

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

FORM 10-Q

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

For the quarterly period ended December 31, 2000

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  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

04-2564110  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

160 Rio Robles  
San Jose, California 95134

(Address of principal executive offices, including 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 Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
registrant was required to file such reports), and (2) has been subject to such  
filing requirements for the past 90 days.

Yes  No

As of January 31, 2001, there were 184,457,114 shares outstanding of the  
Registrant's Common Stock, \$0.001 par value.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KLA-TENCOR CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

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(in thousands)	June 30, 2000	December 31, 2000
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 478,212	\$ 301,999
Short-term investments	119,932	96,720
Accounts receivable, net	481,950	604,921
Inventories	282,489	386,834
Other current assets	189,171	194,705
	-----	-----
Total current assets	1,551,754	1,585,179
Land, property and equipment, net	199,719	248,438
Marketable securities	366,239	417,894
Other assets	85,791	92,888
	-----	-----
Total assets	\$2,203,503	\$2,344,399
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 55,016	\$ 61,185
Other current liabilities	439,811	492,332
	-----	-----
Total current liabilities	494,827	553,517
	-----	-----
Stockholders' equity:		
Common stock and capital in excess of par value	718,165	596,152
Retained earnings	976,846	1,191,970
Accumulated other comprehensive income	13,665	2,760
	-----	-----
Total stockholders' equity	1,708,676	1,790,882
	-----	-----
Total liabilities and stockholders' equity	\$2,203,503	\$2,344,399
	=====	=====

</TABLE>

See accompanying notes to condensed consolidated financial statements.

KLA-TENCOR CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

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	Three months ended December 31,		Six months ended December 31,	
	1999	2000	1999	2000
(In thousands, except per share data)				
<S>	<C>	<C>	<C>	<C>
Revenues	\$330,757	\$573,056	\$ 603,746	\$1,107,646
Costs and operating expenses:				
Costs of goods sold	153,373	244,436	289,490	472,512
Engineering, research and development	55,624	96,229	102,342	176,877
Selling, general and administrative	60,148	94,508	113,562	185,405
Non-recurring acquisition, restructuring and other charges	62	--	(5,938)	--
Total costs and operating expenses	269,207	435,173	499,456	834,794
Income from operations	61,550	137,883	104,290	272,852
Interest income and other, net	6,850	13,931	19,556	25,933
Income before income taxes	68,400	151,814	123,846	298,785
Provision for income taxes	19,151	42,508	35,095	83,661
Net income	\$ 49,249	\$109,306	\$ 88,751	\$ 215,124
Earnings per share:				
Basic	\$ 0.27	\$ 0.59	\$ 0.49	\$ 1.16
Diluted	\$ 0.26	\$ 0.57	\$ 0.47	\$ 1.11
Weighted average number of shares:				
Basic	180,607	185,247	179,307	186,101
Diluted	190,780	190,893	189,352	193,449

</TABLE>

See accompanying notes to condensed consolidated financial statements.

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KLA-TENCOR CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

<TABLE>  
<CAPTION>

	Six Months Ended December 31,	
	1999	2000
(in thousands)		
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 88,751	\$ 215,124
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,525	29,224
Deferred income taxes	(321)	2,378
Restructuring charges	(7,838)	--
Non-recurring acquisition charges	1,900	--
Net gain on sale of marketable securities	(3,323)	(3,880)
Changes in assets and liabilities:		
Accounts receivable, net	(15,778)	(136,464)
Inventories	(26,128)	(107,787)
Other assets	(61,350)	(13,135)
Accounts payable	1,764	6,709
Other current liabilities	56,363	53,058
Net cash provided by operating activities	62,565	45,227
Cash flows from investing activities:		
Purchase of property and equipment, net	(25,642)	(75,903)
Acquisition of assets and technology	(6,900)	--
Purchase of available for sale securities	(337,155)	(415,143)
Proceeds from sale of available for sale securities	362,422	381,226

Net cash used in investing activities	(7,275)	(109,820)
Cash flows from financing activities:		
Issuance of common stock, net	54,690	30,694
Stock repurchases	(7,565)	(149,561)
Net borrowings (payments) under short term debt obligations	(2,729)	1,070
Net cash provided by (used in) financing activities	44,396	(117,797)
Effect of exchange rate changes on cash and cash equivalents	(16,256)	6,177
Net increase (decrease) in cash and cash equivalents	83,430	(176,213)
Cash and cash equivalents at beginning of period	271,488	478,212
Cash and cash equivalents at end of period	\$ 354,918	\$ 301,999
Supplemental cash flow disclosures:		
Income taxes paid, net of refunds	\$ 2,039	\$ 87,594
Interest paid	\$ 166	\$ 410

</TABLE>

See accompanying notes to condensed consolidated financial statements.

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KLA-TENCOR CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

NOTE 1 -- 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 generally accepted accounting principles 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 presentation 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 the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000, filed with the SEC on September 28, 2000.

The results of operations for the three- and six- month periods ended December 31, 2000 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, 2001.

Certain items previously reported in specific financial statement captions have been reclassified to conform to the presentation of the three- and six-month periods ended December 31, 2000.

