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, 2005

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 incorporation 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 ☒ No ☐

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☒ No ☐

As of May 5, 2005 there were 196,876,145 shares of the Registrant's Common Stock, $0.001 par value, outstanding.

INDEX

		Page Number
PART I	**FINANCIAL INFORMATION**	
Item 1	Financial Statements (Unaudited)	
	Condensed Consolidated Balance Sheets at March 31, 2005 and June 30, 2004	3
	Condensed Consolidated Statements of Operations for the Three and Nine Months Ended March 31, 2005 and 2004	4
	Condensed Consolidated Statements of Cash Flows for the Nine Months Ended March 31, 2005 and 2004	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.	22
Item 3	Quantitative and Qualitative Disclosures About Market Risk	42
Item 4	Controls and Pocedures	42
PART II	**OTHER INFORMATION**	
Item 1	Legal Proceedings	44
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 6	Exhibits	45
SIGNATURES		46
EXHIBIT INDEX		47

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

KLA-TENCOR CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

(in thousands)	March 31, 2005	June 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 806,161	$ 598,698
Marketable securities	1,302,183	534,456
Accounts receivable, net	445,227	372,773
Inventories	353,546	337,414
Deferred income taxes	312,042	310,150
Other current assets	48,485	38,011
Total current assets	3,267,644	2,191,502
Land, property and equipment, net	392,773	376,052
Marketable securities	—	743,202
Other assets	299,220	228,423
Total assets	$ 3,959,637	$ 3,539,179
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 65,389	$ 63,991
Deferred system profit	272,207	284,813
Unearned revenue	65,563	57,318
Other current liabilities	573,924	505,507
Total current liabilities	977,083	911,629
Commitments and contingencies (Note 11)		
Minority interest in subsidiary	$ 7,676	$ —
Stockholders' equity:		
Common stock and capital in excess of par value	964,237	984,804
Deferred stock based compensation	(9,843)	—
Retained earnings	2,002,232	1,640,587
Accumulated other comprehensive income	18,252	2,159
Total stockholders' equity	2,974,878	2,627,550
Total liabilities and stockholders' equity	$ 3,959,637	$ 3,539,179

See accompanying notes to condensed consolidated financial statements (unaudited).

KLA-TENCOR CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)

(in thousands except per share data)	Three months ended March 31, 2005	Three months ended March 31, 2004	Nine months ended March 31, 2005	Nine months ended March 31, 2004
Revenues:				
Product	$ 463,171	$ 312,645	$ 1,360,412	$ 827,614
Service	78,440	77,127	232,825	218,666
Total revenues	541,611	389,772	1,593,237	1,046,280
Costs and operating expenses:				
Costs of revenues	221,838	170,605	655,042	482,515
Engineering, research and development	88,812	69,149	253,120	203,531
Selling, general and administrative	76,114	62,265	217,753	184,451
Total costs and operating expenses	386,764	302,019	1,125,915	870,497
Income from operations	154,847	87,753	467,322	175,783
Interest income and other, net	7,292	4,909	22,054	20,642
Income before income taxes and minority interest	162,139	92,662	489,376	196,425
Provision for income taxes	40,065	26,480	130,055	48,891
Income before minority interest	122,074	66,182	359,321	147,534
Minority interest	1,089	—	2,324	—
Net income	$ 123,163	$ 66,182	$ 361,645	$ 147,534
Net income per share:				
Basic	$ 0.63	$ 0.34	$ 1.84	$ 0.76
Diluted	$ 0.61	$ 0.33	$ 1.80	$ 0.73
Weighted average number of shares:				
Basic	196,883	196,159	196,244	194,519
Diluted	202,329	203,150	201,058	201,952

See accompanying notes to condensed consolidated financial statements (unaudited).

KLA-TENCOR CORPORATION
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(in thousands)	Nine months ended March 31, 2005	Nine months ended March 31, 2004
Cash flows from operating activities:		
Net income	$ 361,645	$ 147,534
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	53,398	61,668
Non-cash stock based compensation	1,917	—
Minority interest	(2,324)	—
Net (gain) loss on sale of marketable securities and other investments	3,360	(9,130)
Changes in assets and liabilities, net of effect of acquisitions of businesses:		
Accounts receivable, net	(68,891)	(138,762)
Inventories	(13,985)	(51,530)
Other assets	(39,564)	(29,198)
Accounts payable	(15)	33,584
Deferred system profit	(12,606)	38,657
Other current liabilities	70,124	100,232
Net cash provided by operating activities	353,059	153,055
Cash flows from investing activities:		
Acquisitions of businesses, net of cash received	(44,628)	—
Purchase of land, property and equipment, net	(54,331)	(37,898)
Purchase of available-for-sale securities	(1,761,617)	(1,571,137)
Proceeds from sale of available-for-sale securities	1,463,102	1,378,694
Proceeds from maturity of available-for-sale securities	264,857	116,291
Net cash used in investing activities	(132,617)	(114,050)
Cash flows from financing activities:		
Issuance of common stock	103,304	141,259
Stock repurchases	(135,443)	(19,158)
Proceeds from sale of minority interest in subsidiary	10,000	—
Net cash provided by (used in) in financing activities	(22,139)	122,101
Effect of exchange rate changes on cash and cash equivalents	9,160	9,289
Net increase in cash and cash equivalents	207,463	170,395
Cash and cash equivalents at beginning of period	598,698	449,603
Cash and cash equivalents at end of period	$ 806,161	$ 619,998
Supplemental cash flow disclosures:		
Income taxes paid, net	$ 121,426	$ 22,836
Interest paid	$ 717	$ 425

See accompanying notes to condensed consolidated financial statements (unaudited).

KLA-TENCOR CORPORATION
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1 – BASIS OF PRESENTATION

Basis of presentation The condensed consolidated financial statements have been prepared by KLA-Tencor Corporation ("KLA-Tencor" or the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited interim financial statements reflect all adjustments (consisting only of normal, recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows for the periods indicated. These financial statements and notes, however, should be read in conjunction with Item 8, "Financial Statements and Supplementary Data" included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the SEC on August 30, 2004.

The condensed consolidated financial statements include the accounts of KLA-Tencor and its majority-owned subsidiaries, and the ownership interests of minority investors are recorded as minority interests. All significant intercompany balances and transactions have been eliminated. The Company has included the results of operations of acquired companies from the date of acquisition. See Note 4 – "Business Combinations."

The results of operations for the three month and nine month periods ended March 31, 2005 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year ending June 30, 2005.

Management Estimates The preparation of the condensed 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Reclassifications Certain prior period balances have been reclassified to conform to the current financial statement presentation. These reclassifications had no impact on previously reported results of operations or stockholders' equity.

Accounting for Stock-Based Compensation Plans KLA-Tencor accounts for its employee stock option and employee stock purchase plans under the intrinsic value recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standard ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosures."

Pro forma information regarding net income and net income per share is required by SFAS No. 123, and has been determined as if KLA-Tencor had accounted for its employee stock purchase plan and employee stock options under the fair value method of SFAS No. 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 that assumes no expected dividends with the following weighted-average assumptions:

	2005	2004
Stock option plan:		
Expected stock price volatility	55.8%	64%-67%
Risk free interest rate	3.4%-4.5%	2.8%-3.9%
Expected life of options (in years)	5.5	5.4
Stock purchase plan:		
Expected stock price volatility	34.2%	46%-51%
Risk free interest rate	3.1%-3.8%	1.2%-1.8%
Expected life of options (in years)	1-2	1-2

SFAS No. 123 requires the use of option pricing models that were not developed for use in valuing employee stock options. The Black-Scholes option-pricing model was developed for use in estimating the fair value of short-lived exchange traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. Because the Company's employee stock options 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 the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of employee stock options.

For purposes of pro forma disclosures required by SFAS No. 123, the estimated fair value of the options is amortized to expense over the options' vesting periods using the straight-line method. KLA-Tencor's pro-forma information is as follows (in thousands except per share data):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Net income – as reported	$ 123,163	$ 66,182	$ 361,645	$ 147,534
Add:				
Stock-based compensation expense included in reported net income, net of tax	503	—	1,208	—
Deduct:				
Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(25,078)	(21,718)	(67,313)	(68,569)
Net income – pro forma	$ 98,588	$ 44,464	$ 295,540	$ 78,965
Earnings per share:				
As reported				
Basic	$ 0.63	$ 0.34	$ 1.84	$ 0.76
Diluted	$ 0.61	$ 0.33	$ 1.80	$ 0.73
Pro forma				
Basic	$ 0.50	$ 0.23	$ 1.51	$ 0.41
Diluted	$ 0.49	$ 0.22	$ 1.47	$ 0.39

Recent Accounting Pronouncements In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment." SFAS No. 123(R) would require the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In March 2005, the SEC issued SAB 107, which provides the Staff's views regarding interactions between SFAS No. 123(R) and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies. The adoption of SFAS No. 123(R) will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. SFAS No. 123(R) is effective for the Company beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 123(R) will have a material impact on the Company's consolidated results of operations, financial position and statement of cash flows. The Company is evaluating what transition method and what pricing model to select upon adoption.

