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, 2007

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 0-09992

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 check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of April 30, 2007 there were 191,623,376 shares of the Registrant's Common Stock, $0.001 par value, outstanding.

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EXPLANATORY NOTE REGARDING RESTATEMENTS

This Quarterly Report on Form 10-Q for our quarter ended March 31, 2007 includes restatements of our condensed consolidated financial statements for our quarter ended March 31, 2006 (and related disclosures). See Note 2, "Restatements of Consolidated Financial Statements and Special Committee and Company Findings," to Condensed Consolidated Financial Statements (unaudited) for a detailed discussion of the effect of the restatements.

As a result of an investigation of our historical stock option practices by a Special Committee of our Board of Directors, we discovered that certain of our stock options, primarily those granted from July 1, 1997 to June 30, 2002, had been retroactively priced for all employees who received these grants (less than 15% of these options were granted to executive officers). This means that the option exercise price was not the market price of the option shares on the actual grant date of the option, but instead was a lower market price on an earlier date. The actual grant date—when the essential actions necessary to grant the option were completed, including the final determination of the number of shares to be granted to each employee and the exercise price—is the correct measurement date to determine the market price of the option shares under the accounting rules in effect at the time. More than 95% of the total in-the-money value (market price on the actual grant date minus exercise price) of all of our retroactively priced options was attributable to those granted from July 1, 1997 to June 30, 2002.

We previously applied Accounting Principles Board ("APB") Opinion No. 25 *Accounting for Stock Issued to Employees* and its related Interpretations and provided the required pro forma disclosures under Statement of Financial Accounting Standards ("SFAS") No. 123 *Accounting for Stock-Based Compensation* through the fiscal year ended June 30, 2005. Under APB Opinion No. 25, a non-cash, stock-based compensation expense was recognized for any option for which the exercise price was below the market price on the actual grant date. Because each of our retroactively priced options had an exercise price below the market price on the actual grant date, in periods up through June 30, 2005, we recognized a charge for each of these options under APB Opinion No. 25 equal to the number of option shares, multiplied by the difference between the exercise price and the market price on the actual grant date, amortized over the vesting period of the option. Starting in our fiscal year ended June 30, 2006, we adopted SFAS No. 123(R) *Share-Based Payment*. As a result, beginning with fiscal year 2006, the additional stock-based compensation expense required to be recorded for each retroactively priced option was equal to the incremental fair value of these options on the actual grant date, amortized over the remaining vesting period of the option. We recorded these stock-based compensation expenses under APB Opinion No. 25 or SFAS No. 123(R) related to our retroactively priced options in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006 (which included restatements of our consolidated financial statements as of and for our fiscal year ended June 30, 2005 and 2004; and our unaudited quarterly financial data for the first three quarters in our fiscal year ended June 30, 2006 and for all quarters in our fiscal year ended June 30, 2005) and our Quarterly Reports on Form 10-Q for the quarters ended September 30, 2006 and December 31, 2006. We did not record the required stock-based compensation expenses under SFAS No. 123(R) related to our retroactively priced options in our previously issued financial statements for our quarter ended March 31, 2006, and that is why we are restating them in this filing. To correct our past accounting for stock options, in total we have recorded additional pre-tax, non-cash, stock-based compensation expense of (a) $348 million for the periods July 1, 1994 to June 30, 2005 under APB Opinion No. 25 and (b) $28 million for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R). The impact of this restatement for subsequent periods is immaterial.

Management reviewed the findings of the Special Committee and conducted its own internal review of our past stock option grants and other aspects of our historical financial statements. Management agrees with the Special Committee that there was retroactive pricing of stock options granted to all option holders, primarily from July 1, 1997 to June 30, 2002. The restatements included in this Quarterly Report on Form 10-Q include adjustments arising from the Special Committee investigation and management's internal review.

Unless otherwise noted, all of the information in this Quarterly Report on Form 10-Q is as of March 31, 2007. This Report does not reflect any subsequent events that occurred after March 31, 2007.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

KLA-TENCOR CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands)	March 31, 2007	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 604,416	$ 1,129,191
Marketable securities	980,818	1,196,605
Accounts receivable, net	499,298	439,899
Inventories	530,141	449,156
Deferred income taxes	261,200	253,811
Other current assets	71,282	74,581
Total current assets	2,947,155	3,543,243
Land, property and equipment, net	363,767	395,412
Goodwill and intangibles, net	465,330	70,341
Other assets	564,541	566,915
Total assets	$ 4,340,793	$ 4,575,911
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 93,805	$ 95,192
Deferred system profit	217,232	226,142
Unearned revenue	86,805	80,543
Other current liabilities	631,694	600,604
Total current liabilities	1,029,536	1,002,481
Commitments and contingencies (Note 10 and Note 11)		
Minority interest in subsidiary	—	5,439
Stockholders' equity:		
Common stock and capital in excess of par value	844,891	1,421,373
Retained earnings	2,446,446	2,137,710
Accumulated other comprehensive income	19,920	8,908
Total stockholders' equity	3,311,257	3,567,991
Total liabilities, minority interest and stockholders' equity	$ 4,340,793	$ 4,575,911

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

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

(In thousands except per share data)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated (1)	Nine months ended March 31 2007	Nine months ended March 31 2006 As restated (1)
Revenues:				
Product	$607,390	$ 429,068	$ 1,682,619	$ 1,230,201
Service	108,818	90,580	312,222	261,390
Total revenues	716,208	519,648	1,994,841	1,491,591
Costs and operating expenses:				
Costs of revenues*	306,751	226,575	874,642	657,927
Engineering, research and development*	106,265	97,633	313,659	295,210
Selling, general and administrative*	120,537	110,513	391,536	303,543
Total costs and operating expenses	533,553	434,721	1,579,837	1,256,680
Income from operations	182,655	84,927	415,004	234,911
Interest income and other, net	20,817	17,225	65,931	47,986
Income before income taxes and minority interest	203,472	102,152	480,935	282,897
Provision for income taxes	48,546	6,388	101,551	37,041
Income before minority interest	154,926	95,764	379,384	245,856
Minority interest	(141)	920	1,372	2,920
Net income	$154,785	$ 96,684	$ 380,756	$ 248,776
Net income per share:				
Basic	$ 0.78	$ 0.48	$ 1.91	$ 1.25
Diluted	$ 0.76	$ 0.47	$ 1.87	$ 1.22
Weighted average number of shares:				
Basic	197,930	199,876	199,053	198,498
Diluted	203,474	205,361	203,976	204,294

* includes the following amounts related to equity awards:

Costs of revenues	$ 6,629	$ 6,198	$ 23,218	$ 19,649
Engineering, research and development	$ 11,036	$ 12,488	$ 33,984	$ 38,019
Selling, general and administrative	$ 11,604	$ 29,675	$ 25,182	$ 69,258

(1) See Note 2, "Restatements of Consolidated Financial Statements and Special Committee and Company Findings," to Condensed Consolidated Financial Statements (unaudited)

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

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

(In thousands)	Nine months ended March 31, 2007	2006 As restated (1)
Cash flows from operating activities:		
Net income	$ 380,756	$ 248,776
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	73,152	52,195
Impairment charges	56,830	—
Non-cash, stock-based compensation	73,241	126,926
Tax benefit from employee stock options	2,298	30,676
Excess tax benefit from stock-based compensation	(3,822)	(13,244)
Minority interest	(1,372)	(2,920)
Net loss on sale of marketable securities and other investments	1,175	3,419
Changes in assets and liabilities, net of effect of acquisitions of businesses:		
Accounts receivable, net	(39,737)	(136,176)
Inventories	(31,675)	(78,261)
Other assets	(13,103)	(21,262)
Accounts payable	(10,998)	29,611
Deferred system profit	(8,910)	9,417
Other current liabilities	(22,619)	(64,342)
Net cash provided by operating activities	455,216	184,815
Cash flows from investing activities:		
Acquisitions of businesses, net of cash received	(439,190)	(7,664)
Purchase of property, plant, and equipment, net	(54,641)	(59,124)
Purchase of available-for-sale securities	(2,912,361)	(3,241,357)
Proceeds from sale of available-for-sale securities	2,955,029	3,290,827
Proceeds from maturity of available-for-sale securities	173,203	136,907
Net cash provided by (used in) investing activities	(277,960)	119,589
Cash flows from financing activities:		
Issuance of common stock	122,796	180,307
Stock repurchases	(763,582)	(143,132)
Payment of dividends to stockholders	(72,020)	(71,461)
Proceeds from sale of minority interest in subsidiary	—	4,736
Excess tax benefit from stock-based compensation	3,822	13,244
Net cash used in financing activities	(708,984)	(16,306)
Effect of exchange rate changes on cash and cash equivalents	6,953	10,734
Net (decrease) increase in cash and cash equivalents	(524,775)	298,832
Cash and cash equivalents at beginning of period	1,129,191	663,163
Cash and cash equivalents at end of period	$ 604,416	$ 961,995
Supplemental cash flow disclosures:		
Income taxes paid, net	$ 162,525	$ 61,143
Interest paid	$ 1,514	$ 1,066

(1) See Note 2, "Restatements of Consolidated Financial Statements and Special Committee and Company Findings," to Condensed Consolidated Financial Statements (unaudited)

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, 2006, filed with the SEC on January 29, 2007.

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," to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

The results of operations for the three and nine month periods ended March 31, 2007 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, 2007.

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.

Recent Accounting Pronouncements In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments, an amendment of* SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This Statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This Statement is effective for the Company for all financial instruments acquired or issued after July 1, 2007. The adoption of SFAS No. 155 is not expected to have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for the Company for fiscal years beginning July 1, 2008. The Company is evaluating the impact of the provisions of this statement on its consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other post-retirement plans in their financial statements. The provisions of SFAS No. 158 are effective for the Company as of the end of the fiscal year ending June 30, 2007. The Company is evaluating the impact of the provisions of this statement on its consolidated financial position, results of operations and cash flows.