NOTE 2 - INVENTORIES

Inventories are stated at the lower of cost (on a first-in, first-out basis) or market. The components of inventories are as follows:

<TABLE>  
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(in thousands)	June 30, 2000	December 31, 2000
	-----	-----
<S>	<C>	<C>
Inventories		
Customer service parts	\$ 54,442	\$ 72,066
Raw materials	83,103	136,748
Work-in-process	82,922	101,713
Demonstration equipment	50,817	56,762
Finished goods	11,205	19,545
	-----	-----
	\$282,489	\$386,834

</TABLE>

NOTE 3 -- STOCK REPURCHASE PROGRAM

The Company has adopted a plan to repurchase shares of its Common Stock on the open market for the purpose of partially offsetting dilution created by employee stock options and stock purchase plans. During the six-month period ended December 31, 2000, the Company repurchased 4,450,000 shares of its Common Stock at a cost of approximately \$150 million.

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NOTE 4 -- COMPREHENSIVE INCOME

The components of comprehensive income, net of tax, are as follows:

<TABLE>  
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(in thousands)	Three months ended December 31,		Six months ended December 31,	
	1999	2000	1999	2000
Net Income	\$ 49,249	\$ 109,306	\$ 88,751	\$ 215,124
Other comprehensive income (loss)				
Change in unrealized gain on investments, net	(1,420)	(1,556)	(4,994)	(5,058)
Currency translation adjustments	1,344	(3,986)	3,572	(5,847)
Other comprehensive loss	(76)	(5,542)	(1,422)	(10,905)
Total Comprehensive Income	\$ 49,173	\$ 103,764	\$ 87,329	\$ 204,219

</TABLE>

NOTE 5 -- EARNINGS PER SHARE

Basic earnings per share has been determined using the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share has been determined in the same manner but also includes all dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consisted of stock options.

During the three- and six-month periods ended December 31, 1999, options to purchase 94,900 and 83,430 shares at an average exercise price of \$46.30 and \$44.60, respectively, were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price of the common stock for the period. During the three- and six-month periods ended December 31, 2000, options to purchase 10,875,333 and 4,580,198 shares at an average exercise price of \$43.22 and \$46.32, respectively, were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price of the common stock for the period.

The reconciling difference between the computation of basic and diluted earnings per share for the periods presented is the inclusion of the dilutive effect of stock options issued to employees under employee stock option plans.

NOTE 6 -- NONRECURRING ACQUISITION, RESTRUCTURING AND OTHER COSTS

ACQUISITIONS

On November 30, 1999, KLA-Tencor acquired software developer ACME Systems, Inc. ("ACME"). ACME is a leading supplier of yield engineering analysis software used to correlate parametric electrical test and wafer sort yield data with in-line Work In Process (WIP) and Metrology data. The acquisition was accounted for as a purchase. Accordingly, the estimated fair value of assets acquired and liabilities assumed were in KLA-Tencor's condensed consolidated balance sheet as of December 31, 1999 and the results of operations from November 30, 1999 through December 31, 1999 were included in the Company's condensed consolidated statement of operations.

KLA-Tencor acquired ACME for a total of \$6.9 million in cash. The total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed based on management estimates.

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The in-process research and development charge of \$1.9 million was determined by KLA-Tencor management, utilizing valuation methodologies approved by the SEC. However, there can be no assurance that the SEC will not take issue with assumptions used in KLA-Tencor's valuation model and require KLA-Tencor to revise the amount allocated to in-process research and development.

To determine the value of the in-process technology, the expected future cash flow attributable to the in-process technology was discounted, taking into account the percentage of completion, utilization of pre-existing technology, risks related to the characteristics and applications of the technology, existing and future markets, and technological risk associated with completing the development of the technology. The valuation approach used was a form of discounted cash flow approach commonly known as the "percentage of completion" approach whereby the cash flows from the technology are multiplied by the percentage of completion of the in-process technology.

#### RESTRUCTURING AND OTHER CHARGES

During the three- and six-month periods ended December 31, 1999, KLA-Tencor management determined that \$1.8 million and \$7.8 million of a \$35.0 million restructuring reserve established in November 1998 would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for the Company's products. Accordingly, the restructuring reserve reversal was included in the determination of income from operations for the three- and six-month periods ended December 31, 1999.

#### NOTE 7 -- COMMITMENTS AND CONTINGENCIES

The Company is currently party to various legal proceedings, including those outlined in Part II, Item 1, "Legal Proceedings," in this Quarterly Report on Form 10-Q. While management currently believes the ultimate outcome of these proceedings, both individually and in the aggregate, will not have a material adverse effect on the Company's financial position or operating results, the results of complex legal proceedings are difficult to predict. However, the Company believes that it has defenses in each of the pending claims and is vigorously contesting each of these matters.

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

On July 1, 2000, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Hedging Activities -- An Amendment of FASB Statement No. 133." SFAS No. 133 requires that all derivatives, including foreign currency exchange contracts, be recognized on the balance sheet at fair value. Derivatives that are not hedges must be recorded at fair value through earnings. If a derivative is a qualifying hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of the underlying assets or liabilities through earnings or recognized in Accumulated other comprehensive income until the underlying hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is to be immediately recognized in earnings.

Currently, the Company only uses fair value hedges. In accordance with the transition provisions of SFAS No. 133, the Company recorded the fair value of derivatives designated as fair value hedges on the balance sheet with an offset to earnings. The Company also recorded the change in the fair value of the hedged firm commitments on the balance sheet with an offset to earnings. The net impact on the Company's financial statements of the adjustment for fair value hedges was not material.

DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES The Company's activities expose it to a variety of market risks, including the effects of changes in foreign currency exchange rates and interest rates. The financial exposures are monitored and managed by the Company as an integral part of its

overall risk management program. The Company's risk management program seeks to reduce the potentially adverse effects that the volatility of the markets may have on its operating results.

The Company maintains a foreign currency risk management strategy that uses derivative instruments to protect its interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates.