In March 2005, the FASB published FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," which clarifies that the term, conditional asset retirement obligation, as used in SFAS No. 143, "Accounting for Asset Retirement Obligations," refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. The interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This interpretation is effective no later than the end of the Company's fiscal 2006. The adoption of this Interpretation is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for the Company for nonmonetary asset exchanges beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 153 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004. The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. The Company has yet to complete its evaluation of the Foreign Earnings Repatriation Provision. However, at this time it is not anticipated that the Provision will result in a material impact on the Company's effective rate.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period charges. The provisions of SFAS No.151 are effective for the fiscal year beginning July 1, 2005. The adoption of SFAS No. 151 is not expected to have a material impact on the Company's consolidated financial position, results of operations and cash flows.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on recognition and measurement guidance previously discussed under EITF 03-1. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method. In September 2004, the Financial Accounting Standards Board approved the issuance of a FASB Staff Position to delay the requirement to record impairment losses under EITF 03-1. The approved delay applies to all securities within the scope of EITF 03-1. The Company will evaluate the impact of EITF 03-1 once the final guidance is issued.

NOTE 2 – BALANCE SHEET COMPONENTS

(in thousands)		March 31, 2005		June 30, 2004
Cash equivalents and marketable securities				
U.S. Treasuries	$	152,703	$	113,575
Mortgage-backed securities		75,342		15,148
Municipal bonds		1,527,425		1,400,884
Corporate equity securities		15,641		1,105
Money market bank deposits and other		194,035		212,307
	$	1,965,146	$	1,743,019
Less: Cash equivalents		662,963		465,361
Short-term marketable securities		1,302,183		534,456
Long-term marketable securities	$	—	$	743,202

Prior to the third fiscal quarter of 2005, the Company classified auction rate securities with reset dates of 90 days or less, as cash equivalents on the Consolidated Balance Sheets. In the third fiscal quarter of 2005, the Company classified all auction rate securities as short-term investments. To conform to the current year presentation, the Company reclassified $204.0 million of auction rate securities from cash equivalents to short-term investments as of June 30, 2004. There was no impact on the Consolidated Statements of Operations as a result of the reclassification for the three months and nine months ended March 31, 2004. The impact on the Consolidated Statement of Cash Flows was a decrease of $1.1 million in cash used in investing activities for the nine months ended March 31, 2004.

Prior to the third fiscal quarter of 2005, the Company classified a portion of its available-for-sale securities as long-term investments. During the quarter ended March 31, 2005, the Company made the determination that these investments will be available for use in current operations. Therefore, as of March 31, 2005, the Company classified all available-for-sale securities as short-term investments or cash equivalents.

(in thousands)		March 31, 2005		June 30, 2004
Accounts receivable, net				
Accounts receivable, gross	$	457,443	$	385,171
Allowance for doubtful accounts		(12,216)		(12,398)
	$	445,227	$	372,773
Inventories, net				
Customer service parts	$	112,960	$	104,445
Raw materials		84,607		92,070
Work-in-process		64,070		69,497
Finished goods and demonstration equipment		91,909		71,402
	$	353,546	$	337,414

(in thousands)	March 31, 2005	June 30, 2004
Property and equipment		
Land	$ 84,548	$ 84,053
Buildings and improvements	154,405	149,813
Machinery and equipment	345,449	306,309
Office furniture and fixtures	41,752	41,251
Leasehold improvements	139,412	135,622
Construction in process	5,889	14,672
	771,455	731,720
Less: accumulated depreciation	(378,682)	(355,668)
	$ 392,773	$ 376,052
Other assets		
Goodwill & other intangibles, net	$ 64,380	$ 20,621
Long-term investments	137,166	110,287
Deferred tax assets – long-term	88,364	88,593
Other	9,310	8,922
	$ 299,220	$ 228,423
Other current liabilities		
Warranty and retrofit	$ 56,165	$ 44,497
Compensation and benefits	247,187	224,191
Income taxes payable	170,236	146,632
Restructuring accrual	346	821
Other accrued expenses	99,990	89,366
	$ 573,924	$ 505,507

NOTE 3 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The carrying value of goodwill was $52.3 million and $17.6 million as of March 31, 2005 and June 30, 2004, respectively, and was allocated to KLA-Tencor's reporting units pursuant to SFAS No. 142. In accordance with SFAS No. 142, KLA-Tencor completed its annual evaluation of the goodwill by reporting unit during the quarter ended December 31, 2004, and concluded that there was no impairment. There have been no significant events or circumstances affecting the valuation of goodwill subsequent to our impairment test performed in the second quarter of fiscal year 2005.

Other Intangible Assets

The components of other intangible assets as of March 31, 2005 (in thousands) were as follows:

	Gross Carrying Amount	Accumulated Amortization	Net Amount
Existing technology	$ 12,537	$ 2,243	$ 10,294
Patents	4,761	3,623	1,138
Trademark	1,225	549	676
Other	200	200	—
Total	$ 18,723	$ 6,615	$ 12,108

The components of other intangible assets as of June 30, 2004 (in thousands) were as follows:

		Gross Carrying Amount		Accumulated Amortization		Net Amount
Existing technology	$	1,852	$	992	$	860
Patents		4,761		2,823		1,938
Trademark		625		417		208
Total	$	7,238	$	4,232	$	3,006

For the three month periods ended March 31, 2005 and 2004, amortization expense for other intangible assets was $1.0 million and $0.4 million, respectively. For the nine month periods ended March 31, 2005 and 2004, amortization expense for other intangible assets was $2.4 million and $1.1 million, respectively. Based on intangible assets recorded at March 31, 2005, and assuming no subsequent additions to, or impairment of the underlying assets, the remaining estimated amortization expense is expected to be as follows (in thousands):

Fiscal year ending June 30:		Amount
2005 (remaining 3 months)	$	883
2006		2,784
2007		1,953
2008		1,582
2009 and thereafter		4,906
Total	$	12,108

NOTE 4 – BUSINESS COMBINATIONS

All of the Company's qualifying business combinations have been accounted for using the purchase method of accounting. Consideration includes the cash paid and the value of options assumed, less any cash acquired, and excludes contingent employee compensation payable in cash. The Company accounts for the intrinsic value of stock options assumed related to future services as deferred stock based compensation within stockholders' equity.

During the first nine months of fiscal year 2005, the Company completed the acquisition of the following three businesses for net cash consideration of approximately $43.5 million primarily to expand the Company's product portfolio.

Entity	Date Acquired	Business
Candela Instruments	October 2004	Laser-based surface inspection systems optimized for the data storage industry
Blue29 Corporation	October 2004	Electroless metal deposition
Inspex Incorporated	August 2004	Wafer inspection

The following table summarizes the estimated fair values of the net assets acquired at the date of the acquisitions (in thousands):

		Amount
Cash	$	4,653
Purchased in-process research & development		700
Existing technology		10,685
Trademarks		600
Other intangible assets		200
Other tangible assets and liabilities		(1,615)
Deferred stock based compensation		907
Goodwill		33,541
Net assets acquired	$	49,671
Cash consideration	$	48,181
Value of stock options assumed		1,490
Total consideration	$	49,671

In connection with certain business combinations and purchased technology transactions entered into prior to fiscal year 2005, KLA-Tencor was subject to $1.1 million contingent consideration based upon sales volume and the occurrence of other events. The payment of the contingency in the quarter ended December 31, 2004 also resulted in an increase to goodwill.

In connection with the acquisitions completed during the first nine months of fiscal year 2005, KLA-Tencor is subject to a $9.1 million contingent cash payment based on the continued employment of certain employees over two years. The contingency is accounted for as compensation expense over the contingent employment period. None of this amount was paid at March 31, 2005.

The fair value of the purchased IPR&D and identified intangibles was determined using the income approach, which discounts expected future cash flows from projects to their net present value. Each project was analyzed to determine the technological innovations included; the utilization of core technology; the complexity, cost and time to complete development; any alternative future use or current technological feasibility; and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the products and the underlying technology, relevant market sizes and industry trends. The company determined a discount rate for each project based on the relative risks inherent in the project's development horizon, the estimated costs of development, and the level of technological change in the project and the industry, among other factors. The Company began amortizing the acquired identified intangibles over their useful life of six months to seven years.

The deferred stock based compensation recognized in connection with these business combinations is being amortized over the period earned. Amortization of deferred stock-based compensation was $50,000 and $591,000 during the three months and nine months ended March 31, 2005, respectively.

During the quarter ended December 31, 2004, KLA-Tencor acquired the remaining equity outstanding of Blue29, its variable interest entity consolidated after adoption of FIN46(R). Subsequently, KLA-Tencor transferred the assets of Blue29 to a limited liability corporation in which a third party acquired a minority interest for total proceeds of $10.0 million.

Pro-forma earnings information has not been presented because the effect of these acquisitions was not material either on an individual or an aggregate basis.