In June 2006, the FASB published FASB Interpretation No. 48 ("FIN") *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109 *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for the Company in fiscal years beginning July 1, 2007. The Company is evaluating the impact of the provisions of this Interpretation on its consolidated financial position, results of operations and cash flows.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159*The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115*, which is effective for the Company in fiscal years beginning July 1, 2008. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of this statement on its consolidated financial position, results of operations and cash flows.

NOTE 2 – RESTATEMENTS OF CONSOLIDATED FINANCIAL STATEMENTS AND SPECIAL COMMITTEE AND COMPANY FINDINGS

Special Committee Investigation of Historical Stock Option Practices

On May 22, 2006, the Wall Street Journal published an article about stock option backdating that questioned the stock option practices at several companies, including KLA-Tencor. On May 23, 2006, the Company received a subpoena from the United States Attorney’s Office for the Northern District of California (“USAO”) and a letter of inquiry from the United States Securities and Exchange Commission (“SEC”) regarding the Company’s stock option practices. Later on May 23, 2006, the Board of Directors appointed a Special Committee composed solely of independent directors to conduct a comprehensive investigation of the Company’s historical stock option practices. The Special Committee promptly engaged independent legal counsel and accounting experts to assist with the investigation. The investigation included an extensive review of the Company’s historical stock option practices, accounting policies, accounting records, supporting documentation, email communications and other documentation, as well as interviews of a number of current and former directors, officers and employees. On September 27, 2006, the Special Committee reported the bulk of its findings and recommendations to the Board of Directors.

Findings and Remedial Actions

On September 28, 2006, the Company announced that it would have to restate its previously issued financial statements to correct its past accounting for stock options. As a result of the Special Committee investigation, the Company discovered that certain of its stock options, primarily those granted from July 1, 1997 to June 30, 2002, had been retroactively priced for all employees who received these grants. This means that the option exercise price was not the market price of the option shares on the actual grant date of the option, but instead was a lower market price on an earlier date. The actual grant date—when the essential actions necessary to grant the option were completed, including the final determination of the number of shares to be granted to each employee and the exercise price—is the correct measurement date to determine the market price of the option shares under the accounting rules in effect at the time. More than 95% of the total in-the-money value (market price on the actual grant date minus exercise price) of all of the Company’s retroactively priced options was attributable to those granted from July 1, 1997 to June 30, 2002.

The Company previously applied Accounting Principles Board (“APB”) Opinion No. 25*Accounting for Stock Issued to Employees*and its related Interpretations and provided the required pro forma disclosures under Statement of Financial Accounting Standards (“SFAS”) No. 123 *Accounting for Stock-Based Compensation* through its fiscal year ended June 30, 2005. Under APB Opinion No. 25, a non-cash, stock-based compensation expense was required to be recognized for any option for which the exercise price was below the market price on the actual grant date. Because each of the Company’s retroactively priced options had an exercise price below the market price on the actual grant date, in periods up through June 30, 2005, the Company recognized a non-cash charge for each of these options under APB Opinion No. 25 equal to the number of option shares, multiplied by the difference between the exercise price and the market price on the actual grant date, amortized over the vesting period of the option. Starting in its fiscal year ended June 30, 2006, the Company adopted SFAS No. 123(R) *Share-Based Payment*. As a result, beginning with fiscal year 2006, the additional stock-based compensation expense required to be recorded for each retroactively priced option is equal to the incremental fair value of the option on the actual grant date, amortized over the remaining vesting period of the option. The Company recorded these stock-based compensation expenses under APB Opinion No. 25 or SFAS No. 123(R) related to its retroactively priced options in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2006 (which included restatements of its consolidated financial statements as of and for the Company’s fiscal year ended June 30, 2005 and 2004; and its unaudited quarterly financial data for the first three quarters in the Company’s fiscal year ended June 30, 2006 and for all quarters in its fiscal year ended June 30, 2005) and its Quarterly Reports on Form 10-Q for the quarters ended September 30, 2006 and December 31, 2006. The Company did not record the required stock-based compensation expenses under SFAS No. 123(R) related to its retroactively priced options in the Company’s previously issued financial statements for its quarter ended March 31, 2006, and that is why the Company is restating them in this filing. To correct the Company’s past accounting for stock options, in total, it has recorded additional pre-tax, non-cash, stock-based compensation expense of (a) $348 million for the periods from July 1, 1994 to June 30, 2005 under APB Opinion No. 25 and (b) $28 million for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R). The impact of this restatement for subsequent periods is immaterial.

By October 16, 2006, the Special Committee had substantially completed its investigation. The Special Committee concluded that (1) there was retroactive pricing of stock options granted to all employees who received options, primarily during the periods from July 1, 1997 to June 30, 2002 (less than 15% of these options were granted to executive officers), (2) the retroactively priced options were not accounted for correctly in the Company's previously issued financial statements, (3) the retroactive pricing of options was intentional, not inadvertent or through administrative error, (4) the retroactive pricing of options involved the selection of fortuitously low exercise prices by certain former executive officers, and other former executives may have been aware of this conduct, (5) the retroactive pricing of options involved the falsification of Company records, resulting in erroneous statements being made in financial and other reports previously filed with the SEC, as well as in information previously provided to the Company's independent registered public accounting firm, and (6) in most instances, the retroactive pricing of options violated the terms of the Company's stock option plans. Because virtually all holders of retroactively priced options issued by the Company were not involved in or aware of the retroactive pricing, the Board of Directors decided that the Company should continue to honor the options that violated the terms of the Company's stock option plans, except in certain individual cases as described below.

The Special Committee concluded that, with a few immaterial exceptions, the retroactive pricing of stock options stopped after June 30, 2002. After that time, there were procedures in place to provide reasonable assurance that stock options were priced on the grant date. The Special Committee also concluded that none of the Company's independent Directors was involved in or aware of the retroactive pricing of stock options. Based on the Special Committee's report, the Board of Directors concluded that no current members of management were involved in the retroactive pricing of stock options. During its investigation of the Company's historical stock option practices, the Special Committee did not find evidence of any other financial reporting or accounting issues.

As a result of the Special Committee investigation, on October 16, 2006, the Company terminated its employment relationship and agreement with Kenneth L. Schroeder, and the Company announced its intent to cancel all outstanding stock options held by Mr. Schroeder that were retroactively priced or otherwise improperly granted. Those options were canceled in December 2006. As a result, the Company reversed $16 million and $4 million of stock-based compensation expense for stock options and restricted stock units, respectively. Mr. Schroeder was the Company's Chief Executive Officer and a member of its Board of Directors from mid-1999 until January 1, 2006, and was a member of the Company's stock option committee from 1994 until December 31, 2005. From January 1, 2006 to October 16, 2006, Mr. Schroeder was employed as a Senior Advisor to the Company. On November 10, 2006, Mr. Schroeder's counsel informed the Company that Mr. Schroeder contests the Company's right to terminate his employment relationship and agreement and to cancel any of his options. The Company intends to vigorously defend any claims that may be made by Mr. Schroeder regarding these matters, which could involve a material amount.

Also on October 16, 2006, Stuart J. Nichols, Vice President and General Counsel, resigned. Mr. Nichols and the Company entered into a Separation Agreement and General Release under which Mr. Nichols' outstanding retroactively priced stock options have been re-priced by increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements for the nine months ended March 31, 2007.

On October 16, 2006, Kenneth Levy, Founder and Chairman of the Board of Directors of the Company, retired as a director and employee, and was named Chairman Emeritus by the Board of Directors. Mr. Levy and the Company entered into a Separation Agreement and General Release under which Mr. Levy's outstanding retroactively priced stock options have been re-priced by increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements for the nine months ended March 31, 2007. Mr. Levy was the Company's Chief Executive Officer from 1975 until mid-1999 (with the exception of mid-1997 to mid-1998), was a member of the Company's Board of Directors from 1975 until his retirement, was Chairman of the Board of Directors from 1999 until his retirement, and was a member of the Company's stock option committee from 1994 until use of that committee was suspended in the fall of 2006.

On December 21, 2006, Jon D. Tompkins resigned as a director of the Company, and the Company agreed to modify the outstanding options held by Mr. Tompkins (all of which were fully vested) to extend the post-termination exercisability period to December 31, 2007, which is the last day of the calendar year in which those options would have terminated in the absence of such extension. Mr. Tompkins, the Chief Executive Officer of Tencor Instruments before its merger into the Company in mid-1997, was the Company's Chief Executive Officer from mid-1997 to mid-1998, was a member of the Company's stock option committee from mid-1997 until mid-1999, and was a member of the Company's Board of Directors from mid-1997 until his resignation.

Although the Board of Directors concluded that John H. Kispert, the Company's President and Chief Operating Officer, was not involved in and was not aware of the improper stock option practices, based on the Special Committee's recommendation, his outstanding retroactively priced options have been re-priced because he served as Chief Financial Officer during part of the period in question. This re-pricing involved increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements for the nine months ended March 31, 2007.

The Company learned on February 2, 2007 that the SEC has opened a formal investigation into these matters. The Company is cooperating fully with the USAO and SEC inquiries and intends to continue to do so. These inquiries likely will require the Company to expend significant management time and incur significant legal and other expenses, and could result in civil and criminal actions seeking, among other things, injunctions against the Company and the payment of significant fines and penalties by the Company, which may adversely affect its results of operations and cash flow.

Restatement and Impact on Financial Statements

In addition to restating the consolidated financial statements in response to the Special Committee's findings, the Company recorded additional non-cash adjustments that were previously considered to be immaterial relating primarily to the accounting for employee stock purchase plans, corrections for the recognition of deferred tax assets, the release of tax reserves, the timing of revenue recognition, gains and losses on hedging contracts and the calculation of minority interest. The Company has also corrected the classification of certain amounts presented as cash and cash equivalents and marketable securities relating to investments in Variable Rate Demand Notes.

