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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: December 31, 1998

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-TENCOR CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	04-2564110
(STATE OR OTHER JURISDICTION OF CORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

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

(408) 875-3000
(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 January 29, 1999 there were 87,813,056 shares of the registrant's Common Stock, $0.001 par value, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KLA-TENCOR CORPORATION

CONDENSED CONSOLIDATED UNAUDITED INTERIM BALANCE SHEETS

(In thousands)

<TABLE>
<CAPTION>

<S>	June 30, 1998 <C>	December 31, 1998 <C>
ASSETS		
Current assets:		
Cash and cash equivalents	$ 215,970	$ 177,626
Short-term investments	92,343	70,015
Accounts receivable, net	304,140	286,010
Inventories	234,565	209,669
Deferred income taxes	90,729	94,252
Other current assets	18,624	14,986
Total current assets	956,371	852,558
Land, property and equipment, net	140,937	145,295
Marketable securities	415,168	486,115
Other assets	35,921	40,604
Total assets	$ 1,548,397	$ 1,524,572
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 21,482	$ 20,335
Accounts payable	46,353	23,916
Other current liabilities	282,848	292,732
Total current liabilities	350,683	336,983
Stockholders' equity:		
Common stock and capital in excess of par value	497,583	495,644
Retained earnings	683,836	676,419
Net unrealized gain on investments	26,108	20,367
Cumulative translation adjustment	(9,813)	(4,841)
Total stockholders' equity	1,197,714	1,187,589
Total liabilities and stockholders' equity	$ 1,548,397	$ 1,524,572

</TABLE>

See accompanying notes to unaudited condensed consolidated interim financial statements.

KLA-TENCOR CORPORATION
CONDENSED CONSOLIDATED UNAUDITED INTERIM STATEMENTS OF OPERATIONS
(In thousands, except per share data)

<TABLE>
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	Three months ended December 31,		Six months ended December 31,	
	1997	1998	1997	1998
<S>	<C>	<C>	<C>	<C>
Revenues	$ 326,361	$ 193,371	$ 638,781	$398,601
Costs and operating expenses:				
Costs of goods sold	150,235	104,909	290,999	217,564
Engineering, research and development	47,280	38,470	92,457	81,396
Selling, general and administrative	61,622	49,966	123,760	102,539
Non-recurring acquisition, restructuring and other charges	--	42,700	--	42,700
Total costs and operating expenses	259,137	236,045	507,216	444,199
Income (loss) from operations	67,224	(42,674)	131,565	(45,598)
Interest income and other, net	9,331	14,083	18,116	31,146
Income (loss) before income taxes	76,555	(28,591)	149,681	(14,452)
Provision (benefit) for income taxes	24,497	(10,994)	47,901	(7,035)
Net (loss) income	$ 52,058	$ (17,597)	$ 101,780	$ (7,417)
Earnings (loss) per share:				
Basic	$ 0.61	$ (0.20)	$ 1.20	$ (0.08)
Diluted	$ 0.59	$ (0.20)	$ 1.15	$ (0.08)
Weighted average number of shares:				
Basic	84,657	87,463	84,470	87,414
Diluted	88,105	87,463	88,343	87,414

</TABLE>

See accompanying notes to unaudited condensed consolidated interim financial statements.

KLA-TENCOR CORPORATION
CONDENSED CONSOLIDATED UNAUDITED INTERIM STATEMENTS OF CASH FLOW
(In thousands)

<TABLE>
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	Six Months Ended December 31,	
	1997	1998
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	$ 101,780	$ (7,417)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	18,228	21,721
Non-recurring acquisition charges	--	7,700
Changes in assets and liabilities:		
Accounts receivable, net	(122,067)	40,353
Inventories	(26,791)	21,976
Other assets	(7,217)	(627)
Accounts payable	14,007	(23,690)

Other current liabilities	16,300	3,321
Net cash provided by (used in) operating activities	(5,760)	63,337
Cash flows from investing activities:		
Purchases of property and equipment	(33,701)	(10,173)
Net purchases of available for sale securities	(75,738)	(54,384)
Acquisition of assets and technology	--	(12,522)
Net cash used in investing activities	(109,439)	(77,079)
Cash flows from financing activities:		
Issuance of common stock, net	25,350	18,710
Stock repurchases	(7,546)	(20,648)
Net payments under debt obligations	(1,222)	(4,483)
Net cash provided by financing activities	16,582	(6,421)
Effect of exchange rate changes on cash and cash equivalents	10,525	(18,181)
Net increase (decrease) in cash and cash equivalents	(88,092)	(38,344)
Cash and cash equivalents at beginning of period	279,225	215,970
Cash and cash equivalents at end of period	$ 191,133	$ 177,626
Supplemental cash flow disclosures:		
Income taxes paid	$ 45,292	$ 6,415
Interest paid	$ 1,307	$ 996

</TABLE>

See accompanying notes to unaudited condensed consolidated interim financial statements.