NOTE 5 – NONRECURRING RESTRUCTURING AND OTHER COSTS

There were no restructuring actions during fiscal year 2004 or the first nine months of fiscal year 2005. The Company's restructuring activities are disclosed in Note 3 of Notes to Consolidated Financial Statements included in Item 8 of the Company's Annual Report on Form 10-K for the year ended June 30, 2004. As of June 30, 2004, the remaining accrual balance was $821,000. During the three months and nine months ended March 31, 2005, the Company made lease payments of $167,000 and $475,000, respectively, related to the exited facilities. As of March 31, 2005, the remaining accrual balance of $346,000 is related to lease payments on facilities exited prior to fiscal year 2004 and is expected to be paid by the end of fiscal year 2006. This remaining accrual is included in the condensed consolidated balance sheets under the caption of other current liabilities.

NOTE 6 – 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 increased to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued. The dilutive effect of outstanding options and restricted stock is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from outstanding options and restricted stock. Additionally, the exercise of employee stock options and the vesting of restricted stock can result in a greater dilutive effect on earnings per share.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Numerator:				
Net Income	$ 123,163	$ 66,182	$ 361,645	$ 147,534
Denominator:				
Weighted average shares outstanding, excluding unvested restricted stock	196,883	196,159	196,244	194,519
Effect of dilutive options and restricted stock	5,446	6,991	4,814	7,433
Denominator for diluted earnings per share	202,329	203,150	201,058	201,952
Basic earnings per share	$ 0.63	$ 0.34	$ 1.84	$ 0.76
Diluted earnings per share	$ 0.61	$ 0.33	$ 1.80	$ 0.73

Potentially dilutive securities that were excluded from the computation of diluted earnings per share for the above periods because their effect would have been anti-dilutive were as follows (in thousands except price data):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Number of shares	5,677	1,112	9,921	538
Price range	$46.67-$68.00	$56.31 - $68.00	$43.99-$68.00	$56.31 - $68.00

During the quarter ended March 31, 2005, the Company’s Board of Directors authorized a quarterly cash dividend of $0.12 per share with the first dividend payable on June 1, 2005 to shareholders of record as of May 2, 2005.

NOTE 7 – RESTRICTED STOCK

During the three months and nine months ended March 31, 2005, the Company's Board of Directors approved the grant of 10,000 and 266,110 shares of restricted stock to selected members of the Company's senior management. These restricted stock units generally vest in two equal installments on the fourth and fifth anniversaries of the date of grant. The Company recorded the $10.9 million value of these restricted stock grants as a component of stockholders' equity and will amortize that amount over the service period. The value of the restricted stock awards was based on the closing market price of the Company's common stock on the date of award. Amortization expense for these awards for the three months and nine months ended March 31, 2005 was $748,000 and $1.3 million respectively, and is included in selling, general and administrative expense. These restricted stock units were included in the calculation of diluted earnings per share utilizing the treasury stock method.

NOTE 8 – STOCK REPURCHASE PROGRAM

The Company adopted a plan to repurchase shares of its Common Stock in the open market for the purpose of partially offsetting dilution created by employee stock options and stock purchase plans. Share repurchases for the three months and nine months ended March 31, 2005 and 2004 were as follows (in thousands):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Number of shares of common stock repurchased	533	210	3,346	361
Total cost of repurchase	$ 24,307	$ 11,017	$ 136,824	$ 19,420

As of March 31, 2005, the unsettled amount of $1.4 million is included in the condensed consolidated balance sheet under the caption of other current liabilities.

During the quarter ended March 31, 2005, the Company's Board of Directors authorized the repurchase of an additional 10.0 million shares of common stock under the Company's ongoing stock repurchase program.

NOTE 9 – COMPREHENSIVE INCOME

The components of comprehensive income, net of tax, are as follows (in thousands):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Net Income	$ 123,163	$ 66,182	$ 361,645	$ 147,534
Other comprehensive income (loss):				
Currency translation adjustments	(5,452)	1,504	9,841	13,151
Gain (loss) on cash flow hedging instruments, net	8,795	2,798	2,262	(4,443)
Unrealized gains (losses) on investments, net of taxes (benefits) of $725 and $2,520 for the three and nine months ended March 31, 2005 and ($111) and ($3,567) for the three and nine month months ended March 31, 2004	1,149	(175)	3,990	(5,650)
Other comprehensive income	$ 4,492	$ 4,127	$ 16,093	$ 3,058
Total comprehensive income	$ 127,655	$ 70,309	$ 377,738	$ 150,592

NOTE 10 – EMPLOYEE BENEFIT PLANS

KLA-Tencor sponsors various retirement and pension plans, including defined contribution and defined benefit plans which cover most employees worldwide. Several of KLA-Tencor's foreign subsidiaries have retirement plans for full time employees, some of which are defined benefit plans. KLA-Tencor does not sponsor defined benefit plans in the United States.

Net periodic pension cost, determined in accordance with SFAS No. 87, for KLA-Tencor's defined benefit retirement plans for the three months and nine months ended March 31, 2005 and 2004 include the following components (in thousands):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Service Cost	$ 611	$ 514	$ 1,791	$ 1,543
Interest Cost	99	81	290	243
Expected Return on Assets	(38)	(18)	(110)	(55)
Amortization of Net Transitional Obligation	65	70	192	210
Amortization of Net Gain	18	22	52	67
Net periodic pension cost	$ 755	$ 669	$ 2,215	$ 2,008

KLA-Tencor contributed $369,000 and $677,000 to its foreign subsidiary defined benefit pension plans for the three months and nine months ended March 31, 2005, respectively, and expects to contribute $171,000 during the remainder of fiscal year 2005.

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Factoring

KLA-Tencor has agreements with financial institutions to sell certain of its trade receivables and promissory notes from customers without recourse. During the three months ended March 31, 2005 and 2004, approximately $61.9 million and $37.2 million of receivables were sold under these arrangements, respectively. During the nine months ended March 31, 2005 and 2004, approximately $172.0 million and $98.2 million of receivables were sold under these arrangements, respectively. KLA-Tencor does not believe it is at risk for any material losses as a result of these agreements.

In addition, from time to time KLA-Tencor will discount without recourse Letters of Credit ("LCs") received from customers in payment of goods. No LCs were sold during the three months ended March 31, 2005. During the three months ended March 31, 2004, several LCs were sold with proceeds totaling $6.5 million. Discounting fees were $12,000 for the three months ended March 31, 2004. During the nine months ended March 31, 2005 and 2004, several LCs were sold with proceeds totaling $10.0 million and $32.6 million. Discounting fees were $44,000 and $201,000 for the nine months ended March 31, 2005 and 2004, respectively.

Facilities

KLA-Tencor leases certain of its facilities under operating leases, which qualify for operating lease accounting treatment under SFAS No. 13, "Accounting for Leases," and, as such, these facilities are not included on the Company's condensed consolidated balance sheet.

The following is a schedule of operating leases payments as of March 31, 2005 (in thousands):

Fiscal year ending June 30,		Amount
2005 (remaining 3 months)	$	2,312
2006		7,173
2007		3,987
2008		3,193
2009		2,906
Thereafter		5,229
Total minimum lease payments	$	24,800

Purchase Commitments

KLA-Tencor maintains certain open inventory purchase commitments with its suppliers to ensure a smooth and continuous supply chain for key components. KLA-Tencor's 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 among different suppliers. The Company's open inventory purchase commitments were approximately $110.4 million as of March 31, 2005. Actual expenditures will vary based upon the volume of the transactions and length of contractual service provided. In addition, the amounts paid under these arrangements may be less in the event that the arrangements are renegotiated or cancelled. Certain agreements provide for potential cancellation penalties.

Guarantees

KLA-Tencor provides standard warranty coverage on its systems for twelve months, providing labor and parts necessary to repair the systems during the warranty period. KLA-Tencor accounts for the estimated warranty cost as a charge to cost of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, KLA-Tencor calculates the average service hours and parts expense per system and applies the actual labor and overhead rates to determine the estimated warranty charge. KLA-Tencor updates these estimated charges every quarter. The actual product performance and/or field expense profiles may differ, and in those cases KLA-Tencor adjusts warranty accruals accordingly.

The following table provides the changes in the product warranty accrual, as required by FIN 45 for the three and nine months ended March 31, 2005 and 2004 (in thousands):

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Beginning balance	$ 51,575	$ 30,223	$ 38,865	$ 33,226
Accruals for warranties issued during the period	14,090	11,625	44,497	29,382
Changes in liability related to pre-existing warranties	(5,558)	(972)	(10,317)	(5,540)
Settlements made during the period	(9,640)	(6,591)	(22,578)	(22,783)
Ending balance	$ 50,467	$ 34,285	$ 50,467	34,285

Subject to certain limitations, KLA-Tencor indemnifies its current and former officers and directors for certain events or occurrences. Although the maximum potential amount of future payments KLA-Tencor could be required to make under these agreements is theoretically unlimited, based on prior experience, we believe the fair value of this liability is de minimus and no liability has been recorded.

KLA-Tencor is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, validity of certain intellectual property rights, non-infringement of third-party rights, and certain income tax-related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to and cooperating with the Company pursuant to the procedures specified in the particular contract. This usually allows the Company to challenge the other party's claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company's obligations under these agreements may be limited in terms of amounts, activity (typically at the Company's option to replace or correct the products or terminate agreement with a refund to the other party), and duration. In some instances, the Company may have recourse against third parties and/or insurance covering certain payments made by the Company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements did not have a material effect on its business, financial condition or results of operations.