By using derivative financial instruments to hedge exposures to changes in exchange rates, the Company exposes itself to credit risk and market risk. The Company manages exposure to counterparty credit risk by entering into derivative financial instruments with highly rated institutions that can be expected to fully perform under the terms of the agreement. Market risk is the

adverse effect on the value of a financial instrument that results from a change in currency exchange rates. The Company manages exposure to market risk associated with foreign exchange contracts by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Company enters into 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. The Company attempts to match the forward contracts with the underlying items being hedged in terms of currency, amount and maturity. These forward contracts have a duration of no longer than one year.

ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES All derivatives are recognized on the balance sheet at their fair value. Changes in the fair value of a derivative that is highly effective as a fair value hedge, along with the gain or loss on the hedged asset or liability are recorded in current period Interest income and other, net.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge items. This process includes linking all derivatives that are designated as fair value to specific assets and liabilities on the balance sheet. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the fair value of hedged items.

The Company discontinues hedge accounting prospectively when (1) it is determined that a derivative is no longer effective in offsetting changes in the fair value of a hedged item; (2) the derivative expires or is sold, terminated, or exercised or (3) the derivative is discontinued as a hedge instrument, because it is unlikely that a transaction will occur. For the three- and six-month periods ending December 31, 2000, the amount of hedge ineffectiveness and the gain on hedged commitments no longer qualifying as fair value hedges was immaterial.

When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be carried on the balance sheet at its fair value. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the derivative will continue to be carried on the balance sheet at its fair value, and gains and losses that were accumulated in other comprehensive earnings are recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the balance sheet, with changes in its fair value recognized in current period earnings.

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#### NOTE 9 -- RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2000, the SEC issued Staff Accounting Bulletin ("SAB") No. 101B, "Second Amendment: Revenue Recognition in Financial Statements." SAB No. 101B amends SAB No. 101 "Revenue Recognition in Financial Statements," to defer the implementation date of SAB No. 101 for registrants until no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. SAB No. 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements of all public companies. The Company is required to adopt SAB No. 101 in the fourth quarter of its fiscal year ending June 30, 2001. Accordingly, any shipments previously reported as revenue, including revenue reported for the first three quarters of fiscal 2001, that do not meet SAB No. 101's guidance will be recorded as revenue in future periods. Changes in the Company's revenue recognition policy resulting from the interpretation of SAB No. 101 would not involve the restatement of prior fiscal year statements but would, to the extent applicable, be reported as a change in accounting principle in the fiscal year ending June 30, 2001, with the appropriate restatement of interim periods as required by SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements." The Company's reported results of operations for the 12 months ending June 30, 2001 will include a cumulative adjustment for all prior annual and interim periods as if SAB No. 101 had been adopted on July 1, 2000. Management believes that SAB Nos. 101 and 101B, to the extent that they impact the Company, will not affect the underlying strength or weakness of the Company's business operations as measured by the dollar value of the Company's product shipments and cash flows.

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## FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements. 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. Such forward-looking statements include, among others, those statements regarding our future financial results; the future results of our operations; technological trends in the semiconductor industry; our future product offerings and product features; anticipated revenue from various domestic and international regions; success of our product offerings; completion of backlog; creation of development and engineering programs for research and development; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions; the outcome of any litigation to which we are a party; results of our investment in leading edge technologies, enhancements of current products and strategic acquisitions; our future income tax rate; sufficiency of our existing cash balance, investments and cash generated from operations to meet our liquidity and working capital requirements; and the effects of hedging transactions.

Our actual results may differ significantly from those projected in the forward-looking statements in this report. The following discussion and analysis should be read in conjunction with the section entitled "Factors Affecting Results, Including Risks and Uncertainties," as well as the condensed consolidated financial statements and the notes thereto included in Item 1 in this Quarterly Report, our most recent Annual Report on Form 10-K filed by the Company with the SEC, and our other filings with the SEC made from time to time.

## RESULTS OF OPERATIONS

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

Revenues were \$573 million and \$1,108 million for the three- and six-month periods ended December 31, 2000, compared to \$331 million and \$604 million for the same periods of the prior fiscal year, representing an increase of 73% and 83% for the respective periods. We experienced increased revenues across nearly all product lines as a result of the increased capital spending by major semiconductor manufacturers.

Gross margins as a percentage of revenues were 57% for both the three- and six-month periods ended December 31, 2000, compared to 54% and 52% for the same periods in the prior fiscal year. Gross margins increased primarily due to increased capacity utilization resulting from higher unit volume, as well as faster growth of higher margin product revenue compared to lower margin service revenue.

Engineering, research and development ("R&D") expenses were \$96 million and \$177 million for the three- and six-month periods ended December 31, 2000, compared to \$56 million and \$102 million for the same periods in the prior fiscal year. As a percentage of revenues, R&D expenses were 17% and 16% for the three- and six-month periods ended December 31, 2000, compared to 17% for the same periods in the prior fiscal year. The aggregate amount for R&D investment increased, representing our continued commitment to product development in new and emerging market segments and enhancements to existing products for 0.13 micron, copper development and 300mm wafers.

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Selling, general and administrative expenses were \$95 million and \$185 million for the three- and six-month periods ended December 31, 2000, compared to \$60 million and \$114 million for the same periods in the prior fiscal year. As a percentage of revenues, selling, general and administrative expenses were 16% and 17% for the three- and six-month periods ended December 31, 2000, compared to 18% and 19% for the same periods in the prior fiscal year. Aggregate selling, general and administrative expenses increased, but at a slower rate than the increase in revenues. The aggregate increase was primarily due to increases in our sales and marketing infrastructure and the high level of new product activity during the last six months.