The Company adopted SFAS No. 123(R) effective July 1, 2005. The grant date fair values of stock options granted prior to fiscal year 2006 were changed as a result of the findings that certain stock option grants were retroactively priced. This change resulted in the recognition of additional stock-based compensation expense of $28 million for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R). The impact of this restatement for subsequent periods is immaterial.

Diluted shares in fiscal year 2006 also increased as a result of the restatement adjustments to correct the past accounting for stock options that were retroactively priced. The Company uses the treasury stock method to calculate the weighted-average shares used in the diluted EPS calculation. As part of the restatement, the Company revised its treasury stock calculations in accordance with SFAS No. 128 *Earnings Per Share*. These calculations assume that (i) all retroactively priced options are exercised, (ii) the Company repurchases shares with the proceeds of these hypothetical exercises along with the tax benefit resulting from the hypothetical exercises, and (iii) any unamortized deferred stock-based compensation is also used to repurchase shares.

Because virtually all holders of retroactively priced options issued by the Company were not involved in or aware of the retroactive pricing, the Company has taken certain actions to deal with the adverse tax consequences that may be incurred by the holders of retroactively priced options. The adverse tax consequences are that retroactively priced stock options vesting after December 31, 2004 ("409A Affected Options") subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). One such action by the Company involved offering to amend the 409A Affected Options to increase the exercise price to the market price on the actual grant date or, if lower, the market price at the time of the amendment. The amended options would not be subject to taxation under IRC Section 409A. Under IRS regulations, these option amendments had to be completed by December 31, 2006 for anyone who was an executive officer when he or she received 409A Affected Options; the amendments for non-officers could not be offered until after the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2006 and Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 were filed and do not need to be completed until December 31, 2007.

During the three months ended March 31, 2007, the Company accrued approximately $20 million payable to non-executive holders of the amended options to compensate them for the resulting increase in their option exercise price. The $20 million is payable in January 2008. Of the $20 million, $9 million was recorded as stock-based compensation expense, and the remaining $11 million was recorded in common stock and capital in excess of par value in the balance sheet. The amount of these bonuses would be effectively repaid to the Company if and when the options are exercised and the increased exercise price is paid. However, there is no assurance that the options will be exercised and the employees will retain the bonuses under all circumstances. During the three months ended March 31, 2007, the Company has also recorded approximately $6 million to compensate certain option holders whose employment terminated or who had already exercised 409A Affected Options for the additional taxes they incur under IRC Section 409A (and, as applicable, similar state tax laws).

Three of the Company's option holders were subject to the December 31, 2006 deadline described above. Accordingly, in December 2006, the Company offered to amend the 409A Affected Options held by Mr. Wallace, the Company's Chief Executive Officer, and two former executive officers to increase the exercise price so that these options will not subject the option holder to a penalty tax under IRC Section 409A. All three individuals accepted the Company's offer. In addition, the Company agreed to pay each of the three individuals a cash bonus in January 2008 equal to the aggregate increase in the exercise prices for his amended options. For Mr. Wallace, the amount of this bonus is $0.4 million. To account for these actions, the Company has recorded a net charge of $0.3 million in the nine months ended March 31, 2007.

With respect to certain individuals whose options were canceled or re-priced by the Company following the Special Committee investigation, no bonuses of the type described above will be paid.

The following tables have been revised to reflect the impact of the additional non-cash charges for stock-based compensation expense and related tax effects as well as additional non-cash adjustments that were previously considered to be immaterial on:

- the condensed consolidated statements of operations for the three and nine months ended March 31, 2006
- the condensed consolidated statements of cash flows for the nine months ended March 31, 2006.

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Condensed Consolidated Statements of Operations

(Unaudited)	Three Months Ended March 31, 2006			Nine Months Ended March 31, 2006		
(In thousands, except per share data)	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated
Revenues:						
Product	$ 427,676	$ 1,392	$ 429,068	$ 1,229,346	$ 855	$ 1,230,201
Service	90,580	—	90,580	260,740	650	261,390
Total revenues	518,256	1,392	519,648	1,490,086	1,505	1,491,591
Costs and operating expenses:						
Costs of revenues*	226,620	(45)	226,575	657,943	(16)	657,927
Engineering, research and development*	95,927	1,706	97,633	291,005	4,205	295,210
Selling, general and administrative*	108,364	2,149	110,513	296,440	7,103	303,543
Total costs and operating expenses	430,911	3,810	434,721	1,245,388	11,292	1,256,680
Income from operations	87,345	(2,418)	84,927	244,698	(9,787)	234,911
Interest income and other, net	17,225	—	17,225	48,686	(700)	47,986
Income before income taxes and minority interest	104,570	(2,418)	102,152	293,384	(10,487)	282,897
Provision for income taxes	7,347	(959)	6,388	44,834	(7,793)	37,041
Income before minority interest	97,223	(1,459)	95,764	248,550	(2,694)	245,856
Minority interest	920	—	920	2,920	—	2,920
Net income	$ 98,143	$ (1,459)	$ 96,684	$ 251,470	$ (2,694)	$ 248,776
Net income per share:						
Basic	$ 0.49	$ (0.01)	$ 0.48	$ 1.27	$ (0.02)	$ 1.25
Diluted	$ 0.48	$ (0.01)	$ 0.47	$ 1.23	$ (0.01)	$ 1.22
Weighted average number of shares:						
Basic	199,876	—	199,876	198,498	—	198,498
Diluted	204,818	543	205,361	203,696	598	204,294

* includes the following amounts related to equity awards						
Cost of revenues	$ 6,243	$ (45)	$ 6,198	$ 19,666	$ (17)	$ 19,649
Engineering, Research and development	$ 10,782	$ 1,706	$ 12,488	$ 33,815	$ 4,204	$ 38,019
Selling, general and administrative	$ 27,526	$ 2,149	$ 29,675	$ 62,152	$ 7,106	$ 69,258

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Condensed Consolidated Statements of Cash Flows

(Unaudited)	Nine Months Ended March 31, 2006		
(In thousands)	As previously reported	Adjustments	As restated
Cash flows from operating activities:			
Net income	$ 251,470	$ (2,694)	$ 248,776
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	51,495	700	52,195
Non-cash, stock-based compensation	115,633	11,293	126,926
Minority interest	(2,920)		(2,920)
Net loss on sale of marketable securities and other investments	3,419		3,419
Tax benefit from employee stock options	44,100	(13,424)	30,676
Excess tax benefit from stock-based compensation	(16,676)	3,432	(13,244)
Changes in assets and liabilities, net of effect of acquisitions of businesses:			
Accounts receivable, net	(136,017)	(159)	(136,176)
Inventories	(75,850)	(2,411)	(78,261)
Other assets	(23,720)	2,458	(21,262)
Accounts payable	29,611		29,611
Deferred system profit	9,969	(552)	9,417
Other current liabilities	(69,131)	4,789	(64,342)
Net cash provided by operating activities	181,383	3,432	184,815
Cash flows from investing activities:			
Acquisitions of businesses, net of cash received	(7,664)		(7,664)
Purchase of property, plant, and equipment, net	(59,124)		(59,124)
Purchase of available-for-sale securities	(3,241,357)		(3,241,357)
Proceeds from sale of available-for-sale securities	3,290,827		3,290,827
Proceeds from maturity of available-for-sale securities	136,907		136,907
Net cash provided by investing activities	119,589	—	119,589
Cash flows from financing activities:			
Issuance of common stock	180,307		180,307
Payment of dividends to stockholders	(71,461)		(71,461)
Excess tax benefit from stock-based compensation	16,676	(3,432)	13,244
Stock repurchases	(143,132)		(143,132)
Proceeds from sale of minority interest in subsidiary	4,736		4,736
Net cash used in financing activities	(12,874)	(3,432)	(16,306)
Effect of exchange rate changes on cash and cash equivalents	10,734		10,734
Net increase in cash and cash equivalents	298,832	—	298,832
Cash and cash equivalents at beginning of period	663,163		663,163
Cash and cash equivalents at end of period	$ 961,995	$ —	$ 961,995
Supplemental cash flow disclosures:			
Income taxes paid, net	$ 61,143		$ 61,143
Interest paid	$ 1,066		$ 1,066

NOTE 3 – BALANCE SHEET COMPONENTS

(In thousands)	March 31, 2007	June 30, 2006
Cash equivalents and marketable securities:		
U.S. Treasuries	$ —	$ 25,908
U.S. Government agency securities	3,042	353,567
Municipal bonds	990,359	1,001,073
Corporate equity securities	372	362
Money market bank deposits and other	395,292	804,017
	$1,389,065	$2,184,927
Less: Cash equivalents	(408,247)	(988,322)
Short-term marketable securities	$ 980,818	$1,196,605
Accounts receivable, net		
Accounts receivable, gross	$ 511,085	$ 452,007
Allowance for doubtful accounts	(11,787)	(12,108)
	$ 499,298	$ 439,899
Inventories		
Customer service parts	$ 176,688	$ 169,747
Raw materials	144,487	100,532
Work-in-process	111,058	91,413
Finished goods and demonstration equipment	97,908	87,464
	$ 530,141	$ 449,156
Property and equipment		
Land	$ 84,319	$ 86,408
Buildings and improvements	132,497	162,337
Machinery and equipment	406,462	388,113
Office furniture and fixtures	37,895	42,769
Leasehold improvements	132,474	142,587
Construction in process	25,581	12,809
	819,228	835,023
Less: accumulated depreciation	(455,461)	(439,611)
	$ 363,767	$ 395,412
Other assets		
Long-term investments	$ 186,852	$ 164,552
Deferred tax assets – long-term	367,422	392,028
Other	10,267	10,335
	$ 564,541	$ 566,915
Other current liabilities		
Warranty and retrofit	$ 61,467	$ 50,604
Compensation and benefits	315,598	281,815
Income taxes payable	86,645	126,750
Other accrued expenses	167,984	141,435
	$ 631,694	$ 600,604

NOTE 4 – BUSINESS COMBINATIONS

ADE Corporation (“ADE”)

On October 11, 2006, the Company acquired all of the shares of ADE, a supplier of semiconductor process control solutions. In order to acquire ADE, the Company paid $490 million which includes $8 million of direct costs. The acquisition has been accounted for as a purchase. With the acquisition, the Company gains entry into the wafer metrology market, expands into a broader range of products and services, and gains access to ADE’s workforce and intellectual property portfolio, which will contribute to the growth of the Company’s core businesses. The operating results of ADE have been included in KLA’s consolidated financial statements beginning October 12, 2006

The following table summarizes the estimated fair values of the net assets acquired at the date of acquisition:

(In thousands)	Preliminary Purchase Price Allocation
Cash	$ 99,673
Current assets	78,910
Intangibles:	
Existing technology	59,900
Patents	30,200
Trade name / Trademarks	11,800
Customer relationships	26,800
In Process R&D	2,900
Other intangible assets	8,300
Noncurrent assets	26,656
Goodwill	236,970
Liabilities assumed (1)	(91,266)
	$ 490,843
Cash consideration	$ 489,834
Value of options assumed	1,009
Total consideration	$ 490,843

(1) $4.2 million of accrued severance created as a result of the acquisition has been included in liabilities assumed.

