

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: September 30, 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 04-2564110  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NO.)

160 Rio Robles  
San Jose, California  
95134  
(Address of principal executive offices)  
(Zip Code)

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

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 \_\_\_\_\_

As of September 30, 1996 there were 51,064,895 shares of the registrant's Common Stock, \$0.001 par value, outstanding.

KLA INSTRUMENTS CORPORATION

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 1996

<TABLE>  
<CAPTION>

	Page Number ----- <C>
<S>	
PART I FINANCIAL INFORMATION	
Item 1 Financial Statements:	
Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 1995 and 1996 .....	3
Condensed Consolidated Balance Sheets at June 30 and September 30, 1996.....	4
Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 1995 and 1996 .....	5
Notes to Unaudited Condensed Consolidated Financial Statements.....	6
Item 2 Management's Discussion and Analysis of Results of Operations and Financial Condition.....	7-8

PART II OTHER INFORMATION

Items 1-6.....9  
 Signatures.....10  
 </TABLE>

PART I FINANCIAL INFORMATION

Item 1 Financial Statements

KLA INSTRUMENTS CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 THREE MONTHS ENDED SEPTEMBER 30,  
 (In thousands except per share amounts)  
 (Unaudited)

	1995	1996
	-----	-----
<S>	<C>	<C>
Net sales	\$ 149,076	\$ 164,154
	-----	-----
Costs and expenses:		
Cost of sales	66,672	74,152
Engineering, research and development	15,621	21,495
Selling, general and administrative	27,855	35,556
	-----	-----
	110,148	131,203
	-----	-----
Income from operations	38,928	32,951
Interest income and other, net	4,187	3,532
Interest expense	(418)	(154)
	-----	-----
Income before income taxes	42,697	36,329
Provision for income taxes	15,371	12,352
	-----	-----
Net income	\$ 27,326	\$ 23,977
	=====	=====
Net income per share	\$ 0.52	\$ 0.46
	=====	=====
Shares used in computing net income per share	52,408	52,127

See accompanying notes to unaudited condensed consolidated financial statements.

KLA INSTRUMENTS CORPORATION  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands except per share amounts)  
 (Unaudited)

	September 30,	June 30,
	1996	1996
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	107,106	\$ 109,404
Short-term investments	22,462	14,279
Accounts receivable, net of allowances of \$3,121 and \$3,182		203,470

192,972		
Inventories	132,377	
138,619		
Deferred income taxes	27,246	
27,055		
Other current assets	6,783	
11,870		
-----		-----
Total current assets	493,559	
500,084		
Land, property and equipment, net	71,825	
74,923		
Marketable securities	137,728	
154,882		
Other assets	9,660	
10,936		
-----		-----
Total assets	\$ 712,772	\$
740,825		
=====		=====
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ 3,111	\$
5,807		
Accounts payable	27,330	
21,498		
Income taxes payable	34,595	
37,287		
Other current liabilities	104,167	
107,482		
-----		-----
Total current liabilities	169,203	
172,074		
-----		-----
Deferred income taxes	6,320	
7,792		
-----		-----
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	--	
--		
Common stock, \$0.001 par value, 75,000 shares authorized, 51,030 and 51,065 shares issued and outstanding	51	
51		
Capital in excess of par value	277,892	
278,000		
Retained earnings	259,777	
283,754		
Treasury stock	(581)	
(1,213)		
Net unrealized gain/(loss) on investments	(131)	
171		
Cumulative translation adjustment	241	
196		
-----		-----
Total stockholders' equity	537,249	
560,959		
-----		-----
Total liabilities and stockholders' equity	\$ 712,772	\$
740,825		
=====		=====
=====		

</TABLE>

See accompanying notes to unaudited condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
THREE MONTHS ENDED SEPTEMBER 30,  
(In thousands)  
(Unaudited)