During the three- and six-month periods ended December 31, 1999, we determined that \$1.8 million and \$7.8 million of a \$35 million restructuring reserve established in November 1998 would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for our products. Accordingly, the restructuring reserve reversal was included in the determination of income from operations for the three- and six-month periods ended December 31, 1999.

Non-recurring acquisition charges were \$1.9 million for the three-month period ended December 31, 1999, as a result of the acquisition of ACME Systems,



Inc. Accordingly, the non-recurring acquisition charge was included in the determination of income from operations for the three- and six-month periods ended December 31, 1999.

Interest income and other, net, was \$14 million and \$26 million for the three- and six-month periods ended December 31, 2000, compared to \$7 million and \$20 million in the same periods in the prior fiscal year. The increase was due to gains realized on sales of marketable securities and settlements of certain foreign currency contracts.

Our effective tax rate for the three- and six-month periods ended December 31, 2000 was 28% on pretax income. This rate is consistent with the effective rate applied to income from operations excluding the impact of non-recurring acquisition, restructuring and other charges during the same periods in the prior fiscal year. The tax rate on the restructuring reserve reversal in the three- and six-month periods ended December 31, 1999 was 35%, which is consistent with the tax rate applied when the restructuring reserve was recorded during the three-month period ended December 31, 1998. We anticipate an overall tax rate of approximately 28% for the balance of the fiscal year ending June 30, 2001.

#### LIQUIDITY AND CAPITAL RESOURCES

During the six-month period ended December 30, 2000, cash, cash equivalents, short-term investments and marketable securities balances decreased to \$817 million from \$964 million at June 30, 2000. Net cash provided by operating activities for the six-month period ended December 31, 2000 was \$45 million, compared to \$63 million of net cash provided by operating activities for the same period of the prior fiscal year. This change primarily resulted from increased net income before non-cash charges offset by increases in accounts receivable and inventory. We increased our net purchases of available-for-sale securities and our net purchases of property and equipment in the six-month period ended December 31, 2000 as compared to the same period of the prior fiscal year. Capital expenditures for the six-month period ended December 31, 2000 of \$76 million included \$15 million for the purchase of 31 acres of land in Livermore, California to build a new campus and \$7 million in construction costs. The remaining capital expenditures were for manufacturing and engineering equipment and leasehold improvements necessary for our operations. We received \$31 million through common stock issued through our employee stock purchase program and through stock option exercises during the six-month period ended December 31, 2000, and we repurchased \$150 million of our common stock under our stock repurchase program during the same period.

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Working capital was \$1,032 million as of December 31, 2000, compared to \$1,057 million at June 30, 2000. We believe that existing liquid capital resources and funds generated from operations combined with the ability, if necessary, to borrow funds will be adequate to meet our business requirements for the foreseeable future, including potential acquisitions or strategic investments, capital expenditures for the expansion or upgrading of manufacturing capacity and working capital requirements. However, we can give no assurances that we will continue to generate sufficient funds from operations or that we will be able to borrow funds on reasonable terms in the future, if necessary.

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

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

Our operating results have varied widely in the past, and our future operating results will continue to be subject to quarterly variations based upon a wide variety of factors including those listed in this section and throughout this Quarterly Report on Form 10-Q for the period ending December 31, 2000. In addition, future operating results may not follow any past trends. We believe the factors that make our results fluctuate and difficult to predict include:

- the cyclical nature of the semiconductor industry;
- the reduction in the price and the profitability of our products;
- our timing of new product introductions;
- our ability to develop and implement new technologies;
- the change in customers' schedules for fulfillment of orders;
- the cancellation of contracts by major customers;
- the shortage of qualified workers in the areas we operate; and
- our ability to manage our manufacturing requirements.

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

#### Semiconductor Equipment Industry Volatility

The semiconductor equipment industry is highly cyclical. The purchasing decisions of our customers are highly dependent on the economies of both the local markets in which they are located and the semiconductor industry worldwide. The timing, length and severity of the up-and-down cycles in the semiconductor equipment industry are difficult to predict. This cyclical nature of the industry in which we operate affects our ability to accurately predict future revenues 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.

During industry down cycles, the semiconductor industry typically experiences excess production capacity that causes semiconductor manufacturers to decrease capital spending. We generally

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do not have long-term volume production contracts with our customers, and we do not control the timing or volume of orders placed by our customers. Whether and to what extent our customers place orders for any specific products, as well as the mix and quantities of products included in those orders, are factors beyond our control. Insufficient orders, especially in our down cycles, will result in under-utilization of our manufacturing facilities and infrastructure and will negatively affect our operating results and financial condition.

#### International Trade and Economic Conditions

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

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

#### Competition

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

## Technological Change and Customer Requirements

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

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develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, our business could be seriously harmed.

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

## Key Suppliers

We use a wide range of materials in the production of our products, including custom electronic and mechanical components, and we use numerous suppliers to supply materials. We generally do not have guaranteed supply arrangements with our suppliers. Because of the variability and uniqueness of customers' orders, we do not maintain an extensive inventory of materials for manufacturing. We seek to minimize the risk of production and service interruptions and/or shortages of key parts by selecting and qualifying alternative suppliers for key parts, monitoring the financial stability of key suppliers and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, key parts may be available only from a single supplier or a limited group of suppliers. There can be no assurance that our business will not be harmed if we do not receive sufficient parts to meet our production requirements in a timely and cost-effective manner.