The Company currently has not identified any material pre-merger contingencies where a liability is probable and the amount of the liability can be reasonably estimated. If information becomes available prior to the end of the purchase price allocation period, which would indicate that it is probable that such events had occurred and the amounts can be reasonably estimated, such items will be included in the purchase price allocation. Furthermore, the preliminary nature of the purchase price allocation is also based upon the completion of the ADE integration plan.

The intangible assets are being amortized on a straight-line basis over estimated useful lives ranging from six months for order backlog to nine years for trade name / trademarks.

Other acquisitions

On January 16, 2007, KLA-Tencor acquired OnWafer Technologies, Inc. and SensArray Corporation for a total of $53 million in cash. Both companies design and produce sensors that are embedded in wafers to collect information on the performance of tools used in the semiconductor manufacturing process. The operating results of OnWafer Technologies, Inc. and SensArray Corporation have been included in KLA's consolidated financial statements effective January 17, 2007.

The following table summarizes the estimated fair values of the net assets acquired from OnWafer Technologies, Inc. and SensArray Corporation at the date of acquisition:

(In thousands)	Purchase Price Allocation
Net assets acquired	$ 6,186
Intangibles	22,032
In Process R&D	1,700
Goodwill	22,814
Total	$ 52,732

The business combinations completed during fiscal years 2006 and 2005 are disclosed in Note 6 to Consolidated Financial Statements included in Item 8 of the Company's Annual Report on Form 10-K for the year ended June 30, 2006.

In connection with the acquisitions completed during 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. During the second quarter of fiscal 2006, $5.4 million of this amount was paid and the remaining $3.7 million was paid during the second quarter of fiscal 2007.

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NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The following table presents goodwill balances and the movements during the nine months ended March 31, 2007:

(In thousands)	Amount
As of June 30, 2006	$ 49,292
Acquisitions	260,232
Adjustments	(2,471)
As of March 31, 2007	$307,053

Adjustments to goodwill during the nine months ended March 31, 2007 resulted primarily from the fair value adjustment related to the purchase of minority interest in a subsidiary.

The carrying value of goodwill was allocated to KLA-Tencor's reporting units pursuant to SFAS No. 142*Goodwill and Other Intangible Assets*. The increase in the carrying value of goodwill was primarily due to acquisitions. In accordance with SFAS No. 142, KLA-Tencor completed its annual evaluation of the goodwill by reporting unit during the quarter ended December 31, 2006, and concluded that there was no impairment. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination.

Other Intangible Assets

The components of other intangible assets as of March 31, 2007 and June 30, 2006 were as follows:

(In thousands)	March 31, 2007			June 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Existing technology	$ 85,871	$ 12,065	$ 73,806	$13,078	$ 5,018	$ 8,060
Patents	48,361	9,187	39,174	18,161	5,622	12,539
Trade name / Trademark	14,435	1,569	12,866	1,225	775	450
Customer relationships	34,070	2,139	31,931	—	—	—
Other	8,762	8,262	500	200	200	—
Total	$191,499	$ 33,222	$158,277	$32,664	$ 11,615	$ 21,049

For the three month periods ended March 31, 2007 and 2006, amortization expense for other intangible assets was $11.0 million and $0.9 million, respectively. For the nine month periods ended March 31, 2007 and 2006, amortization expense for other intangible assets was $21.6 million and $3.2 million, respectively.

Based on the intangible assets recorded as of March 31, 2007, and assuming no subsequent additions to, or impairment of the underlying assets, the remaining estimated amortization expense is expected to be as follows:

Fiscal year ending June 30:	Amortization (In thousands)
2007 (remaining 3 months)	$ 6,952
2008	27,745
2009	27,725
2010	27,725
2011	26,717
Thereafter	41,413
Total	$ 158,277

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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, which includes consideration of stock-based compensation required by SFAS No. 123(R) *Share-Based Payment* and SFAS No. 128 *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, 2007	Three months ended March 31, 2006 As restated	Nine months ended March 31, 2007	Nine months ended March 31, 2006 As restated
Numerator:				
Net Income	$ 154,785	$ 96,684	$ 380,756	$ 248,776
Denominator:				
Weighted average shares outstanding, excluding unvested restricted stock units	197,930	199,876	199,053	198,498
Effect of dilutive options and restricted stock units	5,544	5,485	4,923	5,796
Denominator for diluted earnings per share	203,474	205,361	203,976	204,294
Basic earnings per share	$ 0.78	$ 0.48	$ 1.91	$ 1.25
Diluted earnings per share	$ 0.76	$ 0.47	$ 1.87	$ 1.22
Potentially dilutive securities (1)	8,727	14,382	13,080	16,537

(1) These securities are excluded from the computation of diluted earnings per share for the above periods because their effect would have been anti-dilutive.

During the third quarter of fiscal year 2005, the Company's Board of Directors authorized a quarterly cash dividend of $0.12 per share. The total amount of dividends paid during the three and nine months ended March 31, 2007 was $23.9 and $72.0 million, respectively.

In February 2007, the Company entered into an Accelerated Share Repurchase program ("ASR") with a third-party investment bank and prepaid $750 million to repurchase its common stock. See Note 8 for the impact of ASR on earnings per share.

NOTE 7 – STOCK-BASED COMPENSATION

Effective July 1, 2005, KLA-Tencor adopted the provisions of SFAS No. 123(R) *Share-Based Payment*. SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period. The Company previously applied APB Opinion No. 25 *Accounting for Stock Issued to Employees* and its related Interpretations and provided the required pro forma disclosures of SFAS No. 123 *Accounting for Stock-Based Compensation*.

The following table shows pre-tax stock-based compensation expense by type of award for the three and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Stock-based compensation expense by type of award:				
Employee stock options	$ 26.1	$ 39.8	$ 64.2	$ 107.8
Employee stock purchase plan	0.5	4.4	9.6	12.5
Restricted stock units	2.7	4.2	8.6	6.7
Total stock-based compensation (1)	$ 29.3	$ 48.4	$ 82.4	$ 127.0

(1) Stock-based compensation expense for the nine months ended March 31, 2007 includes a $20 million reversal of stock-based compensation charges for the Company's former Chief Executive Officer and $9 million of cash compensation related to bonuses payable to the holders of the amended options to compensate them for the increase in their option exercise price.

Stock Options

The following table shows the number of options granted, grant-date fair value, and stock-based compensation expense related to stock options for the three and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Number of options granted	0.1	0.5	0.3	4.6
Grant-date fair value after estimated forfeitures	$ 0.2	$ 4.4	$ 2.2	$ 49.3
Stock-based compensation expense (1)	$ 26.1	$ 39.8	$ 64.2	$ 107.8

(1) Stock-based compensation expense related to options for the nine months ended March 31, 2007 is net of a $16 million reversal of stock-based compensation charges for the Company's former Chief Executive Officer

As of March 31, 2007, the unrecognized stock-based compensation balance related to stock options was $124.2 million and will be recognized over an estimated weighted average amortization period of 2.8 years.

The following table shows stock-based compensation capitalized as inventory and deferred system profit as of March 31, 2007 and June 30, 2006:

(In millions)	March 31, 2007	June 30, 2006
Inventory	$ 6.6	$ 6.0
Deferred system profit	$ 1.3	$ 1.6

Valuation Assumptions

In connection with the adoption of SFAS No. 123(R), the Company reassessed its valuation technique and related assumptions. The Company estimates the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R), SEC SAB No. 107 and the Company's prior period pro forma disclosures of net earnings, including stock-based compensation (determined under a fair value method as prescribed by 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 straight-line attribution approach with the following weighted-average assumptions:

	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Stock option plan:				
Expected stock price volatility	32%	34%	34%	30%
Risk free interest rate	4.7%	4.5%	5.0%	4.1%
Dividend yield	1.0%	0.9%	1.1%	1.0%
Expected life of options (in years)	4.4	4.2	4.4	4.6
Stock purchase plan:				
Expected stock price volatility	35%	33%	35%	33%
Risk free interest rate	5.0%	3.6%	5.0%	3.6%
Dividend yield	1.0%	1.1%	1.1%	1.1%
Expected life of options (in years)	1.3	1.3	1.3	1.3

SFAS No. 123(R) 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. The expected stock price volatility assumption was determined using the implied volatility of the Company's common stock. Prior to the adoption of SFAS No. 123(R), the Company used a combination of historical and implied volatility in deriving its expected volatility assumption. The Company determined that implied volatility is more reflective of market conditions and a better indicator of expected volatility than a blended volatility.