Legal Matters

KLA-Tencor is named from time to time as a party to lawsuits in the normal course of its 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.

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"). The Company filed a counterclaim in the same court alleging that ADE has infringed four of the Company's patents. 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 was consolidated with the prior action in the Delaware proceeding and ADE amended its complaint in that proceeding to allege that the Company is infringing the '259 patent. KLA-Tencor and ADE have reached final settlement of this litigation during the quarter ended March 31, 2005. The terms of the settlement are confidential. All of the litigation between ADE and KLA-Tencor is now dismissed. This legal matter did not have a material effect on the Company's consolidated financial position or results of operations.

NOTE 12 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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 does not use derivative financial instruments for speculative or trading purposes. At March 31, 2005, KLA-Tencor had foreign exchange forward contracts maturing throughout fiscal 2005 to sell $425.3 million and purchase $96.3 million, in foreign currency, primarily Japanese Yen. At June 30, 2004, KLA-Tencor had foreign exchange forward contracts maturing throughout fiscal year 2005 to sell $334.1 million and purchase $227.2 million, in foreign currency, primarily Japanese yen.

NOTE 13 – SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

KLA-Tencor operates in one segment in accordance with the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. KLA-Tencor's chief operating decision maker is the Chief Executive 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 No. 131 can be found in the condensed 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 revenue reporting, revenues are attributed to the geographic location in which the customer is located. Long-lived assets consist primarily of net property and equipment and are attributed to the geographic region in which they are located.

The following is a summary of revenues by geographic region for three months and nine months ended March 31, 2005 and 2004 (in thousands).

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Revenue:				
United States	$ 139,674	$ 99,524	$ 399,151	$ 238,649
Europe & Israel	46,320	33,419	168,232	156,223
Japan	152,915	114,428	331,262	276,456
Taiwan	128,797	70,738	364,058	151,377
Korea	31,109	23,153	97,053	104,131
Asia Pacific	42,796	48,510	233,481	119,444
Total	$ 541,611	$ 389,772	$ 1,593,237	$ 1,046,280

Long-lived assets by geographic region as of March 31, 2005 and June 30, 2004 were as follows (in thousands):

	March 31, 2005	June 30, 2004
Long-lived assets:		
United States	$ 377,340	$ 367,547
Europe & Israel	10,872	6,263
Japan	4,702	4,280
Taiwan	2,245	2,348
Korea	4,862	3,502
Asia Pacific	2,062	1,034
Total	$ 402,083	$ 384,974

The following is a summary of revenues by major products for three months and nine months ended March 31, 2005 and 2004 (as a percentage of total revenue).

	Three months ended March 31,		Nine months ended March 31,	
	2005	2004	2005	2004
Revenue:				
Defect inspection	63%	65%	65%	63%
Metrology	17%	14%	16%	15%
Service	14%	20%	14%	21%
Other	6%	1%	5%	1%
Total	100%	100%	100%	100%

For the three months ended March 31, 2005, two customers accounted for 11% and 10% of revenue, respectively. For the three months ended March 31, 2004, no single customer accounted for 10% of revenue. For the nine months ended March 31, 2005 and 2004, one customer accounted for 11% and 10% of revenue, respectively. As of March 31, 2005 and June 30, 2004 one customer accounted for 10% of net accounts receivable.

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

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 Quarterly Report on Form 10-Q, other than statements of historical fact, are forward-looking statements. These statements are generally accompanied by words such as "may," "will," "could," "would," "should," "expect," "plan," "anticipate," "rely," "believe," "estimate," "predict," "intend," "potential," "continue," "forecast" or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Such forward-looking statements include, among others, those statements regarding forecasts of the future results of our operations; the percentage of process control of our customers' spending; orders for our products and capital equipment generally; sales of semiconductors; the allocation of capital spending by our customers; growth of revenue in the semiconductor industry, the semiconductor capital equipment industry and business; technological trends in the semiconductor industry;our future product offerings and product features, as well as the success and market acceptance of new products; timing of shipment of backlog; the future of our product shipments and our product and service revenues; our future gross margins; the future of our selling, general and administrative expenses; international sales and operations; maintenance of our competitive advantage; success of our product offerings; creation and funding of programs for research and development; attraction and retention of employees; the outcome of any litigation to which we are a party; results of our investment in leading edge technologies; the effects of hedging transactions; the effect of the sale of trade receivables and promissory notes from customers; sufficiency of our existing cash balance, investments and cash generated from operations to meet our operating and working capital requirements; and the adoption of new accounting pronouncements.

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 this section and those set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 1, "Business" in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the Securities and Exchange Commission ("SEC") on August 30, 2004. You should carefully review these risks and also review the risks described in other documents we file from time to time with the SEC. You are cautioned not to place undue reliance on these forward-looking statements. We expressly disclaim any obligation to update or alter our forward-looking statements, whether, as a result of new information, future events or otherwise.

EXECUTIVE SUMMARY

KLA-Tencor Corporation is the world's leading supplier of process control and yield management solutions for the semiconductor and related microelectronics industries. Our 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.

New system and service orders in the quarter ended March 31, 2005 were 29% lower than the same quarter last year. New system and service orders in the nine months ended March 31, 2005 remained flat compared to the same period in the prior fiscal year. The changes in the levels of orders that we experience are generally due to the cyclical nature of the semiconductor industry, as well as demand for our product offerings.

For the quarter ended March 31, 2005 our total revenues increased approximately 39% over the same quarter last year. Product revenue increased by 48% while service revenue increased by 2% over the same quarter last year. For the nine months ended March 31, 2005 our total revenues increased approximately 52% over the same period last year. Product revenue increased by 64% during the nine months ended March 31, 2005 while service revenue increased by 6% over the same period last year. The increase in our revenues is primarily driven by increased customer demand for our products. The growth in revenue compared to the same period in the prior fiscal year is being driven by our customers' needs to expand capacity, advance existing capacity to next-generation processes, increase the efficiency of existing production lines and overcome yield and reliability problems in next-generation pilot lines.

Gross margin percentage for the quarter ended March 31, 2005 improved by 3 points compared to the same quarter in the prior year. Gross margin percentage for the nine months ended March 31, 2005 improved by 5 points compared to the same period in the prior year. The main reason for the increase was the lower cost of building, installing and maintaining our products, combined with an increase in our revenues.

For the quarter ended March 31, 2005, engineering, research and development ("R&D") expenses were 28% higher compared to the same quarter in the prior year. For the nine months ended March 31, 2005, engineering, research and development ("R&D") expenses were 24% higher compared to the same period in the prior year. The increase in R&D expenses was due to the acquisitions completed during the first half of the fiscal year (as described in Note 4 to the consolidated financial statements), and higher project material and labor costs as we focus on the development of new products and enhancements to existing products.

Selling, general and administrative expenses increased 22% during the quarter ended March 31, 2005 compared to the same quarter in the prior year. Selling, general and administrative expenses increased 18% during the nine months ended March 31, 2005 compared to the same period in the prior year. The increase in selling, general and administrative expenses resulted from an increase in customer application support, increased staffing and stock based compensation expense recorded during the quarter.

During the nine months ended March 31, 2005, we generated $353 million in cash flow from operations. Cash, cash equivalents and marketable securities totaled $2.1 billion as of March 31, 2005.

We intend the discussion of our financial condition and results of operations that follows to provide information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

Outlook

Analysts estimated the semiconductor industry revenue growth rate to approach 30% in calendar year 2004 and slow down to single-digit growth in calendar year 2005. They also estimate that semiconductor capital equipment revenues grew about 60% in calendar year 2004; and expect semiconductor capital equipment revenues to decline by 5% in calendar year 2005. New system and service orders, which are new orders net of cancellations, declined sequentially by approximately $56 million or 12% in the three months ended March 31, 2005, compared to the previous quarter due to the timing of certain orders combined with near-term weakness in demand for semiconductor capital equipment. In the near term, the level of new system orders will depend significantly on the timing of system orders for major new and existing 300-mm fabs.

Over the long-term we expect process control to continue to represent a higher percentage of our customers' capital spending. We believe this increase in process control spending will be driven by the demand for more precise diagnostics capabilities to address multiple new defects as a result of further shrinking of device feature sizes, the transition to copper and other new materials, and the transition to new 300- millimeter fabs.

New system and service orders by region were as follows (in millions):

	Fiscal Quarter 2005			Fiscal Quarter 2004			
	Third	Second	First	Fourth	Third	Second	First
United States	$ 96	$ 98	$ 107	$ 158	$ 192	$ 129	$ 71
Europe & Israel	36	53	79	81	70	75	21
Japan	122	157	123	138	92	128	80
Taiwan	104	66	90	167	97	89	96
Korea	58	57	91	27	74	21	23
Asia Pacific	7	48	39	36	74	66	49
Total orders	$ 423	$ 479	$ 529	$ 607	$ 599	$ 508	$ 340

Orders received in a particular quarter affect revenue recognized in subsequent quarters. Net orders turn to revenue upon positive affirmation by the customer that the system has been installed and is operating according to predetermined specifications. Our backlog for unshipped system orders as of March 31, 2005 was approximately $657 million, a majority of which we expect to ship over the next six to nine months. In addition, we have $593 million that is related to products that have been delivered but are awaiting written acceptance from the customer.