Operations at our primary manufacturing facilities and our assembly subcontractors are subject to disruption for a variety of reasons, including work stoppages, fire, earthquake, 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 a disruption could result in cancellation of orders or loss of customers and could seriously harm our business.

## Intellectual Property Obsolescence and Infringement

Our success is dependent in part on our technology and other proprietary rights. We own various United States and international patents and have additional pending patent applications relating to some of our products and technologies. The process of seeking patent protection is lengthy and expensive, and we cannot be certain that pending or future applications will actually result in issued patents or that issued patents will be of sufficient scope or strength to provide meaningful protection or commercial advantage to us. Other companies and individuals, including our larger competitors, may develop technologies that are similar or superior to our technology or may design around the patents we own.

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

While patent, copyright and trademark protection for our intellectual property is important, we believe our future success in highly dynamic markets is most dependent upon the technical competence and creative skills of our personnel. We attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants and through

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other security measures. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and third parties. 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 litigation or other administrative proceedings will not occur. The inability to obtain necessary licenses or other rights on reasonable terms could seriously harm our operating results and financial condition.

#### Key Employees

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

#### Acquisitions

We seek to develop new technologies from both internal and 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, technologies and products of the acquired companies, the possible write-downs of impaired assets, and the potential loss of key employees of the acquired companies. The inability to manage these risks effectively could seriously harm our business.

#### Litigation

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

#### Regional Electric Shortages

Recently, California has been experiencing a shortage of electric power supply that has resulted in intermittent loss of power in some areas in the form of rolling blackouts. While the Company has not experienced any power failures to date, a blackout may affect our ability to manufacture products and

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meet scheduled deliveries. If blackouts were to interrupt our power supply, we would be temporarily unable to continue operations at some of our facilities. Any such interruption in our ability to continue operations at our facilities could damage our reputation, harm our ability to retain existing customers and to obtain new customers, and could result in lost revenue, any of which could substantially harm our business and results of operations.

A new European currency was implemented commencing in January 1999 to replace the separate currencies of eleven western European countries. This requires changes in our operations as we modify systems and commercial arrangements to deal with the new currency. Modifications are necessary in operations such as payroll, benefits and pension systems, contracts with suppliers and customers, and internal financial reporting systems. During the three-year transition period in which transactions may also be made in the old currencies, we must maintain dual currency processes for our operations. We have identified the issues created by this problem, and the cost of this effort is not expected to have a material effect on our business or results of operations. We cannot be certain, however, that all problems will be foreseen and corrected or that no material disruption of our business will occur as a result of this currency change.

#### EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2000, the SEC issued Staff Accounting Bulletin ("SAB") No. 101B, "Second Amendment: Revenue Recognition in Financial Statements." SAB No. 101B amends SAB No. 101 "Revenue Recognition in Financial Statements," to defer the implementation date of SAB 101 for registrants until no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. SAB No. 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements of all public companies. The Company is required to adopt SAB No. 101 in the fourth quarter of its fiscal year ending June 30, 2001. Accordingly, any shipments previously reported as revenue, including revenue reported for the first three quarters of fiscal 2001, that do not meet SAB No. 101's guidance will be recorded as revenue in future periods. Changes in the Company's revenue recognition policy resulting from the interpretation of SAB No. 101 would not involve the restatement of prior fiscal year statements but would, to the extent applicable, be reported as a change in accounting principle in the fiscal year ending June 30, 2001, with the appropriate restatement of interim periods as required by SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements." The Company's reported results of operations for the 12 months ending June 30, 2001 will include a cumulative adjustment for all prior annual and interim periods as if SAB No. 101 had been adopted on July 1, 2000. Management believes that SAB Nos. 101 and 101B, to the extent that they impact the Company, will not affect the underlying strength or weakness of the Company's business operations as measured by the dollar value of the Company's product shipments and cash flows.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates and in foreign currency exchange rates. To mitigate these risks, we utilize derivative financial instruments. We do not use derivative financial instruments for speculative or trading purposes. All of the potential changes noted below are based on sensitivity analyses performed on our financial position at June 30, 2000 and at December 31, 2000. Actual results may differ materially.

As of June 30 and December 31, 2000, we had an investment portfolio of fixed income securities of \$446 million and \$465 million, respectively, excluding those classified as 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

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10% from levels as of June 30 and December 31, 2000, the fair market value of our portfolio would decline by \$5 million and \$4 million, respectively.

As of June 30, and December 31, 2000, we had forward contracts to sell \$204 million and \$267 million, respectively, in foreign currency in order to hedge currency exposures. The fair market value of these contracts on June 30 and December 31, 2000, based on prevailing exchange rates on those dates, was \$199 million and \$252 million, respectively. A 10% adverse move in currency exchange rates affecting the contracts from their June 30 and December 31, 2000 levels would decrease the fair market value of the contracts by \$20 million and \$28 million, respectively. However, if this occurred, the fair market value of the underlying exposures hedged by the contracts would increase by similar amounts which we believe would result in little or no material impact on our income or cash flows.

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#### PART II. OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

A discussion regarding certain pending legal proceedings is included in Part I, Item 3, "Legal Proceedings," included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000. While the information provided therein has not changed materially as to the lawsuits addressed, the Company has been named as a party in the following additional matter:

ADE Corporation

On October 11, 2000, ADE Corporation ("ADE"), a competitor, filed a patent infringement lawsuit against the Company in the U.S. District Court in Delaware. ADE seeks damages and an injunction under a wafer inspection patent it holds. The Company filed a counterclaim in the same court alleging that ADE has infringed three of its patents. The Company seeks damages and a permanent injunction. In addition, the Company is seeking a declaration from the District Court that ADE's patent is invalid and not infringed by the Company. While these matters remain at a preliminary stage and we cannot predict the outcome, the Company believes it has valid defenses and further believes that its counterclaims have merit.