Equity Incentive Program

The Company's equity incentive program is a broad-based, long-term retention program that is intended to attract and retain key 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 the Company's stock, and another in which non-employee directors, officers, key employees, consultants and all other employees may be granted options to purchase shares of the Company's stock, restricted stock units and other types of equity awards. For the past several years until June 30, 2006, stock options (except for the retroactively priced option grants) have generally been granted at the market price of the Company's common stock on the date of grant, generally have a vesting period of five years and are exercisable for a period not to exceed seven years (ten years for options granted prior to July 1, 2005) from the date of issuance. Restricted stock units may be granted with varying criteria such as time-based or performance-based vesting. Substantially all of the Company's employees that meet established performance goals and qualify as key employees participate in its main equity incentive plan. Since July 1, 2006, the Company has granted only restricted stock units under its equity incentive program, except for options granted to non-employee directors as part of their regular compensation package.

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

(In thousands)	Available For Grant	Awards Outstanding	Weighted-Average Exercise Price
Balances as of June 30, 2006	6,318	30,362	$ 40.00
Additional shares reserved	176	—	—
Plan shares expired	(2,537)	—	—
Options granted	(119)	119	$ 45.05
Restricted stock units granted[(1)]	(4,986)	—	—
Restricted stock units canceled[(1)]	812	—	—
Options canceled/expired/forfeited	3,666	(3,666)	$ 42.27
Options exercised		(3,263)	$ 34.11
Options assumed – ADE acquisition	(176)	176	$ 31.03
Balances as of March 31, 2007	3,155	23,728	$ 41.54

(1) 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.

The weighted average grant date fair value of options, as determined under SFAS No. 123(R), granted during the nine months ended March 31, 2007 and 2006 was $13.66 and $14.03 per share, respectively. The total number of in-the-money options exercisable as of March 31, 2007 was 12.9 million shares.

The total intrinsic value of options exercised during the nine months ended March 31, 2007 and 2006 was $52.5 million and $120.3 million, respectively. The total cash received from employees as a result of employee stock option exercises during the nine months ended March 31, 2007 and 2006 was approximately $112.0 million and $161.5 million, respectively. In connection with these exercises, the tax benefits realized by the Company for the nine months ended March 31, 2007 and 2006 was $18.1 and $44.1 million, respectively.

The Company settles employee stock option exercises with newly issued common shares.

Restricted Stock Units

The following table shows the number of restricted stock units granted, grant-date fair value, and stock-based compensation expense for the three and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Number of shares granted	0.2	0.2	2.8	0.7
Grant-date fair value	$ 6.4	$ 6.4	$ 89.9	$ 23.2
Stock-based compensation expense	$ 2.7	$ 4.2	$ 8.6	$ 6.7

(1) Stock-based compensation expense related to restricted stock units for the nine months ended March 31, 2007 is net of a $4 million reversal of stock-based compensation charges for the Company's former Chief Executive Officer

Beginning in the fiscal year 2007, the restricted stock units generally vest in two equal installments on the second and fourth anniversaries of the date of grant. Prior to fiscal year 2007, the restricted stock units generally vested in two equal installments on the fourth and fifth anniversaries of the date of the grant. The value of the restricted stock units was based on the closing market price of the Company's common stock on the date of award. The restricted stock units were awarded under the Company's 2004 Equity Incentive Plan and each unit will entitle the recipient to one share of common stock when the applicable vesting requirements for that unit are satisfied. However, for each share actually issued under the awarded units, the share reserve under the Plan will be reduced by 1.8 shares, as provided under the terms of such Plan.

As of March 31, 2007, the unrecognized stock-based compensation balance related to restricted stock units was $75.6 million and will be recognized over an estimated weighted average amortization period of 3.5 years.

Employee Stock Purchase Plan

KLA-Tencor's Employee Stock Purchase Plan ("ESPP") provides that eligible employees may contribute up to 10% of their eligible earnings toward the semi-annual purchase of KLA-Tencor's common stock. The ESPP is qualified under Section 423 of the Internal Revenue Code. The employee's purchase price is derived from a formula based on the fair market value of the common stock at the time of enrollment into the offering period versus the fair market value on the date of purchase. Offering periods are generally two years in length. On September 28, 2006, the ESPP plan was suspended due to the ongoing stock option investigation, and accordingly there were no shares purchased under the employee stock purchase plan during the six months ended December 31, 2006. After filing the Company's Annual Report on January 29, 2007 of the Company's Annual Report on Form 10-K for the year-ended June 30, 2006 and its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, approximately 0.3 million shares were purchased under the ESPP on February 1, 2007. Total cash received from employees for the issuance of shares under the ESPP was approximately $10.8 million during the nine months ended March 31, 2007.

The plan shares are replenished annually on the first day of each fiscal year by virtue of an evergreen provision. The provision allows for share replenishment equal to the lesser of 2,000,000 shares or the number of shares which KLA-Tencor estimates will be required to issue under the plan during the forthcoming fiscal year. As of March 31, 2007, a total of 1.5 million shares were reserved and available for issuance under this plan.

On October 12, 2006, the Compensation Committee of the Board of Directors of the Company approved an alternative financial benefit consisting of a cash payment to all employees below the vice president level who had been active participants in the ESPP before it was temporarily suspended on September 28, 2006. The alternative financial benefit is intended to compensate such employees for the estimated financial benefit they would have realized had the ESPP continued in operation after September 28, 2006 and until December 31, 2006. On January 24, 2007, the Compensation Committee extended this alternative financial benefit into 2007 to cover the period until the ESPP suspension ends. The Company recorded approximately $5 million for the alternative financial benefit during the nine months ended March 31, 2007.

Former Chief Executive Officer Agreement and Termination

During November 2005, the Company announced that effective January 1, 2006, Kenneth L. Schroeder would cease to be its Chief Executive Officer and would thereafter be employed as a Senior Advisor. The Company and Mr. Schroeder also revised his prior agreement with the Company and defined the salary, bonus payout and equity award vesting during the period of his employment as a Senior Advisor. Effective January 1, 2006, the Company determined that all service conditions associated with certain prior equity awards under the terms of the revised agreement with Mr. Schroeder had been satisfied; and accordingly, the Company recorded at that time an additional non-cash, stock-based compensation charge of approximately $9.8 million relating to these equity awards. The above mentioned charge is included as a component of Selling, General and Administrative ("SG&A") expense during fiscal year 2006. On October 16, 2006, following the Special Committee investigation of the Company's historical stock option practices, the Company terminated all aspects of Mr. Schroeder's employment relationship and agreement with the Company. As a result, vesting of Mr. Schroeder's then outstanding stock options and restricted stock awards immediately ceased, and the 890,914 unvested option shares and 100,000 unvested restricted stock award shares held by Mr. Schroeder at the time of termination were canceled. Accordingly, during the nine months ended March 31, 2007 the Company reversed $20.3 million of the non-cash, stock-based compensation charges that had been recorded in prior periods related to unvested option shares and restricted stock award shares. In December 2006, the Company canceled 596,740 vested option shares held by Mr. Schroeder as of the time of termination, representing those shares that had been retroactively priced or otherwise improperly granted.

IRC Section 409A Affected Options

Because virtually all holders of retroactively priced options issued by the Company were not involved in or aware of the retroactive pricing, the Company has taken certain actions to deal with the adverse tax consequences that may be incurred by the holders of retroactively priced options. The adverse tax consequences are that retroactively priced stock options vesting after December 31, 2004 ("409A Affected Options") subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). One such action by the Company involved offering to amend the 409A Affected Options to increase the exercise price to the market price on the actual grant date or, if lower, the market price at the time of the amendment. The amended options would not be subject to taxation under IRC Section 409A. Under IRS regulations, these option amendments had to be completed by December 31, 2006 for anyone who was an executive officer when he or she received 409A Affected Options; the amendments for non-officers could not be offered until after the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2006 and Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 were filed and do not need to be completed until December 31, 2007.

During the three months ended March 31, 2007, the Company accrued approximately $20 million payable to non-executive holders of the amended options to compensate them for the resulting increase in their option exercise price. The $20 million is payable in January 2008. Of the $20 million, $9 million was recorded as stock-based compensation expense, and the remaining $11 million was recorded in common stock and capital in excess of par value in the balance sheet. The amount of these bonuses would be effectively repaid to the Company if and when the options are exercised and the increased exercise price is paid. However, there is no assurance that the options will be exercised and the employees will retain the bonuses under all circumstances. During the three months ended March 31, 2007, the Company has also recorded approximately $6 million to compensate certain option holders whose employment terminated or who had already exercised 409A Affected Options for the additional taxes they incur under IRC Section 409A (and, as applicable, similar state tax laws).

Three of the Company's option holders were subject to the December 31, 2006 deadline described above. Accordingly, in December 2006, the Company offered to amend the 409A Affected Options held by Mr. Wallace, the Company's Chief Executive Officer, and two former executive officers to increase the exercise price so that these options will not subject the option holder to a penalty tax under IRC Section 409A. All three individuals accepted the Company's offer. In addition, the Company agreed to pay each of the three individuals a cash bonus in January 2008 equal to the aggregate increase in the exercise prices for his amended options. For Mr. Wallace, the amount of this bonus is $0.4 million. To account for these actions, the Company has recorded a net charge of $0.3 million during the nine months ended March 31, 2007.

With respect to certain individuals whose options were canceled or re-priced by the Company following the Special Committee investigation, no bonuses of the type described above will be paid.

NOTE 8 – STOCK REPURCHASE PROGRAM

In July 1997, the Board of Directors authorized KLA-Tencor to systematically repurchase shares of its common stock in the open market. This plan was put into place to reduce the dilution from KLA-Tencor's employee benefit and incentive plans such as the stock option and employee stock purchase plans, and to return excess cash to the Company's shareholders. From the inception of the repurchase program in 1997 through March 31, 2007 the Board of Directors authorized KLA-Tencor to repurchase a total of 37.8 million shares, including 10 million shares authorized in February 2005, and an additional 10 million shares authorized in February 2007. In addition, the Board of Directors authorized a repurchase of up to $750 million of the Company's common stock pursuant to an Accelerated Share Repurchase program ("ASR") in February, 2007. The Company's systematic buyback program was suspended in May 2006, and resumed in February 2007.