<TABLE>  
<CAPTION>

	1995	1996
	-----	-----
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 27,326	\$ 23,977
Adjustments required to reconcile net income to cash provided by operations:		
Depreciation and amortization	3,385	5,517
Deferred income taxes	--	1,663
Changes in assets and liabilities:		
Accounts receivable	(19,081)	10,498
Inventories	(12,825)	(6,242)
Other assets	9,261	(6,363)
Accounts payable	1,366	(5,832)
Income taxes payable	6,945	2,692
Other current liabilities	10,639	3,315
	-----	-----
Cash provided by operating activities	27,016	29,225
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(8,097)	(8,615)
Purchases of short and long-term available for sale securities	(137,685)	(73,669)
Sales and maturities of short and long-term available for sale securities	114,456	48,634
	-----	-----
Cash used for investing activities	(31,326)	(33,650)
	-----	-----
Cash flows from financing activities:		
Short-term borrowings, net	(2,018)	2,696
Payment of current portion of long-term debt	(20,000)	--
Sales of common stock/tax benefit of options exercised	788	(524)
	-----	-----
Cash provided by/(used for) financing activities	(21,230)	2,172
	-----	-----
Effect of exchange rate changes	(699)	(45)
	-----	-----
Decrease in cash and cash equivalents	(26,239)	(2,298)
Cash and cash equivalents at beginning of period	92,059	109,404
	-----	-----
Cash and cash equivalents at end of period	\$ 65,820	\$ 107,106
	=====	=====

</TABLE>

See accompanying notes to unaudited condensed consolidated financial statements.

Page 5

KLA INSTRUMENTS CORPORATION  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS

1) In the opinion of Company's management, the unaudited consolidated condensed financial statements include all adjustments (consisting only of adjustments that are of a normal recurring nature) necessary for a fair statement of results. The results for the quarter ended September 30, 1996, are not necessarily indicative of results to be expected for the entire year. This financial information should be read in conjunction with the Company's Annual Report on Form 10-K (including items incorporated by reference therein) for the year ended June 30, 1996.

2) Details of certain balance sheet components (in thousands):

<TABLE>  
<CAPTION>

	June 30, 1996	September 30, 1996
	-----	-----
<S>	<C>	<C>
Inventories:		

Systems raw materials	\$ 33,521	\$ 34,608
Customer service spares	13,614	20,843
Work-in-process	47,012	57,908
Demonstration equipment	38,230	25,260
	-----	-----
	\$ 132,377	\$ 138,619
	=====	=====

</TABLE>

- 3) In April 1996, the Company adopted a plan to repurchase, at its discretion, up to \$20 million of KLA common stock on the open market, through October 1997. Shares repurchased during the three month period ended September 30, 1996 totaled 35,000 shares at a total cost of \$631,250.
- 4) In September 1996, the Company granted new replacement stock options in exchange for the cancellation of the entire unexercised portion of the options being replaced. These options were issued at the fair market value on the date of grant. The number of options granted under the first new option was equal to 50% of the number of canceled options. The remaining 50% of new options will be granted as a second new option at some date on or before March 16, 1997, at the fair market value on the date of grant.
- 5) The Company's effective tax rate decreased to 34% for the three months ended September 30, 1996. The Company's tax rate was 36% for the year ended June 30, 1996. This rate decrease is due primarily to the reinstatement of the federal research and development tax credit. The difference between the statutory tax rate and the Company's effective tax rate is primarily due to R&D tax credits, FSC benefits, tax exempt interest and state taxes.
- 6) 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.

Page 6

KLA INSTRUMENTS CORPORATION

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" on page 8.

Results of Operations

First Quarter of Fiscal 1997 Compared with First Quarter of Fiscal 1996

Net Sales

Net sales increased \$15.1 million or 10.1% for the three month period ended September 30, 1996 as compared to the first quarter of the prior fiscal year. The RAPID business unit, driven primarily by changes in technology, was predominately responsible for the increase in sales. The Company attributes the increase in RAPID's sales primarily to the ongoing industry-wide retooling for advanced reticle manufacturing, as well as continuing industry movement towards smaller line widths. Unit sales in the WISARD business unit declined, reflecting the industry's capital spending weakness. Many of the leading manufacturers have placed new fab construction on hold while they evaluate the marketplace and assess the future supply/demand relationship for various semiconductor devices.

Gross Margin

Gross margins were 54.9% for the three month period ended September 30, 1996 compared to 55.3% in the first quarter of the prior fiscal year. The slight decrease in the gross margin reflects a mix shift towards the RAPID business unit. Gross margins for the RAPID business unit have increased as a result of lower cost components and lower installation and warranty costs, but these margins are still below the Company average. Gross margins were favorably affected by the sales of two SEMSpec units during the quarter, however the slight increase was offset by changes in product mix within the WISARD business due to the ramp up of the KLA 2135.

#### Engineering, Research and Development

Engineering, research and development expenses were 13.1% of net sales for the three month period ended September 30, 1996 compared to 10.5% in the first quarter of the prior fiscal year. Net engineering expenditures rose \$5.9 million during the first quarter of fiscal 1997 compared to the first quarter of fiscal 1996. 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.

