	Director	September 20, 2002
/s/ H. RAYMOND BINGHAM ----- H. Raymond Bingham	Director	September 20, 2002
/s/ ROBERT T. BOND ----- Robert T. Bond	Director	September 20, 2002
/s/ RICHARD J. ELKUS, Jr. ----- Richard J. Elkus, Jr.	Director	September 20, 2002
/s/ JON D. TOMPKINS ----- Jon D. Tompkins	Director	September 20, 2002
/s/ LIDA URBANEK ----- Lida Urbaneck	Director	September 20, 2002

&lt;/TABLE&gt;

Certification under Section 302(a) of the Sarbanes-Oxley Act of 2002

I, Kenneth L. Schroeder, certify that:

1. I have reviewed this annual report on Form 10-K of KLA-Tencor Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: September 20, 2002

/s/ KENNETH L. SCHROEDER

-----  
Kenneth L. Schroeder  
Chief Executive Officer

I, John H. Kispert, certify that:

1. I have reviewed this annual report on Form 10-K of KLA-Tencor Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: September 20, 2002

/s/ JOHN H. KISPERT

-----

John H. Kispert  
Chief Financial Officer

Report of Independent Accountants on  
Financial Statement Schedule

To the Board of Directors  
of KLA-Tencor Corporation

Our audits of the Consolidated Financial Statements referred to in our report dated July 31, 2002, also included an audit of the financial statement schedule listed in Item 14(a)2 on this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related Consolidated Financial Statements.

/s/ PricewaterhouseCoopers LLP

San Jose, California  
July 31, 2002

<TABLE>  
<CAPTION>

SCHEDULE II

Valuation and Qualifying Accounts

(in thousands)	Balance at Beginning of Period	Charged to Expense	Deductions	Balance At End of Period
-----				
Year Ended December 31, 2000:				
<S> Allowance for Doubtful Accounts	<C> \$ 16,638	<C> \$ 2,184	<C> \$ 4,033	<C> \$ 14,789
Year Ended December 31, 2001:				
Allowance for Doubtful Accounts	\$ 14,789	\$ 1,962	\$ 1,739	\$ 15,012
Year Ended December 31, 2002:				
Allowance for Doubtful Accounts	\$ 15,012	\$ 1,464	\$ 3,085	\$ 13,391

</TABLE>

EXHIBIT

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

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation (1)
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation (2)
3.3	Bylaws, as amended November 17, 1998 (3)
4.1	Amended and Restated Rights Agreement dated as of August 25, 1996 between the Company and First National Bank of Boston, as Rights Agent. The Agreement includes the Form of Right Certificate as Exhibit A and the Summary of Terms of Rights as Exhibit B (4)

- 10.1 1998 Outside Director Option Plan (5)
- 10.2 1990 Outside Directors Stock Option Plan (6)
- 10.3 Tencor Instruments 1993 Nonemployee Directors Stock Option Plan (7)
- 10.4 1997 Employee Stock Purchase Plan (8)
- 10.5 Second Amended and Restated 1981 Employee Stock Purchase Plan (9)
- 10.6 Tencor Instruments Amended and Restated 1993 Equity Incentive Plan (10)
- 10.7 1993 Employee Incentive Stock Option Plan of Prometrix Corporation (11)
- 10.8 Tencor Instruments Second Amended and Restated 1984 Stock Option Plan (12)
- 10.9 1983 Employee Incentive Stock Option Plan of Prometrix Corporation (13)
- 10.10 Restated 1982 Stock Option Plan, as amended November 18, 1996 (14)
- 10.11 Excess Profit Stock Plan (15)
- 10.12 Form of KLA-Tencor Corporation Corporate Officers Retention Plan (16)
- 10.13 Form of Retention and Non-Competition Agreement (17)
- 10.14 Form of Indemnification Agreement (18)
- 10.15 Livermore Land Purchase and Sale Agreement (19)
- 21.1 List of Subsidiaries
- 23.1 Consent of Independent Accountants
- 99.1 Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Notes

- (1) Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.
- (2) Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2000.
- (3) Filed as Exhibit 3.2 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68415.
- (4) Filed as Exhibit 1 to the Company's report on form 8-A/A, Amendment No. 2 to the Registration Statement on Form 8-A filed September 24, 1996, SEC File No. 0-9992.
- (5) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68423.
- (6) Filed as Exhibit 4.6 to the Company's Annual Report on Form 10-K for the year ended June 30, 1991.
- (7) Filed as Exhibit 10.3 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (8) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (9) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (10) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (11) Filed as Exhibit 10.7 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (12) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (13) Filed as Exhibit 10.6 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (14) Filed as Exhibit 10.74 to the Company's Registration Statement

on Form S-8 filed March 7, 1997, SEC File No. 333-22941.

- (15) Filed as Exhibit 10.15 to the Company's Registration Statement on Form S-8 filed August 7, 1998, SEC File No. 333-60887.
- (16) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (17) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (18) Filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended June 30, 1997.
- (19) Filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended June 30, 2000.

EXHIBIT 21.1

<TABLE>

<CAPTION>

KLA-Tencor Subsidiaries

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

</TABLE>

Consent of Independent Accountants

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 33-15784, No. 2-71584, No. 2-75314, No. 33-26002, No. 33-42973, No. 33-42982, No. 33-42975, No. 33-55362, No. 33-88662, No. 333-03003, No. 333-22939, No. 333-22941, No. 333-26681, No. 333-32537, No. 333-45271, No. 333-60887, No. 333-60883, No. 333-68423, No. 333-68415, No. 333-85121, No. 333-85123, No. 333-46598, No. 333-49766, No. 333-49828, No. 333-60864, No. 333-60866, and No. 333-75944) and in the Prospectus constituting part of the Registration Statement on Form S-3 (No. 333-52393) of KLA-Tencor Corporation of our report dated July 31, 2002 relating to the financial statements and the financial statement schedule, which appear in this Annual Report on Form 10-K.

/s/ PricewaterhouseCoopers LLP

San Jose, California  
September 20, 2002

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Kenneth L. Schroeder, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of KLA-Tencor Corporation on Form 10-K for the fiscal year ended June 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of KLA-Tencor Corporation.

By: /s/ KENNETH L. SCHROEDER  
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Name: Kenneth L. Schroeder  
Title: Chief Executive Officer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, John H. Kispert, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of KLA-Tencor Corporation on Form 10-K for the fiscal year ended June 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of KLA-Tencor Corporation.

By: /s/ JOHN H. KISPERT

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Name: John H. Kispert  
Title: Chief Financial Officer