In February 2007, the Company entered into an Accelerated Share Repurchase program ("ASR") with a third-party investment bank and prepaid $750 million to repurchase its common stock. The program has two separate components. The first component is the purchase of shares, and the second component is the forward contract indexed to the Company's own common stock. The purchase price per share of the common stock repurchased through the ASR will be determined and adjusted based on a discount to the volume-weighted average price of the Company's common stock during a period following the execution of the ASR agreement, subject to a maximum price per share. The exact number of shares repurchased pursuant to the ASR will be determined based on such adjusted price, but is not expected to be less than approximately 13 million shares. During the three months ended March 31, 2007 the Company received approximately 12 million shares under the ASR. The ASR is expected to be completed during the fourth quarter of fiscal year 2007.

The payment of $750 million was included in the cash flows from financing activities in the Company's Consolidated Condensed Statement of Cash Flows. The shares received were multiplied by the closing stock price on the date of receipt to determine the cost of repurchase. The entire $750 million was recorded in the stockholders' equity section of its Consolidated Condensed Balance Sheet. The Company decreases its shares outstanding as shares are physically received under the Company's repurchase program, including the ASR.

Share repurchases for the three and nine months ended March 31, 2007 and 2006 were as follows:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Number of shares of common stock repurchased	12,251	1,148	12,251	2,884
Total cost of repurchase	$ 649,906	$ 58,770	$ 649,906	$ 143,132

NOTE 9 – COMPREHENSIVE INCOME

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

(In thousands)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated	Nine months ended March 31, 2007	Nine months ended March 31, 2006 As restated
Net Income	$ 154,785	$ 96,684	$ 380,756	$ 248,776
Other comprehensive income (loss):				
Currency translation adjustments	1,290	4,094	4,036	(2,814)
Gain (loss) on cash flow hedging instruments, net	(2,281)	(5,633)	3,046	(2,407)
Unrealized gains (losses) on investments (1)	(388)	(575)	3,930	(5,591)
Other comprehensive income (loss)	$ (1,379)	$ (2,114)	$ 11,012	$ (10,812)
Total comprehensive income	$ 153,406	$ 94,570	$ 391,768	$ 237,964

(1) Taxes (benefits) included in unrealized gains (losses) on investments	$ —	$ (342)	$ 2,190	$ (3,326)

NOTE 10 – LITIGATION AND OTHER LEGAL MATTERS

Government Inquiries Relating to Historical Stock Option Practices On May 23, 2006, the Company received a subpoena from the USAO requesting information relating to its past stock option grants and related accounting matters. Also on May 23, 2006, the Company received a letter from the SEC making an informal inquiry and request for information on the same subject matters. The Company learned on February 2, 2007 that the SEC has opened a formal investigation into these matters. The Company is cooperating fully with the USAO and SEC inquiries and intends to continue to do so. These inquiries likely will require the Company to expend significant management time and incur significant legal and other expenses, and could result in civil and criminal actions seeking, among other things, injunctions against the Company and the payment of significant fines and penalties by the Company, which may adversely affect its results of operations and cash flow.

The Company has also responded to inquiries from the U.S. Department of Labor, which is conducting an examination of its 401(k) Savings Plan prompted by the Company's stock option issues. The Company is cooperating fully with this examination and intends to continue to do so.

The Company cannot predict how long it will take to or how much more time and resources it will have to expend to resolve these government inquiries, nor can it predict the outcome of these inquiries. Also, there can be no assurance that other inquiries, investigations or actions will not be started by other United States federal or state regulatory agencies or by foreign governmental agencies.

Shareholder Derivative Litigation Relating to Historical Stock Option Practices Beginning on May 22, 2006, several persons and entities identifying themselves as shareholders of KLA-Tencor filed derivative actions purporting to assert claims on behalf of and in the name of the Company against various of the Company's current and former directors and officers relating to its accounting for stock options issued from 1994 to present. The complaints in these actions allege that the individual defendants breached their fiduciary duties and other obligations to the Company and violated state and federal securities laws in connection with the Company's historical stock option granting process, its accounting for past stock options, and historical sales of stock by the individual defendants. Three substantially similar actions are pending, one in the U.S. District Court for the Northern District of California (which consists of three separate lawsuits consolidated in one action); one in the California Superior Court for Santa Clara County; and one in the Delaware Chancery Court.

The plaintiffs in the derivative actions have asserted claims for violations of Sections 10(b) (including Rule 10b-5 thereunder), 14(a), and 20(a) of the Securities Exchange Act of 1934, unjust enrichment, breach of fiduciary duty and aiding and abetting such breach, negligence, misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, breach of contract, constructive fraud, rescission, and violations of California Corporations Code section 25402, as well as a claim for an accounting of all stock option grants made to the named defendants. KLA-Tencor is named as a nominal defendant in these actions. On behalf of KLA-Tencor, the plaintiffs seek unspecified monetary and other relief against the named defendants.

The plaintiffs are James Ziolkowski, Mark Ziering, Alaska Electrical Pension Fund, Jeffrey Rabin, and Benjamin Langford. The individual named defendants are current directors and officers; Edward W. Barnholt, H. Raymond Bingham, Robert T. Bond, Jeffrey L. Hall, Stephen P. Kaufman, John H. Kispert, Lida Urbanek and Richard P. Wallace; and former directors and officers; Robert J. Boehlke, Leo Chamberlain, Gary E. Dickerson, Richard J. Elkus, Jr., Dennis J. Fortino, Kenneth Levy, Michael E. Marks, Stuart J. Nichols, Arthur P. Schnitzer, Kenneth L. Schroeder and Jon D. Tompkins. Current director David C. Wang and former director Dean O. Morton were originally named as defendants in one of the derivatives actions filed in the U.S. District Court for the Northern District of California, but were dropped as named defendants as of December 22, 2006 upon the filing of a consolidated complaint in that action.

The derivative actions are at an early stage and the defendants are not yet required to respond to the complaints. The Company's Board of Directors has appointed a Special Litigation Committee ("SLC") composed solely of independent directors to conduct an independent investigation of the claims asserted in the derivative actions and to determine the Company's position with respect to those claims. The SLC's investigation is in progress. The Company cannot predict whether these actions are likely to result in any material recovery by or expense to KLA-Tencor.

Shareholder Class Action Litigation Relating to Historical Stock Option Practices KLA-Tencor and various of its current and former directors and officers were named as defendants in a putative securities class action filed on June 29, 2006 in the U.S. District Court for the Northern District of California. Two similar actions were filed later in the same court, and all three cases have been consolidated into one action. The consolidated complaint alleges claims under the Securities Exchange Act of 1934 as a result of the Company's past stock option grants and related accounting and reporting, and seek unspecified monetary damages and other relief. The plaintiffs seek to represent a class consisting of purchasers of KLA-Tencor stock between June 30, 2001 and May 22, 2006 who allegedly suffered losses as a result of material misrepresentations in KLA-Tencor's SEC filings during that period. The lead plaintiffs, who seek to represent the class, are the Police and Fire Retirement System of the City of Detroit, the Louisiana Municipal Police Employees' Retirement System, and the City of Philadelphia Board of Pensions and Retirement. The defendants are KLA-Tencor, Edward W. Barnholt, H. Raymond Bingham, Robert J. Boehlke, Robert T. Bond, Gary E. Dickerson, Richard J. Elkus, Jr., Jeffrey L. Hall, Stephen P. Kaufman, John H. Kispert, Kenneth Levy, Michael E. Marks, Stuart J. Nichols, Kenneth L. Schroeder, Jon D. Tompkins, Lida Urbanek and Richard P. Wallace.

This litigation is at an early stage. Discovery has not commenced, the court has not yet determined whether the plaintiffs may sue on behalf of any class of purchasers, and the defendants are not yet required to respond to the complaints. The Company intends to vigorously defend this litigation.

As part of a derivative lawsuit filed in the Delaware Chancery Court on July 21, 2006 (described above), a plaintiff claiming to be a KLA-Tencor shareholder also asserted a separate putative class action claim against the Company and certain of its current and former directors and officers alleging that shareholders incurred damage due to purported dilution of KLA-Tencor common stock resulting from historical stock option granting practices.

The Company cannot predict the outcome of the shareholder class action cases (described above), and it cannot estimate the likelihood or potential dollar amount of any adverse results. However, an unfavorable outcome in this litigation could have a material adverse impact upon the financial position, results of operations or cash flows for the period in which the outcome occurs and in future periods.

Indemnification Obligations Subject to certain limitations, the Company is obligated to indemnify its current and former directors, officers and employees in connection with the investigation of the Company's historical stock option practices and related government inquiries and litigation. These obligations arise under the terms of the Company's certificate of incorporation, its bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify generally means that the Company is required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. The Company is currently paying or reimbursing legal expenses being incurred in connection with these matters by a number of its current and former directors, officers and employees. Although the maximum potential amount of future payments KLA-Tencor could be required to make under these agreements is theoretically unlimited, the Company believes the fair value of this liability is adequately covered within the reserves it has established for currently pending legal proceedings.

Other Legal Matters The Company 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 legal proceedings are difficult to predict.

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. 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.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs and related discounting fees paid for the three months and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Receivables sold under factoring agreements	$ 53.0	$ 70.8	$ 197.6	$ 182.0
Proceeds from sales of LCs	$ 4.3	$ 21.6	$ 43.0	$ 55.3
Discounting fees paid on sales of LCs (1)	$ 0.05	$ 0.3	$ 0.5	$ 0.6

(1) Discounting fees were equivalent to interest expense and were recorded in interest and other income net.

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 its Condensed Consolidated Balance Sheet.