RESULTS OF OPERATIONS

Revenues and Gross Margin

	Three months ended			Nine months ended	
(in millions)	March 31, 2005	December 31, 2004	March 31, 2004	March 31, 2005	March 31, 2004
Revenues:					
Product	$ 463	$ 455	$ 313	$ 1,360	$ 828
Service	79	78	77	233	218
Total revenues	$ 542	$ 533	$ 390	$ 1,593	$ 1,046
Gross margin	$ 320	$ 315	$ 219	$ 938	$ 564
Gross margin percentage	59%	59%	56%	59%	54%

Product revenues

Product revenues increased $8 million or 2% to $463 million during the third quarter of fiscal year 2005 from $455 million during the second quarter of fiscal year 2005. Product revenues increased $150 million or 48% to $463 million during the third quarter of fiscal year 2005 from $313 million during the same period in the previous fiscal year. Product revenues increased by $532 million or 64% to $1,360 million during the nine months ended March 31, 2005 from $828 million during the nine months ended March 31, 2004. Product revenue increases were primarily the result of fulfilling higher level of orders received in prior quarters as a result of increased capital spending by our customers.

Total revenue recognized under conditions where we deviate from the need for a written acceptance by the customer were approximately 6.0%, 9.9% and 5.2% of total revenue for the three months ended March 31, 2005, December 31, 2004 and March 31, 2004, respectively, and 7.4% and 3.8% for the nine months ended March 31, 2005 and 2004, respectively. The increase in revenue exceptions resulted from an increase in multiple shipments of tools to the same customer fab location which have already met the required acceptance criteria.

For the three months ended March 31, 2005, two customers accounted for 11% and 10% of revenue, respectively. For the three months ended December 31, 2004, one customer accounted for 11% of revenue. For the three months ended March 31, 2004, no single customer accounted for 10% of revenue. For the nine months ended March 31, 2005 and 2004, one customer accounted for 11% and 10% of revenue, respectively.

Service revenues

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 remained flat at approximately $78 million during the third quarter of fiscal year 2005 compared to the second quarter of fiscal year 2005 and the same period in the previous fiscal year. Service revenues increased by $14 million or 6% to $233 million during the nine months ended March 31, 2005 from $218 million during the nine months ended March 31, 2004. 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.

Revenues by region

Revenues by region for the periods indicated were as follows (in millions):

	Three months ended						Nine months ended			
	March 31, 2005		December 31, 2004		March 31, 2004		March 31, 2005		March 31, 2004	
United States	$ 140	26%	$ 131	25%	$ 100	26%	$ 399	25%	$ 239	23%
Europe & Israel	46	8%	64	12%	33	8%	168	10%	156	15%
Japan	153	28%	102	19%	114	29%	331	21%	277	27%
Taiwan	129	24%	116	22%	71	18%	364	23%	151	14%
Korea	31	6%	40	7%	23	6%	97	6%	104	10%
Asia Pacific	43	8%	80	15%	49	13%	234	15%	119	11%
Total	$ 542	100%	$ 533	100%	$ 390	100%	$ 1,593	100%	$ 1,046	100%

International revenues were 74% of revenue during the three months ended March 31, 2005, 75% of revenue during the three months ended December 31, 2004, and 74% of revenue during the three months ended March 31, 2004. International revenues were 75% and 77% of revenue during the nine months ended March 31, 2005 and 2004, respectively. A significant portion of our revenue continues to be generated overseas where a significant portion of the world's semiconductor manufacturing capacity is located.

Gross margin

Gross margin remained flat at 59% during the third quarter of fiscal year 2005 compared to the second quarter of fiscal year 2005. Gross margin improved by 3 points to 59% during the three months ended March 31, 2005 from 56% during the same period in the previous fiscal year. Gross margin improved by 5 points to 59% during the nine months ended March 31, 2005 from 54% during the same period in the previous fiscal year. The improvement can be attributed to the lower cost of building, installing and maintaining our products, combined with an increase in our revenues.

In an environment where business volumes remain flat, product mix changes can have noticeable impact on gross margins. Additionally, gross margins might be adversely impacted if our production levels are reduced as a consequence of an industry slowdown, order cancellations or push-outs by our customers.

Engineering, Research and Development

	Three months ended			Nine months ended	
(in millions)	**March 31, 2005**	**December 31, 2004**	**March 31, 2004**	**March 31, 2005**	**March 31, 2004**
Net research and development (‘R&D’) expenses	$ 89	$ 87	$ 69	$ 253	$ 204
Percentage of total revenues	16%	16%	18%	16%	19%

Net R&D expenses increased $2 million or 2% to $89 million during the third quarter of fiscal year 2005 from $87 million during the second quarter of fiscal year 2005. Net R&D expenses increased $20 million or 28% to $89 million during the third quarter of fiscal year 2005 from $69 million during the same period in the previous fiscal year. Net R&D expenses increased by $49 million or 24% to $253 million during the nine months ended March 31, 2005 from $204 million during the nine months ended March 31, 2004.

The gross dollars for R&D investment were partially offset by $2 million and $5 million of external funding received during the three and nine months ended March 31, 2005, respectively, for certain strategic development programs conducted with several of our customers and from government grants.

The entities acquired during this fiscal year contributed $18 million of the increase in net R&D expenses for the nine months ended March 31, 2005 compared to the same period in the prior year. The reduction in R&D expenses as a percentage of revenue compared to the prior fiscal year was driven by our continued focus on cost reduction initiatives and by the increase in revenues. We expect our net R&D expenses to increase in absolute dollars as we accelerate our investments in critical programs focusing on new technologies and enhancements to existing products.

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 further shrinking of device feature sizes, the transition to copper and other new materials, and the transition to new 300-millimeter fabs. 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

	Three months ended			Nine months ended	
(in millions)	March 31, 2005	December 31, 2004	March 31, 2004	March 31, 2005	March 31, 2004
Selling, general and administrative (‘SG&A’) expenses	$ 76	$ 72	$ 62	$ 218	$ 184
Percentage of total revenues	14%	14%	16%	14%	18%

SG&A expenses increased $4 million or 5% to $76 million during the third quarter of fiscal year 2005 from $72 million during the second quarter of fiscal year 2005. SG&A expenses increased $14 million or 22% to $76 million during the third quarter of fiscal year 2005 from $62 million during the same period in the previous fiscal year. SG&A expenses increased by $34 million or 18% to $218 million during the nine months ended March 31, 2005 from $184 million during the nine months ended March 31, 2004.

The increase in SG&A expenses compared to the prior fiscal year is due to an increase in customer application support, increased staffing, stock based compensation expense and consolidating the results of operations of the entities acquired during the quarter. The entities acquired during this fiscal year contributed $6 million of the increase in SG&A expenses for the nine months ended March 31, 2005 compared to the same period in the prior year. The reduction in selling, general and administrative expenses as a percentage of revenue was driven by our continued focus on cost reduction initiatives and by the increase in revenues. We expect our selling, general and administrative expenses to increase in absolute dollars as we build up our organization to meet increased customer demands.

Restructuring and Other Costs

There were no restructuring actions during fiscal year 2004 or the first nine months of fiscal year 2005. Our restructuring activities are more fully disclosed in Note 3 of Notes to Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended June 30, 2004. The annual estimated cost savings from the restructuring actions incurred prior to fiscal year 2004 was $9 million, of which $7 million related to workforce reductions and $2 million related to consolidation of facilities and was not expected to have a material effect on our cost of goods sold or operating expenses. There were no material variances between the actual and anticipated costs of restructuring. As of June 30, 2004, the remaining accrual balance was $821,000. During the three and nine months ended March 31, 2005, we made lease payments of $167,000 and $475,000, respectively, related to the exited facilities. As of March 31, 2005, the remaining accrual balance of $346,000 is related to lease payments on facilities exited prior to fiscal year 2004 and is expected to be paid by the end of fiscal year 2006.

Interest Income and Other, Net

(in millions)	Three months ended March 31, 2005	Three months ended December 31, 2004	Three months ended March 31, 2004	Nine months ended March 31, 2005	Nine months ended March 31, 2004
Interest income and other, net	$ 7	$ 8	$ 5	$ 22	$ 21
Percentage of total revenues	1%	1%	1%	1%	2%

Interest income and other, net is comprised primarily of interest income earned on the investment and cash portfolio, realized gains or losses on sales of marketable securities, as well as income recognized upon settlement of certain foreign currency contracts.

Provision for Income Taxes

Our effective tax rates for the three months and nine months ended March 31, 2005 were 24.7% and 26.6%, respectively. The nine month effective tax rate of 26.6% includes the reinstatement of the Federal R&D credit, which yielded a benefit of $12.6 million or approximately 2%. The reduction in the tax rate for the current quarter is due to a true-up during the quarter of the fiscal year 2004 tax provision versus the fiscal 2004 federal tax return as completed during the current quarter. Favorable variances between the return and the provision were recognized in the current quarter.