KLA-TENCOR CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM
FINANCIAL STATEMENTS

NOTE 1. In the opinion of the management of KLA-Tencor Corporation (the Company), the unaudited condensed consolidated interim financial statements include only those normal recurring adjustments necessary for a fair statement of results. The results for the three month period ended December 31, 1998 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 for the year ended June 30, 1998.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual amounts could differ materially from those amounts.

NOTE 2. Inventories (in thousands):

<TABLE>
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<S>	June 30, 1998 <C>	December 31, 1998 <C>
Customer service parts	$ 31,671	$ 57,159
Raw materials	49,630	42,967
Work-in-process	79,238	54,184
Demonstration equipment	47,234	26,896
Finished goods	26,792	28,463
	$234,565	$209,669

</TABLE>

NOTE 3. In August 1997, the Company adopted a plan to repurchase shares of its own Common Stock on the open market the purpose of which is to partially offset dilution created by employee stock options and stock purchase plans. During the six month period ended December 31, 1998, the Company repurchased 542,000 shares of its Common Stock at a cost of $20.6 million.

NOTE 4. As of July 1, 1998, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income" which establishes the requirements for reporting and presentation of comprehensive income and its components. SFAS No. 130 requires accumulated translation adjustments and net unrealized gains/losses on investments to be included in other comprehensive income. The adoption of SFAS No. 130 did not impact the Company's net income (loss) or total stockholders' equity. For the three month and six month period ended December 31, 1997 and 1998, the components of total comprehensive income (loss) are as follows:

<TABLE>
<CAPTION>

	Three months ended December 31,		Six months ended December 31,	
	1997	1998	1997	1998
<S>	<C>	<C>	<C>	<C>
Net income (loss)	$ 52,058	$ (17,597)	$ 101,780	$ (7,417)
Foreign currency translation adjustments	(4,490)	3,790	(5,054)	4,972
Unrealized gains (losses) on investments, net of taxes	1,295	(4,759)	9,678	(5,741)
Other comprehensive income (loss)	(3,195)	(969)	4,624	(769)
Total comprehensive income (loss)	$ 48,863	$ (18,566)	$ 106,404	$ (8,186)

</TABLE>

NOTE 5. Basic net income (loss) per share, is calculated using the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed in the same manner and additionally gives effect to all dilutive potential common shares outstanding during the period. Diluted net loss per share is calculated using the weighted average number of shares of common stock outstanding during the period; the options outstanding during the three and six month periods ended December 31, 1998 were excluded from the computation of diluted net loss per share because the effect in periods with a net loss would be antidilutive. The reconciling difference between the computation of basic and diluted earnings per share for the three and six month period ended December 31, 1997, is the inclusion of the dilutive effect of stock options issued to employees under employee stock option plans.

NOTE 6. In November 1998, the Company entered into a restructuring plan to address the downturn in the semiconductor industry. The total restructuring charge was $35 million or $0.26 cents per share for the three months ended December 31, 1998. The plan includes consolidation of facilities, a write-down of assets associated with affected programs and reductions in the Company's global workforce. Restructuring and related charges were as follows for the period ended December 31, 1998 (in thousands):

<TABLE>
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	Facilities	Inventory	Severance and Benefits	Other	Total
<S>	<C>	<C>	<C>	<C>	<C>
Restructuring provision	$12,491	$ 9,721	$ 8,126	$ 4,662	$35,000
Incurred to date	2,724	6,300	1,710	2,165	12,899
Balance at December 31, 1998	$ 9,767	$ 3,421	$ 6,416	$ 2,497	$22,101

</TABLE>

NOTE 7. During the second quarter of fiscal 1999 the Company acquired certain assets and intellectual property in separate transactions with Keithley Instruments, Inc. and Uniphase Corporation. These acquisitions were accounted for using the purchase method of accounting. The aggregate purchase price of approximately $13 million was allocated to the acquired assets, liabilities assumed, intangible assets and goodwill and resulted in a pre-tax charge of approximately $7.7 million for acquired in-process research and development.