The following is a schedule of operating leases payments:

Fiscal year ended June 30,	Amount (In thousands)
2007 (remaining 3 months)	$ 2,402
2008	8,268
2009	6,817
2010	4,440
2011	3,332
2012 and thereafter	10,412
Total minimum lease payments	$ 35,671

Purchase Commitments KLA-Tencor maintains certain open inventory purchase commitments with its suppliers to ensure a smooth and continuous supply 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 $166.3 million as of March 31, 2007 and are primarily due within the next 12 months. 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 canceled. 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 periodically. The actual product performance and/or field expense profiles may differ, and in those cases KLA-Tencor adjusts warranty accruals accordingly.

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The following table provides the changes in the product warranty accrual for the three and nine months ended March 31, 2007 and 2006:

(In thousands)	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Beginning balance	$ 48,390	$43,353	$ 45,642	$ 46,647
Accruals for warranties issued during the period	14,788	13,576	43,737	34,541
Changes in liability related to pre-existing warranties	(1,578)	(3,355)	(6,368)	(6,136)
Settlements made during the period	(11,982)	(9,864)	(33,393)	(31,342)
Ending balance	$ 49,618	$43,710	$ 49,618	$ 43,710

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 minimis 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 the 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, results of operations or cash flows.

The Company maintains guarantee arrangements of $27 million in various locations to fund Custom's guarantee for VAT and letter of credits needs of its subsidiaries in Europe and Asia. Approximately $20 million was outstanding under these arrangements as of March 31, 2007.

Pending Acquisition On January 7, 2007, the Company signed a definitive merger agreement to acquire Therma-Wave, Inc. through a cash tender offer of $1.65 per share, or a total of approximately $74 million. Therma-Wave develops, manufactures, markets and services process control metrology systems used in the manufacture of semiconductors. The transaction is subject to customary closing conditions, including regulatory approvals and the acquisition by the Company of a majority of the voting power of Therma-Wave in the tender offer.

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 future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions. KLA-Tencor does not use derivative financial instruments for speculative or trading purposes.

The outstanding hedge contracts, with maximum maturity of 13 months, were as follows:

(In millions)	As of March 31, 2007	As of June 30, 2006
Cash flow hedge contracts		
Purchase	$ 21.8	$ 15.2
Sell	(180.3)	(167.5)
Other foreign currency hedge contracts		
Purchase	93.9	128.4
Sell	(272.1)	(260.2)
Net	$ (336.7)	$ (284.1)

NOTE 13 – ASSET IMPAIRMENT AND SEVERANCE CHARGES

During the three months ended December 31, 2006, as part of the long-term business plan, the Company decided to sell certain real estate properties owned by the Company in San Jose, California and Livermore, California. Based on the valuation of these assets, the Company recorded an asset impairment charge of approximately $57 million, which has been included in SG&A during the quarter ended December 31, 2006. In November 2006, the Company reduced its work-force by approximately 150 people (primarily in San Jose, California and Milpitas, California) and accrued approximately $10 million in severance charges during the quarter ended December 31, 2006. Approximately $3 million of the charges has been recorded as cost of revenues, $2 million in engineering, research and development expenses, and $5 million has been recorded as SG&A expenses. These severance charges will be paid over the next twelve months.

The following table provides the changes in the severance accrual for the three and six months ended March 31, 2007:

(In thousands)	Amounts
Balance as of September 30, 2006	$ —
Severance charges	9,685
Cash payments	(179)
Balance as of December 31, 2006	9,506
Severance charges	594
Cash payments	(8,168)
Balance as of March 31, 2007	$ 1,932

NOTE 14 – SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

KLA-Tencor reports one reportable 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 makers are the Chief Executive Officer and the Chief Operating 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. The Company's service products are an extension of the system product portfolio and provide customers with spare parts and fab management services (including system preventive maintenance and optimization services) to improve yield, increase production uptime and throughput, and lower the cost of ownership. 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 manufacturing facilities in Israel and Singapore, 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 the three and nine months ended March 31, 2007 and 2006:

(In thousands)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated	Nine months ended March 31, 2007	Nine months ended March 31, 2006 As restated
Revenue:				
United States	$198,479	$ 90,487	$ 494,497	$ 275,577
Europe & Israel	82,341	68,667	204,310	203,938
Japan	173,362	152,738	415,826	420,981
Taiwan	143,949	83,006	407,559	255,463
Korea	51,976	71,351	213,232	217,769
Asia Pacific	66,101	53,399	259,417	117,863
Total	$716,208	$519,648	$1,994,841	$1,491,591

Long-lived assets by geographic region as of March 31, 2007 and June 30, 2006 were as follows:

(In thousands)	March 31, 2007	June 30, 2006
Long-lived assets:		
United States	$ 319,845	$ 366,714
Europe & Israel	12,560	9,503
Japan	3,625	3,665
Taiwan	1,840	1,919
Korea	5,766	6,216
Asia Pacific	30,400	17,730
Total	$ 374,036	$ 405,747

The following is a summary of revenues by major products for the three and nine months ended March 31, 2007 and 2006 (as a percentage of total revenue):

	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Revenue:				
Defect inspection	62%	62%	62%	61%
Metrology	21%	14%	18%	16%
Service	14%	17%	15%	17%
Other	3%	7%	5%	6%
Total	100%	100%	100%	100%

For the three and nine months ended March 31, 2007, no customer accounted for greater than 10% of revenue. For the three and nine months ended March 31, 2006, no customer accounted for greater than 10% of revenue. As of March 31, 2007, no customer accounted for greater than 10% of net accounts receivable. As of June 30, 2006, one customer accounted for 13% of net accounts receivable.

NOTE 15 – SUBSEQUENT EVENTS

On May 4, 2007, the Company announced a quarterly cash dividend of 12 cents per share to be paid on June 1, 2007 to stockholders of record on May 15, 2007.

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

SPECIAL NOTE REGARDING 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 other than statements of historical fact may be forward-looking statements. You can identify these and other forward-looking statements by the use of words such as "may," "will," "could," "would," "should," "expects," "plans," "anticipates," "relies," "believes," "estimates," "predicts," "intends," "potential," "continue," 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 the future impact of the restatement of our historical financial statements, shareholder litigation and related matters arising from the discovery that we had retroactively priced stock options (primarily from July 1, 1997 to June 30, 2002) and had not accounted for them correctly; forecasts of the future results of our operations; the percentage of spending that our customers allocate to process control; 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; 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; 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; our future income tax rate; dividends; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions and development of acquired technologies; 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. You should carefully review these risks and also review the risks described in other documents we file from time to time with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements. We expressly assume no obligations to update our forward-looking statements in this report that occur after the date hereof.

Restatements of Consolidated Financial Statements and Special Committee and Company Findings

Special Committee Investigation of Historical Stock Option Practices

On May 22, 2006, the Wall Street Journal published an article about stock option backdating that questioned the stock option practices at several companies, including KLA-Tencor. On May 23, 2006, we received a subpoena from the United States Attorney's Office for the Northern District of California ("USAO") and a letter of inquiry from the United States Securities and Exchange Commission ("SEC") regarding our stock option practices. Later on May 23, 2006, our Board of Directors appointed a Special Committee composed solely of independent directors to conduct a comprehensive investigation of our historical stock option practices. The Special Committee promptly engaged independent legal counsel and accounting experts to assist with the investigation. The investigation included an extensive review of our historical stock option practices, accounting policies, accounting records, supporting documentation, email communications and other documentation, as well as interviews of a number of current and former directors, officers and employees. On September 27, 2006, the Special Committee reported the bulk of its findings and recommendations to our Board of Directors.

Findings and Remedial Actions

On September 28, 2006, we announced that we would have to restate our previously issued financial statements to correct our past accounting for stock options. As a result of the Special Committee investigation, we discovered that certain of our stock options, primarily those granted from July 1, 1997 to June 30, 2002, had been retroactively priced for all employees who received these grants. This means that the option exercise price was not the market price of the option shares on the actual grant date of the option, but instead was a lower market price on an earlier date. The actual grant date—when the essential actions necessary to grant the option were completed, including the final determination of the number of shares to be granted to each employee and the exercise price—is the correct measurement date to determine the market price of the option shares under the accounting rules in effect at the time. More than 95% of the total in-the-money value (market price on the actual grant date minus exercise price) of all of our retroactively priced options was attributable to those granted from July 1, 1997 to June 30, 2002.

We previously applied Accounting Principles Board ("APB") Opinion No. 25 *Accounting for Stock Issued to Employees* and its related Interpretations and provided the required pro forma disclosures under Statement of Financial Accounting Standards ("SFAS") No. 123 *Accounting for Stock-Based Compensation* through our fiscal year ended June 30, 2005. Under APB Opinion No. 25, a non-cash, stock-based compensation expense was required to be recognized for any option for which the exercise price was below the market price on the actual grant date. Because each of our retroactively priced options had an exercise price below the market price on the actual grant date, in periods up through June 30, 2005, we recognized a non-cash charge for each of these options under APB Opinion No. 25 equal to the number of option shares, multiplied by the difference between the exercise price and the market price on the actual grant date, amortized over the vesting period of the option. Starting in our fiscal year ended June 30, 2006, we adopted SFAS No. 123(R) *Share-Based Payment*. As a result, beginning with fiscal year 2006, the additional stock-based compensation expense required to be recorded for each retroactively priced option was equal to the incremental fair value of these options on the actual grant date, amortized over the remaining vesting period of the option. We recorded these stock-based compensation expenses under APB Opinion No. 25 or SFAS No. 123(R) related to our retroactively priced options in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006 (which included restatements of our consolidated financial statements as of and for our fiscal year ended June 30, 2005 and 2004; and our unaudited quarterly financial data for the first three quarters in our fiscal year ended June 30, 2006 and for all quarters in our fiscal year ended June 30, 2005)and our Quarterly Reports on Form 10-Q for the quarters ended September 30, 2006 and December 31, 2006. We did not record the required stock-based compensation expenses under SFAS No. 123(R) related to our retroactively priced options in our previously issued financial statements for our quarter ended March 31, 2006, and that is why we are restating them in this filing. To correct our past accounting for stock options, in total we have recorded additional pre-tax, non-cash, stock-based compensation expense of (a) $348 million for the periods July 1, 1994 to June 30, 2005 under APB Opinion No. 25 and (b) $28 million for the period from July 1, 2005 through December 31, 2006 under SFAS No. 123(R). The impact of this restatement for subsequent periods is immaterial.

