

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 1996

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 NUMBER 0-9992

KLA INSTRUMENTS 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 NO.)

160 Rio Robles
San Jose, California
(Address of principal executive offices)

95134
(Zip Code)

Registrant's telephone number, including area code: (408) 468-4200

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 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 X No
--- ---

Common shares outstanding at March 31, 1996: 50,825,000

This report, including all exhibits and attachments, contains 15 pages.

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KLA INSTRUMENTS CORPORATION

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PART I FINANCIAL INFORMATION
Item 1 Financial Statements

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
THREE MONTHS ENDED MARCH 31,
(In thousands except per share amounts)
(Unaudited)

<TABLE>
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	1995	1996
	----	----
<S>	<C>	<C>
Net sales	\$ 118,142	\$ 187,494
	-----	-----
Costs and expenses:		
Cost of sales	54,202	85,215
Engineering, research and development	12,294	20,942
Selling, general and administrative	21,565	33,655
	-----	-----
	88,061	139,812
	-----	-----
Income from operations	30,081	47,682
Interest income and other, net	2,327	2,306
Interest expense	(643)	(273)
	-----	-----
Income before income taxes	31,765	49,715
Provision for income taxes	10,927	17,898
	-----	-----
Net income	\$ 20,838	\$ 31,817
	=====	=====
Net income per share	\$ 0.43	\$ 0.61
	=====	=====
Shares used in computing net income per share	48,532	52,170

</TABLE>
See accompanying notes to unaudited condensed consolidated financial information.

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KLA INSTRUMENTS CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
NINE MONTHS ENDED MARCH 31,
(In thousands except per share amounts)
(Unaudited)

<TABLE>
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	1995	1996
	----	----
<S>	<C>	<C>
Net sales	\$ 306,032	\$ 502,320
	-----	-----
Costs and expenses:		
Cost of sales	143,178	227,239
Engineering, research and development	29,284	54,599
Selling, general and administrative	59,754	90,957
Write-off of acquired in-process technology	25,240	--
	-----	-----
	257,456	372,795
	-----	-----
Income from operations	48,576	129,525
Interest income and other, net	5,359	10,401
Interest expense	(1,725)	(897)
	-----	-----

Income before income taxes	52,210	139,029
Provision for income taxes	17,528	50,051
	-----	-----
Net income	\$ 34,682	\$ 88,978
	=====	=====
Net income per share	\$.72	\$ 1.70
	=====	=====
Shares used in computing net income per share	48,160	52,321

</TABLE>

See accompanying notes to unaudited condensed consolidated financial information.

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KLA INSTRUMENTS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET
(In thousands)
(Unaudited)

<TABLE>
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	June 30, 1995	March 31, 1996
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 92,059	\$ 46,626
Short-term investments	26,681	19,636
Accounts receivable, net of allowances of \$2,196 and \$2,693	129,274	227,232
Inventories	79,759	130,964
Deferred income taxes	18,155	18,155
Other current assets	14,949	8,715
	-----	-----
Total current assets	360,877	451,328
Land, property and equipment, net	49,004	65,625
Marketable securities	126,013	145,405
Other assets	10,402	11,918
	-----	-----
Total assets	\$ 546,296	\$ 674,276
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ 4,458	\$ 1,971
Current portion of long-term debt	20,000	--
Accounts payable	19,376	36,330
Income taxes payable	22,797	29,666
Other current liabilities	66,220	100,977
	-----	-----
Total current liabilities	132,851	168,944
Deferred income taxes	9,476	9,480
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	--	--
Common shares, \$0.001 par value, 75,000 shares authorized, 50,160 and 50,825 shares issued and outstanding	25	25
Capital in excess of par value	263,016	267,802
Retained earnings	138,893	227,871
Treasury stock	(581)	(581)
Net unrealized gain on investments	1,241	384
Cumulative translation adjustment	1,375	351
	-----	-----
Total stockholders' equity	403,969	495,852
Total liabilities and stockholders' equity	\$ 546,296	\$ 674,276
	=====	=====

</TABLE>

See accompanying notes to unaudited condensed consolidated financial information.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
NINE MONTHS ENDED MARCH 31
(In thousands)
(Unaudited)