Our effective tax rates for the three and nine months ended March 31, 2004 were 28.6% and 24.9%, respectively. The fiscal 2005 year-to-date tax rate of 26.6% is higher than the prior fiscal year due primarily to higher estimates of pre-tax income for the current fiscal year which reduces the relative benefit of certain items such as tax exempt interest, R&D tax credits and the credit for foreign sales.

Equity Incentive Program

Our equity incentive 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 equity incentive program consists of two plans: one under which non-employee directors may be granted options to purchase shares of our stock, and another in which non-employee directors, officers, key employees, consultants and all other employees may be granted options to purchase shares of our stock, restricted stock units and other types of equity awards. Under our equity incentive program, stock options generally have a vesting period of five years, are exercisable for a period not to exceed ten years from the date of issuance and are generally granted at prices not less than the fair market value of our common stock at the grant date. Restricted stock units may be granted with varying criteria such as time based or performance based vesting. Substantially all of our employees that meet established performance goals and that qualify as Knowledge Employees participate in our main equity incentive plan.

The following table summarizes our equity compensation plans as of March 31, 2005:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights[1]	Weighted-average exercise price of outstanding options, warrants and rights.	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column 1)[2]
Equity compensation plans approved by stockholders	26,105,381	$ 36.61	11,947,055
Equity compensation plans not approved by stockholders	7,936,728	$ 38.24	—
Total	34,042,109	$ 36.99	11,947,055

(1) Amounts shown are for options granted only. There were 266,110 shares of restricted stock units issued under the 2004 Equity Incentive Plan as of March 31, 2005.

(2) Any 2004 equity Incentive Plan awards of restricted stock, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date shall be counted against the total number of shares issuable under the plan as 1.8 shares for every one share subject thereto. Including the restricted stock units issued during the quarter ended March 31, 2005, and applying the 1.8 ratio as required by the 2004 Equity Incentive Plan, the number of shares remaining available for future issuance under our equity compensation plans was 11,947,055 shares as of March 31, 2005.

On October 18, 2004, the Company's stockholders approved the 2004 Equity Incentive Plan (the "Omnibus Plan") which provides for the grant of options to purchase shares of the Company's Common Stock, stock appreciation rights, restricted stock, performance shares, performance units and deferred stock units to our employees, consultants and members of our Board of Directors. This new Plan replaces future grants under the 1982 Stock Option Plan and 2000 Nonstatutory Stock Option Plan and supplements the 1998 Outside Director Option Plan. The shareholder approval included the creation of a reserve establishment of 11,000,000 shares of common stock for use under the plan and the ability to transfer up to an additional 1,500,000 shares of forfeited or expired stock under the 1982 Stock Option Plan and the 2000 Nonstatutory Plan.

During the nine months ended March 31, 2005, the following actions were taken with regard to the New Equity Incentive Plan: a) a reserve of 11,000,000 shares was established, b) 967,565 shares were added to the reserve from the 1982 Stock Option Plan and the 2000 Nonstatutory Plan due to forfeitures or expiration, c) the 1982 Stock Option Plan was terminated; as a result, 11,932,986 shares expired, and d) the 2000 Nonstatutory Plan was terminated; and, as a result, 3,350,660 shares expired.

The following table summarizes the combined activity under the equity incentive plans for the indicated periods:

	Available For Grant	Awards Outstanding	Weighted Average Price
Balances at June 30, 2002	6,144,818	30,089,707	$ 28.60
Additional shares reserved	13,280,928	—	—
Options granted	(4,922,001)	4,922,001	35.26
Options canceled/expired	2,415,973	(2,415,973)	35.16
Options exercised	—	(2,861,777)	20.94
Balances at June 30, 2003	16,919,718	29,733,958	$ 29.94
Additional shares reserved	5,751,033	—	—
Options granted	(6,298,343)	6,298,343	52.09
Options canceled/expired	978,478	(978,478)	38.66
Options exercised	—	(5,357,878)	25.74
Balances at June 30, 2004	17,350,886	29,695,945	$ 35.11
Additional shares reserved	17,871,350	—	—
Plan shares expired	(15,283,646)	—	—
Options granted	(9,233,576)[1]	9,233,576	40.36
Restricted stock units granted[2]	(478,998)	—	—
Options canceled/expired	1,721,039	(1,721,039)	41.82
Options exercised	—	(3,166,373)	26.32
Balances at March 31, 2005	11,947,055	34,042,109	$ 36.99

(1) Employees received options totaling 2,007,283 shares of common stock as an advance on their fiscal year 2006 focal option grants in the first fiscal quarter of 2005. The grant was equivalent to 50% of the employee's fiscal year 2005 stock option grant. These advanced grant options vest on a six year schedule with 20% vesting after year two and the remaining option shares vesting 1/48th per month for the remainder of the vesting term.

(2) Any 2004 equity Incentive Plan awards of restricted stock, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date shall be counted against the total number of shares issuable under the plan as 1.8 shares for every one share subject thereto

During the three months and nine months ended March 31, 2005, our Board of Directors approved the grant of 10,000 and 266,110 shares, respectively, of restricted stock units to selected members of our senior management. These restricted stock units generally vest in two equal installments on the fourth and fifth anniversaries of the date of grant. We recorded the $10.9 million value of these restricted stock unit grants as a component of shareholders' equity and will amortize that amount over the service period. The value of the restricted stock unit awards was based on the closing market price of our common stock on the date of award. Amortization expense for these awards for the three months and nine months ended March 31, 2005 was $748,000 and $1.3 million, respectively, and is included in selling, general and administrative expense. These restricted stock units were included in the calculation of diluted earnings per share utilizing the treasury stock method.

LIQUIDITY AND CAPITAL RESOURCES

(in millions)	March 31, 2005	June 30, 2004	Change
Cash and cash equivalents	$ 806	$ 599	$ 207
Marketable securities	1,302	1,277	25
Total cash, cash equivalents and marketable securities	$ 2,108	$ 1,876	$ 232
Percentage of total assets	53%	53%	

	Nine months ended	
(in millions)	March 31, 2005	March 31, 2004
Cash provided by operating activities	$ 353	$ 153
Cash used in investing activities	(133)	(114)
Cash provided by (used in) financing activities	(22)	122
Effect of exchange rate changes on cash and cash equivalents	9	9
Net increase in cash and cash equivalents	$ 207	$ 170

We have historically financed our operations through cash generated from operations. Net cash provided by operating activities during the nine months ended March 31, 2005 consisted primarily of $362 million provided by net income, adjusted for $53 million of non-cash depreciation and amortization, an increase in other current liabilities of $70 million and partially offset by an increase in net accounts receivable balances by $69 million, an increase in inventory balances by $14 million, an increase in other asset balances by $40 million and a decrease in deferred profit balances by $13 million.

Net cash provided by investing activities during the nine months ended March 31, 2005 consisted primarily of proceeds from the sale of marketable securities of $1.5 billion, proceeds from the maturity of marketable securities of $265 million partially offset by purchases of marketable securities of $1.8 billion, net purchases of property, plant and equipment of $54 million and acquisitions of business, net of cash received of $45 million.

Net cash used in financing activities during the nine months ended March 31, 2005 primarily consisted of stock repurchases of $135 million offset by proceeds from the issuance of common stock of $103 million and proceeds from the sale of a minority interest in a subsidiary of $10 million.

The following is a schedule summarizing our significant operating lease commitments as of March 31, 2005 (in millions):

	Payments Due by Fiscal Year						
	Total	2005(1)	2006	2007	2008	2009	Thereafter
Operating leases	$ 24.8	$ 2.3	$ 7.2	$ 4.0	$ 3.2	$ 2.9	$ 5.2

(1) Remaining 3 months

We have agreements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. During the three months ended March 31, 2005 and 2004, approximately $62 million and $37 million of receivables were sold under these arrangements, respectively. During the nine months ended March 31, 2005 and 2004, approximately $172 million and $98 million of receivables were sold under these arrangements, respectively. We do not believe that we are at risk for any material losses as a result of these agreements.

In addition, from time to time we will discount without recourse, Letters of Credit ("LCs") received from customers in payment of goods. No LCs were sold during the three months ended March 31, 2005. During the three months ended March 31, 2004, several LCs were sold with proceeds totaling $7 million. Discounting fees were $12,000 for the three months ended March 31, 2004. During the nine months ended March 31, 2005 and 2004, several LCs were sold with proceeds totaling $10 million and $33 million. Discounting fees were $44,000 and $201,000 for the nine months ended March 31, 2005 and 2004, respectively.

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 among different suppliers. We estimate our open inventory purchase commitment as of March 31, 2005 to be approximately $110 million. Actual expenditures will vary based upon the volume of the transactions and length of contractual service provided. In addition, the amounts paid under these arrangements may be less in the event that the arrangements are renegotiated or cancelled. Certain agreements provide for potential cancellation penalties.

During the quarter ended March 31, 2005, our Board of Directors approved the initiation of a quarterly cash dividend and declared a dividend of 12 cents per share of our outstanding common stock, payable on June 1, 2005 to our stockholders of record on May 2, 2005. The total amount of dividend payable during the fourth quarter of fiscal year 2005 is approximately $24 million.