Although we cannot predict the outcome of these claims, management does not believe that any of these legal matters will have a material adverse effect on the Company. Were an unfavorable ruling to occur in one or more of the pending claims, there exists the possibility of a material impact on the Company's operating results for the period in which the ruling occurred.

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

The Annual Meeting of Stockholders of KLA-Tencor Corporation was held on November 10, 2000 at the Company's offices in Milpitas, California. Of the 187,435,070 shares of Common Stock outstanding as of September 27, 2000 (the record date) 162,202,069 shares (86%) were present or represented by proxy at the meeting.

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

<TABLE>  
<CAPTION>

	Votes for -----	Votes Withheld -----
<S>	<C>	<C>
H. Raymond Bingham	160,618,607	1,583,462
Robert T. Bond	160,655,412	1,546,657
Richard J. Elkus, Jr.	160,599,990	1,602,079

The terms of Kenneth Levy, Edward W. Barnholt, Dean O. Morton, Jon D. Tompkins and Lida Urbanek, as directors of the Company, continued after the meeting.

2. The stockholders approved an amendment to the Company's Certificate of Incorporation to increase the number of shares of Common Stock reserved for issuance thereunder by 250,000,000 shares to 500,000,000 shares. This proposal received 150,186,916 votes for and 11,514,879 votes against, with 500,274 shares abstaining.

3. The stockholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent accountants for the fiscal year ended June 30, 2001. This proposal received 159,676,528 votes for and 2,525,541 votes against.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

<TABLE>	<C>
<S>	
3.1	Amended and Restated Certificate of Incorporation, dated January 12, 2000
10.1	2000 Nonstatutory Stock Option Plan
27.1	Financial Data Schedule.

(b) Form 8-K

On December 20, 2000, the Company filed a current report on Form 8-K, dated December 15, 2000, to report a press release announcing the continuation of the Company's systematic plan to

repurchase its shares.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KLA-TENCOR CORPORATION  
(Registrant)

February 14, 2000  
-----  
(Date)

/s/ JOHN H. KISPERT  
-----  
John H. Kispert  
Executive Vice President  
and Chief Financial Officer

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EXHIBIT INDEX

<TABLE>	
Exhibit No. -----	Description -----
<S>	<C>
3.1	Amended and Restated Certificate of Incorporation, dated January 12, 2001
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27.1	Financial Data Schedule.

</TABLE>

STATE OF DELAWARE

OFFICE OF THE SECRETARY OF STATE

-----

I HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO  
HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF  
AMENDMENT OF "KLA-TENCOR CORPORATION", FILED IN THIS OFFICE ON THE TWELFTH DAY  
OF JANUARY, A.D. 2001, AT 9 O'CLOCK A.M.

[SEAL] /s/ HARRIET SMITH WINDSOR  
-----  
Harriet Smith Windsor, Secretary of State

0814199 8100 AUTHENTICATION: 0932528

010037785 DATE: 01-24-01

STATE OF DELAWARE  
SECRETARY OF STATE  
DIVISION OF CORPORATIONS  
FILED 09:00 AM 01/12/2001  
010022228 - 0814199

STATE OF DELAWARE  
CERTIFICATION OF AMENDMENT OF  
AMENDED AND RESTATED  
CERTIFICATE OF INCORPORATION  
OF  
KLA-TENCOR CORPORATION

KLA-Tencor Corporation, a corporation organized and existing under and by  
virtue of the General Corporation Law of the State of Delaware, does hereby  
certify:

1. That the board of directors of said corporation, at a meeting duly  
convened and held, adopted a resolution proposing and declaring advisable the  
following amendment to the Certification of Incorporation of said corporation:

RESOLVED, that the Amended and Restated Certificate of Incorporation of the  
corporation be amended by changing Article thereof numbered "FOURTH" so that, as  
amended, said Article shall be read as follows:

"FOURTH: The aggregate number of shares of stock which the corporation  
shall have authority to issue shall be 501,000,000 shares, with the par value of  
each of such shares being \$0.001. These shares shall be divided into the  
following classes:

- (1) 500,000,000 shares shall be designated as Common Stock; and
- (2) 1,000,000 shares shall be designated as Preferred Stock.

The Board of Directors is authorized, subject to any limitations prescribed  
by law, to provide for the issuance of shares of Preferred Stock in series, and  
by filing a certificate pursuant to the applicable law of the State of Delaware,  
to establish from time to time the number of shares to be included in each such  
series, and to fix the designation, powers, preferences, and rights of the  
shares of each such series and any qualifications, limitations or restrictions  
thereof. The number of authorized shares of Preferred Stock may be increased or  
decreased (but not below the number of shares thereof then outstanding) by the  
affirmative vote of the holders of a majority of the then outstanding shares of  
Common Stock, without a vote of the holders of the Preferred Stock, or of any  
series thereof, unless a vote of any such holders is required pursuant to the  
certificate or certificates establishing the series of Preferred Stock."

2. That thereafter, pursuant to resolution of its Board of Directors, a  
special meeting of the stockholders of said corporation was duly called and  
held, upon notice in accordance with Section 222 of the General Corporation Law  
of the State of Delaware at which meeting the necessary number of shares as  
required by statute were voted in favor of the amendment.