NOTE 8. In June 1997, the Financial Accounting Standards Board issued Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information." This Statement establishes standards for public business enterprises to report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments and related disclosures about products and services, geographic areas, and major customers. This Statement is required to be adopted in the Company's annual

financial statements for fiscal year ending June 30, 1999. The effect of SFAS No. 131 is not expected to be material to the Company's financial statement disclosure.

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). It establishes accounting and reporting standards for derivative instruments including standalone instruments, such as forward currency exchange contracts and interest note swaps or embedded derivatives and requires that these instruments be marked-to-market on an ongoing basis. These market value adjustments are to be included either in the income statement or stockholders' equity, depending on the nature of the transaction. The Company is required to adopt SFAS 133 in the first quarter of its fiscal year ending June 30, 2000. The effect of SFAS No. 133 is not expected to be material to the Company's financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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. Important factors that could cause actual results to differ are described in the following discussion and under "Risk Factors" below.

RESULTS OF OPERATIONS

Revenues were $193 million and $399 million for the three and six month periods ended December 31, 1998, compared to $326 million and $639 million for the same periods of the prior fiscal year, representing a decrease of 41% and 38% for the respective periods. The decrease in revenues is primarily attributable to reductions in capital spending by major semiconductor manufacturers worldwide due in part to excess manufacturing capacity resulting from smaller dimensions, reduced demand from Asian markets and continued price competition in response to oversupply in the DRAM market.

In response to the current market conditions, the Company implemented a restructuring plan during its second fiscal quarter which resulted in a one-time charge of $35 million. The charge consisted primarily of costs associated with the consolidation of facilities, a write-down of assets associated with affected programs and employee severance and related benefits associated with a reduction in force completed during the quarter.

Gross margins were 46% and 45% of revenues for the three and six month periods ended December 31, 1998, compared to 54% of revenues for the same periods in the prior fiscal year. Gross margins declined year over year primarily due to reduced capacity utilization resulting from lower business volume. Additionally, margins were impacted by a shift in product mix away from higher margin product sales in the wafer inspection products and an increase in the percentage of sales in the lower margin service business.

Engineering, research and development (R&D) expenses were $38 million and $81 million for the three and six month periods ended December 31, 1998 compared to $47 million and $92 million for the same periods in the prior fiscal year. As a percentage of revenues, R&D expenses increased to 20% for the three and six month periods ended December 31, 1998 compared to 14% for the same periods in the prior fiscal year. The decrease in absolute dollars is primarily attributable to the cost reduction measures and the restructuring actions the Company has executed as result of the current semiconductor industry downturn.

Selling, general and administrative (SG&A) expenses were $50 million and $103 million for the three and six month periods ended December 31, 1998, compared to $62 million and $124 million for the same periods in the prior fiscal year. The decrease in dollars during the period is primarily due to cost reduction and restructuring actions implemented by the Company during fiscal 1999, including headcount reduction and the consolidation of facilities.

Interest income and other, net, increased $5 million and $13 million for the three and six month periods ended December 31, 1998, compared to the same periods in the prior fiscal year. The increase is due primarily to gains realized on the sale of equity securities held in a former supplier company as well as increases in interest income on higher average cash equivalents and investment balances.

During the three month period ended December 31, 1998, the Company realized an effective 38% tax rate for the period which is comprised of a 35% tax benefit

from the effect of non-recurring restructuring and acquisition costs and a 28% tax rate on income excluding the one-time charge. The Company anticipates approximately a 28% tax rate in the balance of fiscal 1999 which is lower than the 32% tax rate incurred in the prior fiscal year due primarily to a higher proportion of income derived from tax-exempt interest in the current year.

LIQUIDITY AND CAPITAL RESOURCES

During the six month period ended December 31, 1998, cash, cash equivalents, short-term investments and marketable securities balances increased approximately $10 million to $734 million. Cash provided by operations for the six month period was $63 million, resulting primarily from collections on accounts receivable and reduced inventory spending. Capital expenditures of $10 million were primarily for manufacturing equipment necessary for the Company's operations. In addition, the Company paid approximately $13 million for the acquisition of assets and intellectual property from Keithley Instruments, Inc. and from Uniphase Corporation during the second quarter of fiscal 1999.