During the quarter ended March 31, 2005, our Board of Directors also authorized the repurchase of an additional ten million shares of common stock under our ongoing stock repurchase program.

Working capital increased to $2.3 billion as of March 31, 2005, compared to $1.3 billion at June 30, 2004. 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, we believe that cash generated from operations, together with the liquidity provided by existing cash balances, will be sufficient to satisfy our liquidity requirements for at least the next twelve months.

CRITICAL ACCOUNTING ESTIMATES

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us 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 help 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 our critical accounting estimates as described in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004. For the nine months ended March 31, 2005, there were no changes to these critical accounting estimates.

FACTORS AFFECTING RESULTS, INCLUDING RISKS AND UNCERTAINTIES

Fluctuations in Operating Results and Stock Price

Our operating results and stock price have varied widely in the past, and our future operating results will continue to be subject to quarterly variations based upon numerous factors, including those listed in this section and throughout this Quarterly Report on Form 10-Q. Our stock price will continue to be subject to daily variations as well. In addition, our future operating results and stock price may not follow any past trends. We believe the factors that could make our results fluctuate and difficult to predict include:

- our ability to successfully implement new systems;
- the cyclical nature of the semiconductor industry;
- global economic uncertainty;
- changing international economic conditions;
- competitive pressure;
- our ability to develop and implement new technologies and introduce new products;
- our ability to comply with internal controls evaluations and attestation requirements;
- our customers' acceptance and adoption of our new products and technologies;
- our ability to maintain supply of key components;
- our ability to manage our manufacturing requirements;
- our reliance on services provided by third parties;
- our ability to protect our intellectual property;
- our ability to attract, retain, and replace key employees;
- our ability to manage risks associated with acquisitions;
- litigation;
- worldwide political instability;
- recently enacted and proposed changes in securities laws and regulations;
- earthquake and other uninsured risks;
- future changes in accounting and tax standards or practices;
- changing regulatory environment;
- our exposure to fluctuations in foreign currency exchange rates; and
- our ability to guard against computer viruses

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 revenue, 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.

Implementation of New Systems

We may experience difficulties with our new enterprise resource planning (“ERP”) system implemented as of February 7, 2005 that could disrupt our ability to timely and accurately process and report key components of the results of our consolidated operations, our financial position and cash flows. Any disruptions or difficulties that may occur in connection with this new ERP system or any future systems could also adversely affect our ability to complete the evaluation of our internal controls and attestation activities pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. System failure or malfunctioning may result in disruption of operations and the inability to process transactions and could adversely affect our financial results. If we encounter unforeseen problems with regard to system operations or the new ERP system, we could be adversely affected.

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.

Global Economic Uncertainty

Our business is ultimately driven by the global demand for electronic devices by consumers and businesses. The picture of end-user demand has been mixed over the last few months and visibility has been reduced as a result of high oil prices, the continued threat of terrorist activities and political instability in certain regions of the world. A protracted global economic slowdown may adversely affect our business and results of operations.

International Trade, Operations and Economic Conditions

We serve an increasingly global market. A majority of our annual revenue is derived from outside the United States, and we expect that international revenue will continue to represent a substantial percentage of our revenue. Our international revenue and operations are affected by economic conditions specific to each country and region. Because of our significant dependence on international revenue, 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 or terrorism in regions where we have operations along with 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 us. 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 service 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, similar to what we offer, using innovative technology to sell products into specialized markets. Loss of competitive position could negatively affect our prices, customer orders, revenue, 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, in the current semiconductor industry, the size of semiconductor devices continues to shrink, there is a transition to copper and other new materials, and a transition to new 300-millimeter fabs. While we expect these trends will increase our customers' reliance on our diagnostic products, we cannot ensure that they will directly improve our business. 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 staffing of highly qualified employees. 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 revenue 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 the market in which we operate does not accept our products.

Our independent registered public accounting firm's ability to attest on the adequacy of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002.

The Securities and Exchange Commission, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal controls over financial reporting in their annual reports on Form 10-K that contain an assessment by management of the effectiveness of the Company's internal controls over financial reporting. In addition, the Company's independent registered public accounting firm must attest to and report on management's assessment of the effectiveness of the internal controls over financial reporting. This requirement will first apply to our Annual Report on Form 10-K for the fiscal year ending June 30, 2005. Although we intend to diligently and vigorously review our internal controls over financial reporting in order to ensure compliance with the Section 404 requirements, if our independent registered public accounting firm is not satisfied with our internal controls over financial reporting or the level at which these controls are documented, designed, operated or reviewed, or if the independent registered public accounting firm interprets the requirements, rules and/or regulations differently from us, then they may decline to attest to management's assessment or may issue a report that is qualified. This could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price.

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 these 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

Most of our manufacturing facilities are located in the United States, with a small operation located in Israel. Operations at our manufacturing facilities and our assembly subcontractors are subject to disruption for a variety of reasons, including work stoppages, acts of war, terrorism, fire, earthquake, energy shortages, flooding or other natural disasters. 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 disruption could result in cancellation of orders or loss of customers and could seriously harm our business. We currently are in the initial stages of design and implementation of a new integrated financial and supply chain management system. Disruptions or delays in making changes to our integrated financial and supply chain management system could adversely impact our operations and our ability to forecast sales demand, ship products, manage our product inventory and record and report financial and management information on a timely and accurate basis.

Reliance on services provided by third parties

We outsource a number of services including our transportation and logistics management of spare parts to domestic and overseas third party service providers. While outsourcing arrangements may lower our cost of operations, they also reduce our direct control over the services rendered. It is uncertain what effect such diminished control will have on the quality or quantity of products delivered or services rendered, or our ability to quickly respond to changing market conditions. Disruptions or delays at our third-party service providers due to events such as regional economic, business, environmental, political, informational technology system failures, or military actions could adversely impact our operations and our ability to ship products, manage our product inventory and record and report financial and management information on a timely and accurate basis.

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 and obtain patents relating to our technology that are similar or superior to our technology or may design around the patents we own, adversely affecting our business.

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, or instigation of litigation or other administrative proceedings 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.

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 alleging 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.

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 adversely affect 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 terrorist attacks, and the continuing instability in the Middle East, may hinder our ability to do business and may increase our costs of operations. Such continuing instability could cause us to incur increased costs in transportation, make such transportation unreliable, increase our 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. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.

Recently enacted and proposed changes in securities laws and regulations

Recently enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002, will increase our expenses as we evaluate the implications of new rules and devote resources to respond to the new requirements. Sarbanes-Oxley Act mandates, among other things, that companies adopt new corporate governance measures and imposes comprehensive reporting and disclosure requirements, sets stricter independence and financial expertise standards for audit committee members and imposes increased civil and criminal penalties for companies, their chief executive officers and chief financial officers and directors for securities law violations. In particular, we expect to incur additional administrative expense as we implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our Independent Registered Public Accounting Firm to attest to, our internal controls. In addition, The Nasdaq National Market, on which our common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management's attention from business operations. We also expect these developments to make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficultly attracting and retaining qualified board members and executive officers, which would adversely affect our business.

Earthquake and Other Uninsured Risks

We purchase insurance to help mitigate the economic impact of certain insurable risks, however, certain other risks are uninsurable or are insurable only at significant costs and cannot be mitigated with insurance. An earthquake could significantly disrupt our manufacturing operations, most of which are conducted in California. It could also significantly delay our research and engineering effort on new products, most of which is also conducted in California. We take steps to minimize the damage that would be caused by an earthquake, but there is no certainty that our efforts will prove successful in the event of an earthquake. We self insure earthquake risks because we believe this is the prudent financial decision based on our large cash reserves and the high cost and limited coverage available in the earthquake insurance market. Certain other risks are also self insured either based on a similar cost benefit analysis, or based on the unavailability of insurance. If one or more of the uninsured events occurs, we could suffer major financial loss.

Future Changes in Accounting and Taxation Standards or Practices

A change in accounting standards or practices or a change in existing taxation rules or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practice have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

For example, the adoption of SFAS No. 123(R) which would require us to measure all employee stock-based compensation awards using a fair value method beginning in fiscal year 2006 and record such expense in our consolidated financial statements will have a material impact on our consolidated financial statements as reported under generally accepted accounting principles in the United States.

Exposure to various risks related to the regulatory environment.

We are subject to various risks related to new, different, inconsistent or even conflicting laws, rules and regulations that may be enacted by legislative bodies and/or regulatory agencies in the countries in which we operate and with which we must comply.

Exposure to fluctuations in foreign currency exchange rates

We have some exposure to fluctuations in foreign currency exchange rates. We have international subsidiaries that operate and sell our products globally. We routinely hedge these exposures in an effort to minimize the impact of currency fluctuations. However, we may still be adversely affected by changes in foreign currency exchange rates or declining economic conditions in these countries.

Computer viruses may disrupt our operations

Despite our implementation of network security measures, our tools and servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems and tools located at customer sites. Any such event could have an adverse effect on our business, operating results, and financial condition.