3. That the aforesaid amendment was duly adopted in accordance with the  
applicable provisions of Sections 242 and 222 of the General Corporation Law of  
the State of Delaware.

4. That the capital of said corporation will not be reduced under or by  
reason of said amendment.



IN WITNESS WHEREOF, said KLA-Tencor Corporation has caused this certificate to be signed by JOHN H. KISPERT, its Chief Financial Officer, and STUART J. NICHOLS, its Assistant Secretary, this 10 day of January 2001.

/s/ JOHN H. KISPERT  
-----  
JOHN H. KISPERT  
Chief Financial Officer

/s/ STUART J. NICHOLS  
-----  
STUART J. NICHOLS  
Assistant Secretary

KLA-TENCOR CORPORATION

2000 NONSTATUTORY STOCK OPTION PLAN

1. Purposes of the Plan. The purposes of this Nonstatutory Stock Option Plan are:

- o to attract and retain the best available personnel for positions of substantial responsibility,
- o to provide additional incentive to Employees and Consultants, and
- o to promote the success of the Company's business.

Options granted under the Plan will be Nonstatutory Stock Options.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Administrator" means the Board or any of its Committees as shall be administering the Plan, in accordance with Section 4 of the Plan.

(b) "Applicable Laws" means the requirements relating to the administration of stock option plans under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Options are, or will be, granted under the Plan.

(c) "Board" means the Board of Directors of the Company.

(d) "Code" means the Internal Revenue Code of 1986, as amended.

(e) "Committee" means a committee of Directors appointed by the Board in accordance with Section 4 of the Plan.

(f) "Common Stock" means the Common Stock of the Company.

(g) "Company" means KLA-Tencor Corporation.

(h) "Consultant" means any person, including an advisor, engaged by the Company or a Parent or Subsidiary to render services to such entity.

(i) "Director" means a member of the Board.

(j) "Disability" means total and permanent disability as defined in Section 22(e)(3) of the Code.

(k) "Employee" means any person, including officers, employed by the Company or any Parent or Subsidiary of the Company. A Service Provider shall not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, any Subsidiary, or any successor. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute "employment" by the Company.

(l) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(m) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the date of determination, as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the date of determination, as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(n) "Notice of Grant" means a written or electronic notice evidencing

certain terms and conditions of an individual Option grant. The Notice of Grant is part of the Option Agreement.

(o) "Option" means a nonstatutory stock option granted pursuant to the Plan, that is not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(p) "Option Agreement" means an agreement between the Company and an Optionee evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.

(q) "Optioned Stock" means the Common Stock subject to an Option.

(r) "Optionee" means the holder of an outstanding Option granted under the Plan.

(s) "Parent" means a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

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(t) "Plan" means this 2000 Nonstatutory Stock Option Plan.

(u) "Service Provider" means an Employee, Consultant or Director.

(v) "Share" means a share of the Common Stock, as adjusted in accordance with Section 12 of the Plan.

(w) "Subsidiary" means a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Stock Subject to the Plan. Subject to the provisions of Section 12 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is 5,600,000 Shares. The Shares may be authorized, but unissued, or reacquired Common Stock.

If an Option expires or becomes unexercisable without having been exercised in full, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated).

#### 4. Administration of the Plan.

(a) Administration. The Plan shall be administered by (i) the Board or (ii) a Committee, which Committee shall be constituted to satisfy Applicable Laws.

(b) Powers of the Administrator. Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator shall have the authority, in its discretion:

(i) to determine the Fair Market Value of the Common Stock;

(ii) to select the Service Providers to whom Options may be granted hereunder;

(iii) to determine whether and to what extent Options are granted hereunder;

(iv) to determine the number of shares of Common Stock to be covered by each Option granted hereunder;

(v) to approve forms of agreement for use under the Plan, including the ability to approve forms of agreement allowing for early exercise of stock options prior to vesting, subject to the Optionee entering into a form of restricted stock purchase agreement;

(vi) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Options may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction

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or limitation regarding any Option or the shares of Common Stock relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine;

(vii) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan;

(viii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;

(ix) to modify or amend each Option (subject to Section 14(b) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Options longer than is otherwise provided for in the Plan;

(x) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Option previously granted by the Administrator;

(xi) to determine the terms and restrictions applicable to Options;

(xii) to allow Optionees to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Option that number of Shares having a Fair Market Value equal to the amount required to be withheld (but not more than the amount required to be withheld). The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by an Optionee to have Shares withheld for this purpose shall be made in such form and under such conditions as the Administrator may deem necessary or advisable; and

(xiii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) Effect of Administrator's Decision. The Administrator's decisions, determinations and interpretations shall be final and binding on all Optionees and any other holders of Options.

5. Eligibility. Options may be granted to Service Providers.

6. Limitation. Neither the Plan nor any Option shall confer upon an Optionee any right with respect to continuing the Optionee's relationship as a Service Provider with the Company, nor shall they interfere in any way with the Optionee's right or the Company's right to terminate such relationship at any time, with or without cause.

7. Term of Plan. The Plan shall become effective upon its adoption by the Board. It shall continue in effect for ten (10) years, unless sooner terminated under Section 14 of the Plan.

8. Term of Option. The term of each Option shall be stated in the Option Agreement.

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9. Option Exercise Price and Consideration.

(a) Exercise Price. The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be determined by the Administrator.

(b) Waiting Period and Exercise Dates. At the time an Option is granted, the Administrator shall fix the period within which the Option may be exercised and shall determine any conditions which must be satisfied before the Option may be exercised.