<TABLE>
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	1995	1996
	-----	-----
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 34,682	\$ 88,978
Adjustments required to reconcile net income to cash provided by operations:		
Depreciation and amortization	7,994	10,700
Write-off of acquired in-process technology	16,154	--
Changes in assets and liabilities:		
Accounts receivable	(47,701)	(97,958)
Inventories	(18,354)	(51,205)
Other assets	(2,649)	4,718
Accounts payable	1,439	16,954
Income taxes payable	10,516	6,869
Other current liabilities	22,562	34,757
	-----	-----
Cash provided by operations	24,643	13,813
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(12,756)	(27,321)
Purchases of short and long-term available for sale securities	(150,617)	(374,289)
Sales and maturities of short and long-term available for sale securities	69,884	361,085
Investment in Metrologix	(14,182)	--
	-----	-----
Cash used for investing activities	(107,671)	(40,525)
	-----	-----
Cash flows from financing activities:		
Short-term borrowings, net	(3,225)	(2,487)
Payment of current portion of long-term debt	--	(20,000)
Sales of common stock/tax benefit of options exercised	5,847	4,786
	-----	-----
Cash provided by (used for) financing activities	2,622	(17,701)
	-----	-----
Effect of exchange rate changes	1,003	(1,020)
	-----	-----
Decrease in cash and cash equivalents	(79,403)	(45,433)
Cash and cash equivalents at beginning of period	139,126	92,059
	-----	-----
Cash and cash equivalents at end of period	\$ 59,723	\$ 46,626
	=====	=====
CASH PAID DURING THE PERIOD FOR:		
INTEREST	\$ 1,712	\$ 841
INCOME TAXES	15,530	43,924

</TABLE>

See accompanying notes to unaudited condensed consolidated financial information.

- 1) This information is unaudited but, in the opinion of Registrant's management, all adjustments (consisting only of adjustments that are of a normal recurring nature) necessary for a fair statement of results have been included. The results for the quarter ended March 31, 1996, are not necessarily indicative of results to be expected for the entire year. This financial information should be read in conjunction with the Registrant's Annual Report on Form 10-K (including items incorporated by reference therein) for the year ended June 30, 1995.
- 2) Details of certain balance sheet components:

<TABLE>
<CAPTION>

	June 30, 1995	March 31, 1996
	-----	-----
<S>	<C>	<C>
Inventories:		
Systems raw materials	\$ 18,944	\$ 34,700
Customer service spares	13,050	15,534
Work-in-process	26,863	54,397
Demonstration equipment	20,902	26,333
	-----	-----
	\$ 79,759	\$ 130,964
	=====	=====

</TABLE>

- 3) In August of 1995, the Company repaid the \$20.0 million mortgage on its principal facility.
- 4) Net income per share is computed using the weighted average number of common and common equivalent shares outstanding during the respective periods, including the assumed net shares issuable upon exercise of stock options, when dilutive.

A two-for-one stock split was declared by the Board of Directors on July 24, 1995. The stock split was in the form of a 100% stock dividend. The dividend was paid on September 29, 1995, to stockholders of record on August 31, 1995. Earnings per share was calculated on a post-split basis.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF
OPERATIONS AND FINANCIAL CONDITION

The following discussion and analysis may contain forward-looking statements that reflect the Company's current judgment regarding the matters addressed by such statements. Because such statements apply to future events, they are subject to risks and uncertainties that could cause actual results to differ substantially. Important factors that could cause actual results to differ are described in the following discussion and are particularly noted under "Future Operating Results" at page 9.

Results of Operations

Third Quarter and Nine Months of Fiscal 1996 Compared with Third Quarter and Nine Months of Fiscal 1995

Net Sales

Net sales increased 59% and 64%, respectively, for the three and nine month periods ended March 31, 1996 compared to the same periods of the prior fiscal year. The WISARD and RAPID business units were primarily responsible for the increase in net sales. The Company attributes the continuing increase in WISARD's sales primarily to the growing acceptance of the Company's in-line wafer monitoring equipment that allows semiconductor manufacturers to optimize device yields. The increase in RAPID sales reflects the ongoing industry-wide retooling for advanced reticle manufacturing. The Metrology Group and Automated Test Systems business unit also recorded significant increases in net sales.

Gross Margin

Gross margins were 54.6% and 54.8%, respectively, for the three and nine month periods ended March 31, 1996 compared to 54.1% and 53.2% for the same periods of the prior fiscal year. Increased gross margins in the RAPID business unit accounted for most of the overall improvement. The Company attributes this increase primarily to volume efficiencies and learning curve improvements.