Working capital decreased to $516 million as of December 31, 1998 compared to $606 million at June 30, 1998 primarily due to a shift of the Company's investment portfolio to a higher percentage of long-term securities. The Company believes that existing liquid resources and funds generated from operations combined with its ability, if necessary, to borrow funds will be adequate to meet its operating and capital requirements and obligations through the foreseeable future.

YEAR 2000 COMPLIANCE

Many currently installed computer systems and software products are coded to accept only two digit entries in the date code field. These date code fields will need to accept four digit entries to distinguish 21st century dates from 20th century dates. As a result, many companies' software and computer systems may need to be upgraded or replaced in order to comply with such "Year 2000" requirements. The Company believes that the majority of its products and systems are Year 2000 ready or will be brought to a state of readiness prior to the year 2000. Costs to bring its products and systems to a state of compliance with the year 2000 have not been material and the Company does not anticipate future costs will have a material impact on the financial statements; however, complete testing is not feasible and unexpected problems may remain. In addition, the Company utilizes third-party equipment and software that which are also under evaluation and planning for Year 2000 readiness. Failure of the Company's products or third-party equipment or software to operate properly with regard to the Year 2000 and thereafter could require the Company to incur unanticipated expenses to remedy any problems, which could have a material adverse effect on the Company's business and operating results.

The Company is in the process of contacting its critical suppliers, manufacturers, distributors, and other vendors to determine if their operations and the products and services that they provide to the Company are Year 2000 compliant. Where practicable, the Company will attempt to mitigate its risks with respect to the failure of third parties to be Year 2000 ready, including developing contingency plans. However, such failures, including failures of any contingency plans, remain a possibility and could have a material adverse impact on the Company's results of operations or financial condition. Furthermore, the purchasing patterns of customers or potential customers may be affected by Year 2000 issues as companies expend significant resources to correct their current systems for Year 2000 compliance. These expenditures may result in reduced funds available to purchase products and services such as those offered by the Company, which could have a material adverse effect on the Company's business and operating results.

RISK FACTORS

During the calendar year operating results have been adversely affected as the Company experienced declines in orders, revenues and margins due to reduced capital equipment spending by the semiconductor industry. During the second quarter of fiscal 1999, the Company implemented a restructuring plan to address the current downturn in the semiconductor industry which resulted in a non-recurring pre-tax charge of $35 million. This restructuring plan includes a consolidation of facilities, a write-down of assets associated with affected programs and employee severance and related benefits costs. There can be no assurance that this cost reduction plan will be sufficient to address the current market conditions. The current semiconductor industry decline is primarily due to excess semiconductor manufacturing capacity worldwide, coupled with the Asian financial crisis. The Company's operating results are dependent on many factors, including economic conditions in the semiconductor and related industries, both in the US and abroad, the size and timing of orders from customers, customer cancellations or delays in shipments, the Company's ability to develop, introduce, and market new and enhanced products on a timely basis, among others. The Company has experienced reductions in orders, cancellations and delays in shipments which may continue to adversely affect sales and margins in future periods. The Company's expense levels are based, in part, on expectations of future revenues. Operating results have fluctuated in the past and may fluctuate in the future. If revenue levels in a particular period do not

meet expectations, operating results may be adversely affected and additional cost reduction measures may be necessary for the Company to remain competitive in the marketplace.

Rapid technological changes in semiconductor manufacturing processes subject the semiconductor manufacturing equipment industry to increased pressure to maintain technological parity with deep sub-micron process technology. Although the Company is focused on controlling expenses in the current downturn in the semiconductor industry, the Company continues to believe that its future success will depend in part upon its ability to develop, manufacture and successfully introduce new products with improved capabilities (including 300mm wafers and sub-quarter micron design rules) and to continue to enhance existing products. The Company must be able to forecast demand for new products while managing the transition from older products. There can be no assurance that the Company will successfully or timely develop and manufacture new products or that any such products will be accepted in the marketplace. If new products have reliability or quality problems, reduced orders, higher manufacturing costs, delays in collecting accounts receivable and additional service and warranty expense may result. Additionally, there can be no assurance that future technologies, processes or product developments will not render the Company's current product offerings obsolete. However, if the Company does not continue to successfully introduce new products, its results of operations will be adversely affected. The Company expects to continue to make significant investments in research and development and to sustain its current spending levels for customer support in fiscal year 1999 to meet current customer requirements and effectively position the Company for growth when the business cycle turns favorable.