(c) Form of Consideration. The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment. Such consideration may consist entirely of:

(i) cash;

(ii) check;

(iii) promissory note;

(iv) other Shares which (A) in the case of Shares acquired upon exercise of an option, have been owned by the Optionee for more than six months on the date of surrender, and (B) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised;

(v) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan;

(vi) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws; or

(vii) any combination of the foregoing methods of payment.

#### 10. Exercise of Option.

(a) Procedure for Exercise; Rights as a Shareholder. Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Option Agreement. An Option may not be exercised for a fraction of a Share.

An Option shall be deemed exercised when the Company receives: (i) written or electronic notice of exercise (in accordance with the Option Agreement) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Option Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Optionee or, if requested by the Optionee, in the name of the Optionee and his or her spouse. Until the Shares are issued (as evidenced by the appropriate

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entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 12 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) Termination of Relationship as a Service Provider. If an Optionee ceases to be a Service Provider, other than upon the Optionee's death or Disability, the Optionee may exercise his or her Option, but only within such period of time as is specified in the Option Agreement, and only to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for three (3) months following the Optionee's termination. If, on the date of termination, the Optionee is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Optionee does not exercise his or her Option within the time specified by the Administrator, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(c) Disability of Optionee. If an Optionee ceases to be a Service Provider as a result of the Optionee's Disability, the Optionee may exercise his or her Option within such period of time as is specified in the Option Agreement, to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Option Agreement). In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following the Optionee's termination. If, on the date of termination, the Optionee is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Optionee does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(d) Death of Optionee. If an Optionee dies while a Service Provider, the Option may be exercised within such period of time as is specified in the Option Agreement (but in no event later than the expiration of the term of such Option as set forth in the Notice of Grant), by the Optionee's estate or by a person who acquires the right to exercise the Option by bequest or inheritance, but only to the extent that the Option is vested on the date of death. In the absence of a specified time in the Option Agreement, the Option shall remain exercisable for twelve (12) months following the Optionee's termination. If, at the time of death, the Optionee is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall immediately revert to the Plan. The Option may be exercised by the executor or administrator of the Optionee's estate or, if none, by the person(s) entitled to exercise the Option under the Optionee's will or the laws of

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descent or distribution. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

11. Transferability of Options. During the lifetime of the Optionee, an Option shall be exercisable only by the Optionee or the Optionee's guardian, legal representative or permitted transferees. Except as specified below, no Option shall be assignable or transferable by the Optionee except by will or by the laws of descent and distribution. At the sole discretion of the Administrator, and subject to such terms and conditions as the Administrator deems advisable, the Administrator may allow, by means of a writing to the Optionee, for all or part of an Option to be assigned or transferred, during an Optionee's lifetime, to a member of the Optionee's immediate family or to a trust, LLC or partnership for the benefit of any one or more members of such Optionee's immediate family. "Immediate family" as used herein means the spouse, lineal descendants, father, mother, brothers and sisters of the Optionee. In such case, the transferee shall receive and hold the Option subject to the provisions of this Section 11, and there shall be no further assignment or transfer of the Option. The terms of Options granted hereunder shall be binding upon the transferees, purchasers, executors, administrators, heirs, successors and assigns of the Optionee.

12. Adjustments Upon Changes in Capitalization, Dissolution, Merger, Asset Sale or Corporate Reorganization.

(a) Changes in Capitalization. Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each outstanding Option, and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per share of Common Stock covered by each such outstanding Option, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Option.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator shall notify each Optionee as soon as practicable prior to the effective date of such proposed transaction. The Administrator in its discretion may provide for an Optionee to have the right to exercise his or her Option until ten (10) days prior to such transaction as to all of the Optioned Stock covered thereby, including Shares as to which the Option would not otherwise be exercisable. In addition, the Administrator may provide that any Company repurchase option applicable to any Shares purchased upon exercise of an Option shall lapse as to all such Shares, provided the proposed dissolution or liquidation takes place at the time and in the

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manner contemplated. To the extent it has not been previously exercised, an Option will terminate immediately prior to the consummation of such proposed action.

(c) Merger or Asset Sale. In the event of a merger of the Company with or into another corporation, or the sale of substantially all of the assets of the Company, each outstanding Option shall be assumed or an equivalent option or right substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Option, the Optionee shall fully vest in and have the right to exercise the Option as to all of the Optioned Stock, including Shares as to which it would not otherwise be vested or exercisable. If an Option becomes fully vested and exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator shall notify the Optionee in writing or electronically that the Option shall be fully vested and exercisable for a period of fifteen (15) days from the date of such notice, and the Option shall terminate upon the expiration of such period. For the purposes of this paragraph, the Option shall be considered assumed if, following the merger or sale of assets, the option or right confers the right to purchase or receive, for each Share of Optioned Stock, immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders

were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option, for each Share of Optioned Stock to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or sale of assets.

13. Date of Grant. The date of grant of an Option shall be, for all purposes, the date on which the Administrator makes the determination granting such Option, or such other later date as is determined by the Administrator. Notice of the determination shall be provided to each Optionee within a reasonable time after the date of such grant.

14. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend or terminate the Plan.

(b) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Optionee, unless mutually agreed otherwise between the Optionee and the Administrator, which agreement must be in writing and signed by the Optionee and the Company. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to options granted under the Plan prior to the date of such termination.

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15. Conditions Upon Issuance of Shares.

(a) Legal Compliance. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise of an Option the Company may require the person exercising such Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

16. Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

17. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

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

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