Effects of Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-Based Payment.” SFAS No. 123(R) would require us to measure all employee stock-based compensation awards using a fair value method and record such expense in our consolidated financial statements. In March 2005, the SEC issued SAB 107, which provides the Staff’s views regarding interactions between SFAS No. 123(R) and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies.

We are currently evaluating FAS 123R and SAB 107 to determine the fair value method to measure compensation expense, the appropriate assumptions to include in the fair value model, the transition method to use upon adoption and the period in which to adopt the provisions of FAS 123R. SFAS No. 123(R) is effective for us beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 123(R) will have a material impact on our consolidated results of operations, financial position and statement of cash flows.

In March 2005, the FASB published FASB Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations,” which clarifies that the term, conditional asset retirement obligation, as used in SFAS No. 143, “Accounting for Asset Retirement Obligations,” refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. The interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This interpretation is effective no later than the end of the Company’s fiscal 2006. The adoption of this Interpretation is not expected to have a material effect on the our consolidated financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for us for nonmonetary asset exchanges beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 153 is not expected to have a material effect on the our consolidated financial position or results of operations.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004. The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. The Company has yet to complete its evaluation of the Foreign Earnings Repatriation Provision. However, at this time it is not anticipated that the Provision will result in a material impact on the Company’s effective rate.

In November 2004, the FASB issued SFAS No. 151, “Inventory Costs, an amendment of ARB No. 43, Chapter 4”. SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period charges. The provisions of SFAS No.151 are effective for the fiscal year beginning July 1, 2005. The adoption of SFAS No. 151 is not expected to have a material impact on the our consolidated financial position, results of operations and cash flows.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on recognition and measurement guidance previously discussed under EITF 03-1. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method. In September 2004, the Financial Accounting Standards Board approved the issuance of a FASB Staff Position to delay the requirement to record impairment losses under EITF 03-1. The approved delay applies to all securities within the scope of EITF 03-1. The Company will evaluate the impact of EITF 03-1 once the final guidance is issued.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES 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 March 31, 2005. Actual results may differ materially.

As of March 31, 2005, we had an investment portfolio of fixed income securities of $1.3 billion, excluding those classified as cash and cash equivalents. 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 March 31, 2005, the fair value of the portfolio would have declined by $5 million.

As of March 31, 2005, we had net forward contracts to sell $329 million in foreign currency in order to hedge currency exposures (see Note 12 of the Notes to the Condensed Consolidated Financial Statements under "Derivative Instruments"). If we had entered into these contracts on March 31, 2005, the U.S. dollar equivalent would be $321 million. A 10% adverse move in all currency exchange rates affecting the contracts would decrease the fair value of the contracts by $47 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 net income or cash flows.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures and Related CEO and CFO Certifications

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (Disclosure Controls) as of the end of the period covered by this Quarterly Report. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Based on this evaluation, our CEO and our CFO have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Attached as exhibits to this Quarterly Report are certifications of the CEO and the CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (Exchange Act). This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Definition of Disclosure Controls

Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our Disclosure Controls include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the U.S. To the extent that components of our internal control over financial reporting are included within our Disclosure Controls, they are included in the scope of our quarterly controls evaluation.

Limitations on the Effectiveness of Controls

The Company's management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in internal controls over financial reporting

The changes in our internal controls over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting consisted of the implementation of a new enterprise resource planning system and related control processes.

PART II. OTHER INFORMATION

ITEM 1. 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.

Legal Matters

ADE Corporation

On October 11, 2000, ADE Corporation ("ADE"), a competitor, filed a patent infringement lawsuit against us 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. 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 was consolidated with the prior action in the Delaware proceeding and ADE amended its complaint in that proceeding to allege that we are infringing the '259 patent. KLA-Tencor and ADE have reached final settlement of this litigation during the quarter ended March 31, 2005. The terms of the settlement are confidential. All of the litigation between ADE and KLA-Tencor is now dismissed.

This legal matter did not have a material effect on our consolidated financial position or results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Following is a summary of stock repurchases for the quarter ended March 31, 2005.[1]

Period	Total Number of Shares (or Units) Purchased[2]	Average Price Paid per Share (or Unit)	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs[3]
January 1, 2005 to January 31, 2005	265,000	$ 44.12	218,000
February 1, 2005 to February 28, 2005	93,000	$ 48.08	10,125,000 (2)
March 1, 2005 to March 31, 2005	175,000	$ 46.53	9,950,000
Total	533,000	$ 45.60	

(1) In July 1997, the Board of Directors authorized KLA-Tencor to systematically repurchase shares of its common stock in the open market. This program was entered in order to reduce the dilution from KLA-Tencor's employee benefit and incentive plans such as the stock option and employee stock purchase plans. Since the inception of the repurchase program in 1997 through March 31, 2005 the Board of Directors had authorized KLA-Tencor to repurchase a total of 27.8 million shares. All such shares remain as treasury shares.

(2) All shares were purchased pursuant to the program publicly announced in July 1997 and as extended by the Board of Directors most recently in February 2005 by an additional 10.0 million shares.

(3) The stock repurchase program has no expiration date. We intend to continue making further purchases under the stock repurchase program.

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer under Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of Chief Financial Officer under Rule 13a-14(a) of the Securities Exchange Act of 1934.

32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

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)

May 9, 2005	/s/ KENNETH L. SCHROEDER
(Date)	**Kenneth L. Schroeder** **President and Chief Executive Officer** **(Principal Executive Officer)**
May 9, 2005	/s/ JOHN H. KISPERT
(Date)	**John H. Kispert** **Executive Vice President** **and Chief Financial Officer** **(Principal Accounting Officer)**

KLA-TENCOR CORPORATION
EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit Number	Filing Date
3.1	Amended and Restated Certificate of Incorporation	10-Q	No. 000-09992	3.1	May 14, 1997
3.2	Certificate of Amendment of Amendment and Restated Certificate of Incorporation	10-Q	No. 000-09992	3.1	February 14, 2001
3.3	Bylaws, as amended November 17, 1998	S-8	No. 333-68415	3.2	December 4, 1998
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	8-A/A, Amendment No. 2	No. 0-9992	1	September 24, 1996
10.1	1998 Outside Director Option Plan*	S-8	No. 333-68423	10.1	December 4, 1998
10.2	1997 Employee Stock Purchase Plan*	S-8	No. 333-45271	10.2	January 30, 1998
10.3	Tencor Instruments Amended and Restated 1993 Equity Incentive Plan	S-8	No. 333-22939	10.75	March 7, 1997
10.4	Restated 1982 Stock Option Plan, as amended November 18, 1996*	S-8	No. 333-22941	10.74	March 7, 1997
10.5	Excess Profit Stock Plan*	S-8	No. 333-60883	10.15	August 7, 1997
10.6	Form of KLA-Tencor Corporation Corporate Officers Retention Plan*	S-4	No. 333-23075	10.2	March 11, 1997
10.7	Form of Indemnification Agreement*	10-K	No. 000-09992	10.3	September 29, 1997
10.8	Livermore Land Purchase and Sale Agreement	10-K	No. 000-09992	10.16	September 28, 2000

10.9	Severance Agreement and General Release	10-K	No. 000-09992	10.9	August 30, 2004
10.10	2004 Equity Incentive Plan*	Proxy	No. 000-09992	Appendix A	September 9, 2004
10.11	Form of Option Agreement under 1998 Outside Director Option Plan*	8-K	No. 000-09992	10.1	October 18, 2004
10.12	Blue29 Corporation 2003 Stock Incentive Plan*	S-8	No. 333-120218	10.1	November 4, 2004
10.13	Agreement by and between KLA-Tencor Corporation and Kenneth L. Schroeder*	8-K	No. 000-09992	10.1	February 23, 2005
31.1	Certification of Chief Executive Officer under Rule 13a-14(a) of the Securities Exchange Act of 1934				
31.2	Certification of Chief Financial Officer under Rule 13a-14(a) of the Securities Exchange Act of 1934				
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350				

* Denotes a management contract, plan or arrangement

Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Kenneth L. Schroeder certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over the financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 9, 2005

(Date)

/s/ KENNETH L. SCHROEDER

Kenneth L. Schroeder
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, John H. Kispert certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over the financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 9, 2005	/s/ JOHN H. KISPERT
(Date)	**John H. Kispert** **Executive Vice President and Chief Financial Officer** **(Principal Accounting Officer)**

Exhibit 32

CERTIFICATION OF CHIEF EXECUTIVE 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 Quarterly Report of KLA-Tencor Corporation on Form 10-Q for the fiscal quarter ended March 31, 2005 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 Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of KLA-Tencor Corporation.

May 9, 2005	By:	/s/ KENNETH L. SCHROEDER
Dated	Name:	**Kenneth L. Schroeder**
	Title:	**President and Chief Executive Officer**

CERTIFICATION OF 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 Quarterly Report of KLA-Tencor Corporation on Form 10-Q for the fiscal quarter ended March 31, 2005 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 Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of KLA-Tencor Corporation.

May 9, 2005	By:	/s/ JOHN H. KISPERT
Dated	Name:	**John H. Kispert**
	Title:	**Executive Vice President and Chief Financial Officer**