Engineering, Research and Development

Engineering, research and development expenses were 11.2% and 10.9% of net sales, respectively, for the three and nine month periods ended March 31, 1996 compared to 10.4% and 9.6% for the same periods of the prior fiscal year. Net engineering expenditures rose \$8.6 million and \$25.3 million, respectively, during the three and nine month periods ended March 31, 1996 compared to the same periods of the prior fiscal year. The Company is concentrating on the broad opportunities in yield management, including the networking of all measurement

tools in a fab, the development of new measurement tools and the related software for using those tools. The WISARD business unit accounted for 57% and 44% of the dollar spending increase, respectively, for the three and nine month periods ended March 31, 1996. The next largest dollar increase was recorded in the Metrology Group, which accounted for 14% and 23% of the dollar spending increase, respectively, for the three and nine month periods ended March 31, 1996. Smaller increases in dollar spending were also recorded in the RAPID, PRISM and SEMSpec business units.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF
OPERATIONS AND FINANCIAL CONDITION

Selling, General and Administrative

Selling, general and administrative expenses were 17.9% and 18.1% of net sales, respectively, for the three and nine month periods ended March 31, 1996 compared to 18.3% and 19.5% for the same periods of the prior fiscal year. Sales, general and administrative spending was up significantly in dollar terms as the Company began establishing a direct sales force in Japan and also strengthened its sales force in other regions. However, the Company did realize some economies of scale due to the strong increase in revenues.

Interest Income and Other, net

Interest income and other, net for the three months ended March 31, 1996 was flat with the comparable period of the prior fiscal year due primarily to lower yields on the Company's investment portfolio offset by higher average cash balances. Interest income and other, net increased by \$5.0 million for the nine month period ended March 31, 1996 compared to the same period of the prior fiscal year. The increase was due to higher average cash balances and higher yields on the Company's investment portfolio.

Provision for Income Taxes

The Company's effective tax rate increased to 36% for the three and nine month periods ended March 31, 1996. The Company's tax rate was 34% for the year ended June 30, 1995. This rate increase is due primarily to the lower impact of the realization of previously reserved deferred tax assets and the expiration of the federal research and development tax credit on June 30, 1995.

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

Future Operating Results

The Company's future results will depend on its ability to continuously introduce new products and enhancements to its customers as demands for higher performance yield management and process control systems change or increase. Due to the risks inherent in transitioning to new products, the Company must accurately forecast demand in both volume and configuration and also manage the transition from older products. New product introductions involve the integration of complex systems and components in order to obtain customer acceptance. Failure to complete the integration process on a timely basis could result in delays in customer acceptance and deferrals of net sales to future periods. The Company's results could also be affected by the ability of competitors to introduce new products which have technological and/or pricing advantages. The Company's results also will be affected by strategic decisions made by management regarding whether to continue particular product lines, and by volume, mix and timing of orders received during a period, fluctuations in foreign exchange rates, and changing conditions in both the semiconductor industry and key semiconductor markets around the world. As a result, the Company's operating results may fluctuate, especially when measured on a quarterly basis.

Liquidity and Capital Resources

Cash, cash equivalents, short-term investments and marketable securities decreased \$33.1 million at March 31, 1996 compared to June 30, 1995. Cash provided by operations was \$13.8 million. This was offset by the repayment in full of the Company's \$20 million mortgage on its principal facility, and by \$27.3 million in capital expenditures. Cash provided by operations was substantially less than reported earnings, primarily due to investments in accounts receivable and inventories. Accounts receivable increased \$98.0 million

due primarily to an overall increase in net sales. Additional factors were higher than normal shipments to Japan, where payment terms are longer, and non-linear shipments in the quarter ended March 31, 1996. Inventories increased \$51.2 million to support the increase in net sales and the ramp-up of new products. Capital expenditures were primarily for computer equipment to accommodate the planned introduction of the Company's new enterprise business systems, engineering computers and equipment to support KLA's rapidly expanding research and development efforts, plus continued expenditures for facilities expansion. Other current liabilities increased \$34.8 million primarily due to increases in accrued warranty costs associated with higher shipment volumes and increases in accrued compensation and benefits. The Company believes that its current level of liquid assets, credit facilities and expected cash generated from operations are sufficient to fund growth through the next fiscal year.