The semiconductor equipment industry is highly competitive and global in nature and the Company has experienced and expects to continue to face substantial competition. The Company believes that to remain competitive will require significant financial resources in order 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. The Company's business depends and will continue to depend in the future upon the capital equipment expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits and products utilizing integrated circuits. The current industry downturn has had an adverse effect on the semiconductor industry's level of capital expenditures. The Company believes that it is relatively well positioned for this downturn because of its array of products, its focus on yield improvement and process development rather than pure wafer fabrication facility capacity, its sales of metrology products to non-semiconductor industries and

its strong balance sheet. The Company believes that the semiconductor equipment industry is becoming increasingly dominated by large manufacturers with the resources to support customers worldwide. Some of these competitors have substantially greater financial resources and more extensive engineering, manufacturing, marketing and customer service and support capabilities than the Company. In addition, there are smaller emerging semiconductor equipment companies which can provide innovative technology. No assurance can be given that the Company will be able to compete successfully worldwide or that the Company will be able to withstand the effects of an industry downturn in the short term or over an extended period if the downturn is prolonged.

The Company expects that international revenues will continue to represent a significant percentage of its revenues and international revenues and operations may be adversely affected by economic conditions specific to each country. The future performance of the Company depends, in part, upon its ability to continue to compete successfully worldwide. Asia Pacific is one of the largest regions for the sale of yield management and process monitoring equipment and countries in this region, including Japan, Korea and Taiwan, have experienced weaknesses in their currency, banking and equity markets in recent periods. The US and Europe have shown relative strength during this downturn; however, weaknesses in these regions may also adversely affect demand for the Company's products and the Company's consolidated results of operations. In addition, international sales may be adversely affected by fluctuations in foreign currency, 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. Although the Company attempts to manage near term currency risks through the use of hedging instruments, there can be no assurance that such efforts will be adequate. These factors may have a material adverse effect on the Company's future business and financial results.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk exposures as set forth in its Annual Report on Form 10-K for the year ended June 30, 1998 have not changed significantly.

PART II. OTHER INFORMATION

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

The Annual Meeting of Stockholders of KLA-Tencor Corporation was held on November 19, 1998 at the Company's offices in Milpitas, California. Of the 87,321,556 shares outstanding as of September 18, 1988, the record date, 75,126,534 shares (86%) were present or represented by proxy at the meeting.

1. The table below presents the results of the election to the Company's board of directors.

	Votes For	Votes Withheld
James W. Bagley	74,367,931	488,603
Edward W. Barnholt	74,656,074	470,460
Dean O. Morton	74,642,236	484,298
Kenneth L. Schroeder	74,641,810	484,724

2. The stockholders approved an amendment to the 1997 Employee Stock Purchase Plan to increase the number of shares reserved for issuance thereunder by 1,000,000 shares of Common Stock. This proposal received 57,480,851 votes for, 3,456,114 votes against, with 398,961 votes abstaining, and 13,790,608 broker non-votes.

3. The stockholders approved amendments to the 1997 Employee Stock Purchase Plan to increase the number of shares of Common Stock reserved for issuance thereunder on the first day of each subsequent fiscal year by the lesser of (a) 2,000,000 shares or (b) the number of shares which the Company estimates (based on the previous 12 month period) it will be required to issue under the 1997 Purchase Plan during the forthcoming fiscal year. This proposal received 44,757,829 votes for, 16,174,363 votes against, with 403,734 votes abstaining, and 13,790,608 broker non-votes.

4. The stockholders approved the 1998 Outside Director Option Plan and reserved for issuance thereunder 1,000,000 shares of Common Stock. This proposal received 46,643,026 votes for, 15,245,588 votes against, with 447,312 votes abstaining, and 13,790,608 broker non-votes.

5. The stockholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent accountants for the fiscal year ended June 30, 1999. This proposal received 74,728,073 votes for, 172,205 votes against, with 226,256 votes abstaining.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

27.1 Financial Data Schedule.

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-TENCOR CORPORATION
(Registrant)

February 9, 1999 — (Date)

ROBERT J. BOEHLKE
Robert J. Boehlke

Executive Vice President
and Chief Financial Officer

Index to Exhibits

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EXHIBIT NUMBER	DESCRIPTION
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27.1	Financial Data Schedule

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