#### Selling, General and Administrative

Selling, general and administrative expenses were 21.7% of net sales for the three month period ended September 30, 1996 compared to 18.7% in the first quarter of the prior fiscal year. Operating costs included approximately \$5.0 million of representative commissions which relate to orders previously taken by the Company's former representative in Japan but which shipped during the first quarter. These commissions will phase out substantially during the next several

Page 7

quarters. Some reductions in other operating costs were initiated during the quarter, the full effects of which will not be realized until the next quarter.

#### Interest Income and Other

Interest income and other, net, decreased \$0.7 million for the three month period ended September 30, 1996 compared to the first quarter of the prior fiscal year. This decrease is due to lower yields on the Company's investment portfolio offsetting higher average cash balances.

#### Provision for Income Taxes

The Company's effective tax rate decreased to 34% for the three months ended September 30, 1996. The Company's tax rate was 36% for the year ended June 30, 1996. This rate decrease is due primarily to the reinstatement of the federal research and development tax credit. The difference between the statutory tax rate and the Company's effective tax rate is primarily due to R&D tax credits, FSC benefits, tax exempt interest and state taxes.

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 for such years. The Company filed a tax protest letter with the IRS on June 10, 1996, in response to the IRS notice. 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. The Company's results could be affected by the ability of competitors to introduce new products which have technological and/or pricing advantages. The Company's results also will be affected by strategic decisions made by management regarding whether to continue particular product lines, and by volume, mix and timing of orders received during a period, fluctuations in foreign exchange rates, and changing conditions in both the semiconductor industry and key semiconductor markets around the world. As a result, the Company's operating results may fluctuate, especially when measured on a quarterly basis.

#### Liquidity and Capital Resources

Cash, cash equivalents and marketable securities balances increased to \$284.5 million for the three months ended September 30, 1996. Cash generated by operations was \$30.7 million, derived primarily from net income and reductions in receivables. This was offset by long term investments of \$17.2 million for the quarter. The Company's capital expenditures were primarily in facility improvements, new computers to accommodate general business needs, and engineering computers and equipment to support the Company's expanding research and development efforts. 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.

Page 8

KLA INSTRUMENTS CORPORATION

FORM 10-Q

PART II: OTHER INFORMATION

Item 1      Legal Proceedings  
            None

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

(a)      Exhibits

            27.1 Financial Data Schedule

(b)      Reports on Form 8-K

            Current report on Form 8-K filed September 24, 1996:

            The Company filed a Form 8-K on September 24, 1996, reporting that as of April 26, 1996, the Company amended its Shareholder Rights Plan. The amendment increased the exercise price from \$50.00 to \$160.00, changed the acquisition threshold from 20% to 15%, extended the term from 1999 to 2006, added an exchange provision and made certain other technical changes.

Page 9

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 INSTRUMENTS CORPORATION

November 12, 1996  
-----  
[Date]

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

Page 10

<TABLE> <S> <C>

<ARTICLE> 5

<LEGEND>

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.

</LEGEND>

<MULTIPLIER> 1000

<S>	<C>
<PERIOD-TYPE>	3-MOS
<FISCAL-YEAR-END>	JUN-30-1997
<PERIOD-START>	JUL-01-1996
<PERIOD-END>	SEP-30-1996
<CASH>	107,106
<SECURITIES>	22,462
<RECEIVABLES>	196,154
<ALLOWANCES>	3,182
<INVENTORY>	138,619
<CURRENT-ASSETS>	500,084
<PP&E>	128,347
<DEPRECIATION>	53,424
<TOTAL-ASSETS>	740,825
<CURRENT-LIABILITIES>	172,074
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	51
<OTHER-SE>	560,908
<TOTAL-LIABILITY-AND-EQUITY>	740,825
<SALES>	164,154
<TOTAL-REVENUES>	0
<CGS>	74,152
<TOTAL-COSTS>	74,152
<OTHER-EXPENSES>	0
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	154
<INCOME-PRETAX>	36,329
<INCOME-TAX>	12,352
<INCOME-CONTINUING>	23,977
<DISCONTINUED>	0
<EXTRAORDINARY>	0
<CHANGES>	0
<NET-INCOME>	23,977
<EPS-PRIMARY>	0.46
<EPS-DILUTED>	0.46

</TABLE>