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FORM 10-Q

PART II: OTHER INFORMATION

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	Item 1 -	Legal Proceedings	Not Applicable
	Item 2 -	Changes in Securities	Not Applicable
	Item 3 -	Defaults Upon Senior Securities	Not Applicable
	Item 4 -	Submission of Matters to a Vote of Security Holders	Not Applicable
	Item 5 -	Other Events	Not Applicable
	Item 6 -	Exhibits and Reports on Form 8-K	Page 13-14

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SIGNATURES

Pursuant to the requirements 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.

[KLA LOGO] INSTRUMENTS CORPORATION

May 13, 1996

ROBERT J. BOEHLKE

[Date]

Robert J. Boehlke
V.P. Finance and Administration
Chief Financial Officer

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INDEX TO EXHIBITS

- (i) EXHIBITS INCORPORATED BY REFERENCE:
- 3.1 Certificate of Incorporation as amended(7)
 - 3.2 Bylaws, as amended(7)
 - 4.1 Amended and Restated Rights Agreement dated as of August 30, 1995, between the Company and First National Bank of Boston, as Rights Agent. The Rights Agreement includes as Exhibit A, the form of Right Certificate.(1)
 - 10.15 Statement of Partnership to Triangle Partners dated April 12, 1983(2)
 - 10.16 Lease Agreement and Addendum thereto dated January 10, 1983, between BB&K Partnership and the Company(2)
 - 10.18 Purchase and Sale Agreement dated January 10, 1983, between BB&K Partnership, Triangle Partners and the Company(2)
 - 10.35 Research and Development Agreement, Cross License and Technology Transfer Agreement and Agreement for Option to License and Purchase Resulting Technology, all dated October 1, 1986, by and between KLA

Development No. 4, Ltd., and the Company(3)

- 10.45 Distribution Agreement dated July 1990, by and between Tokyo Electron Limited, a Japanese Corporation, and the Company(4)
- 10.46 Principal facility Purchase Agreement dated July 1990, including all exhibits and amendments; Lease Agreement, Termination of Lease, Lot line adjustment, rights of first refusal, Deeds of Trust(4)
- 10.47 Joint Venture Agreement between the Company and Nippon Mining Company, Limited, dated September 18, 1990(5)
- 10.49 Exercise of Option to Purchase Technology made effective as of January 1, 1990, by and between KLA Development No. 4, and the Company(5)
- 10.54 Micrion Corporation Series E Preferred Stock Purchase Agreement, dated September 13, 1991(6)
- 10.67 Amendment of Credit Agreement between Bank of America NT & SA and the Company, dated March 31, 1994(9)
- 10.68 Credit Agreement between Bank of America NT & SA and the Company as amended, on February 7, 1996(9)
- 10.71 1990 Outside Directors Stock Option Plan(8)
- 10.73 Amendment of Credit Agreement between Bank of America NT & SA and the Company dated December 31, 1994(10)
- 10.74 1981 Employee Stock Purchase Plan, as amended by the Board of Directors on October 7, 1994(10)
- 10.75 1982 Stock Option Plan, as amended on November 15, 1995(10)
- 10.76 Amendment of Credit Agreement between Bank of America NT & SA and the Company dated February 15, 1995(10)
- 10.77 Lease Agreement, Ground Lease Agreement and Purchase Agreement dated June 5, 1995, between BNP Leasing Corporation and the Company(10)
- 10.78 Lease Agreement and Purchase Agreement dated August 10, 1995, between BNP Leasing Corporation and the Company(10)
- 10.79 Amendment of Credit Agreement between Bank of America NT & SA and the Company dated December 29, 1995(11)

(ii) EXHIBITS INCLUDED HEREWITH:

27 Financial Data Schedule

- (1)Filed as exhibit number 1 to Form 8-A/A, filed effective September 25, 1995
- (2)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1983
- (3)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1987
- (4)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1990
- (5)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1991
- (6)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1992
- (7)Filed as the same exhibit number to Registrant's registration statement no.33-51819 on Form S-3, dated February 2, 1994
- (8)Filed as exhibit number 4.6 as set forth herein to Registrant's Form 10-K for the year ended June 30, 1991

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- (9)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1994
- (10)Filed as the same exhibit number as set forth herein to Registrant's Form 10-K for the year ended June 30, 1995
- (11)Filed as the same exhibit number as set forth herein to Registrant's Form 10-Q for the quarter ended December 31, 1995

<TABLE> <S> <C>

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

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