By October 16, 2006, the Special Committee had substantially completed its investigation. The Special Committee concluded that (1) there was retroactive pricing of stock options granted to all employees who received options, primarily during the periods from July 1, 1997 to June 30, 2002 (less than 15% of these options were granted to executive officers), (2) the retroactively priced options were not accounted for correctly in our previously issued financial statements, (3) the retroactive pricing of options was intentional, not inadvertent or through administrative error, (4) the retroactive pricing of options involved the selection of fortuitously low exercise prices by certain former executive officers, and other former executives may have been aware of this conduct, (5) the retroactive pricing of options involved the falsification of Company records, resulting in erroneous statements being made in financial and other reports previously filed with the SEC, as well as in information previously provided to our independent registered public accounting firm, and (6) in most instances, the retroactive pricing of options violated the terms of our stock option plans. Because virtually all holders of retroactively priced options issued by the Company were not involved in or aware of the retroactive pricing, the Board of Directors decided that we should continue to honor the options that violated the terms of the Company's stock option plans, except in certain individual cases as described below.

The Special Committee concluded that, with a few immaterial exceptions, the retroactive pricing of stock options stopped after June 30, 2002. After that time, there were procedures in place designed to provide reasonable assurance that stock options were priced on the grant date. The Special Committee also concluded that none of our independent Directors was involved in or aware of the retroactive pricing of stock options. Based on the Special Committee's report, our Board of Directors concluded that no current members of management were involved in the retroactive pricing of stock options. During its investigation of our historical stock option practices, the Special Committee did not find evidence of any other financial reporting or accounting issues.

As a result of the Special Committee investigation, on October 16, 2006, we terminated our employment relationship and agreement with Kenneth L. Schroeder, and we announced our intent to cancel all outstanding stock options held by Mr. Schroeder that were retroactively priced or otherwise improperly granted. Those options were canceled in December 2006. Mr. Schroeder was the Company's Chief Executive Officer and a member of its Board of Directors from mid-1999 until January 1, 2006, and was a member of the Company's stock option committee from 1994 until December 31, 2005. From January 1, 2006 to October 16, 2006, Mr. Schroeder was employed as a Senior Advisor to the Company. On November 10, 2006, Mr. Schroeder's counsel informed us that Mr. Schroeder contests our right to terminate his employment relationship and agreement and to cancel any of his options. We intend to vigorously defend any claims that may be made by Mr. Schroeder regarding these matters, which could involve a material amount.

Also on October 16, 2006, Stuart J. Nichols, Vice President and General Counsel, resigned. Mr. Nichols and we entered into a Separation Agreement and General Release under which Mr. Nichols' outstanding retroactively priced stock options have been re-priced by increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements during the nine months ended March 31, 2007.

On October 16, 2006, Kenneth Levy, Founder and Chairman of the Board of Directors of the Company, retired as a director and employee, and was named Chairman Emeritus by our Board of Directors. Mr. Levy and we entered into a Separation Agreement and General Release under which Mr. Levy's outstanding retroactively priced stock options have been re-priced by increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements for the quarter ended December 31, 2006. Mr. Levy was the Company's Chief Executive Officer from 1975 until mid-1999 (with the exception of mid-1997 to mid-1998), was a member of the Company's Board of Directors from 1975 until his retirement, was Chairman of the Board of Directors from 1999 until his retirement, and was a member of the Company's Stock Option Committee from 1994 until use of that committee was suspended in the fall of 2006.

On December 21, 2006, Jon D. Tompkins resigned as a director of the Company, and we agreed to modify the outstanding options held by Mr. Tompkins (all of which were fully vested) to extend the post-termination exercisability period to December 31, 2007, which is the last day of the calendar year in which those options would have terminated in the absence of such extension. Mr. Tompkins, the Chief Executive Officer of Tencor Instruments before its merger into the Company in mid-1997, was the Company's Chief Executive Officer from mid-1997 to mid-1998, was a member of the Company's stock option committee from mid-1997 until mid-1999, and was a member of the Company's Board of Directors from mid-1997 until his resignation.

Although the Board of Directors concluded that John H. Kispert, our President and Chief Operating Officer, was not involved in and was not aware of the improper stock option practices, based on the Special Committee's recommendation, his outstanding retroactively priced options have been re-priced because he served as Chief Financial Officer during part of the period in question. This re-pricing involved increasing the exercise price to the market price of the option shares on the actual grant date. Under SFAS No. 123(R), no incremental charge was recognized in the financial statements during the nine months ended March 31, 2007.

Restatement and Impact on Financial Statements

In addition to restating the consolidated financial statements in response to the Special Committee's findings, we recorded additional non-cash adjustments that were previously considered to be immaterial relating primarily to the accounting for the employee stock purchase plans, corrections for the recognition of deferred tax assets, the release of tax reserves, the timing of revenue recognition, gains and losses on hedging contracts and the calculation of minority interest. We have also corrected the classification of certain amounts presented as cash and cash equivalents and marketable securities relating to investments in Variable Rate Demand Notes.

Government Inquiries Relating to Historical Stock Option Practices

As noted above, we received a subpoena from the USAO and a letter of inquiry from the SEC regarding our stock option practices on May 23, 2006. We learned on February 2, 2007 that the SEC has opened a formal investigation into these matters. We are cooperating fully with the USAO and SEC inquiries and intend to continue to do so. These inquiries likely will require us to expend significant management time and incur significant legal and other expenses, and could result in civil and criminal actions seeking, among other things, injunctions against the Company and the payment of significant fines and penalties by the Company, which may adversely affect our results of operations and cash flow. We cannot predict how long it will take or how much more time and resources we will have to expend to resolve these government inquiries, nor can we predict the outcome of these inquiries.

Shareholder Litigation Relating to Historical Stock Option Practices

Several derivative actions have been filed purporting to assert claims on behalf of and in the name of the Company against various of our current and former directors and officers relating to our accounting for stock options issued from 1994 to the present. The complaints in these actions allege that the individual defendants breached their fiduciary duties and other obligations to the Company and violated state and federal securities laws in connection with our historical stock option granting process, our accounting for past stock options, and historical sales of stock by the individual defendants. On behalf of KLA-Tencor, the plaintiffs seek unspecified monetary and other relief against the named defendants. The derivative actions are at an early stage. Our Board of Directors has appointed a Special Litigation Committee ("SLC") composed solely of independent Directors to conduct an independent investigation of the claims asserted in the derivative actions and to determine the Company's position with respect to those claims. The SLC's investigation is in progress. We cannot predict whether these actions are likely to result in any material recovery by or expense to KLA-Tencor.

KLA-Tencor and various of our current and former directors and officers were named as defendants in several putative securities class action lawsuits that have been consolidated into one action. The complaints allege claims under the Securities Exchange Act of 1934 as a result of our past stock option grants and related accounting and reporting, and seek unspecified monetary damages and other relief. The plaintiffs seek to represent a class consisting of purchasers of KLA-Tencor stock between February 13, 2001 and May 22, 2006 who allegedly suffered losses as a result of material misrepresentations in KLA-Tencor's SEC filings during that period. This litigation is at an early stage. One of the derivative actions noted above also includes a putative class action claim on behalf of KLA-Tencor shareholders against the Company and certain of our current and former directors and officers alleging that shareholders incurred damage due to purported dilution of KLA-Tencor common stock resulting from historical stock option granting practices. The Company intends to vigorously defend these litigations.

We cannot predict the outcome of the shareholder class action cases described above and we cannot estimate the likelihood or potential dollar amount of any adverse results. However, an unfavorable outcome in this litigation could have a material adverse impact upon the financial position, results of operations or cash flows for the period in which the outcome occurs and in future periods.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of our Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in applying our accounting policies 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 ensure that 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 the Company's related disclosure in this Quarterly Report on Form 10-Q. The items in our financial statements requiring significant estimates and judgments are as follows:

Allowance for Doubtful Accounts A majority of our trade receivables are derived from sales to large multinational semiconductor manufacturers throughout the world. In order to monitor potential credit losses, we perform ongoing credit evaluations of our customers' financial condition. An allowance for doubtful accounts is maintained for probable credit losses based upon our assessment of the expected collectibility of all accounts receivable. The allowance for doubtful accounts is reviewed on a quarterly basis to assess the adequacy of the allowance. We take into consideration (1) any circumstances of which we are aware of a customer's inability to meet its financial obligations; and (2) our judgments as to prevailing economic conditions in the industry and their impact on our customers. If circumstances change, and the financial condition of our customers are adversely affected and unable to meet their financial obligations to us, we may need to take additional allowances, which would result in a reduction of our net income.

Inventories Inventories are stated at the lower of cost (on a first-in, first-out basis) or market. Demonstration units are stated at their manufacturing cost and reserves are recorded to state the demonstration units at their net realizable value. We review the adequacy of our inventory reserves on a quarterly basis.

We review and set standard costs semi-annually at current manufacturing costs in order to approximate actual costs. Our manufacturing overhead standards for product costs are calculated assuming full absorption of forecasted spending over projected volumes, adjusted for excess capacity. Abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are recognized as current period charges.

We write down inventory based on forecasted demand and technological obsolescence. These factors are impacted by market and economic conditions, technology changes, new product introductions and changes in strategic direction and require estimates that may include uncertain elements. Actual demand may differ from forecasted demand and such differences may have a material effect on recorded inventory values.

Warranty We provide standard warranty coverage on our systems for 40 hours per week for twelve months, providing labor and parts necessary to repair the systems during the warranty period. We account for the estimated warranty cost as a charge to costs of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, we calculate the average service hours and parts expense per system and apply the labor and overhead rates to determine the estimated warranty charge. We update these estimated charges on a quarterly basis. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty reserves accordingly. The difference between the estimated and actual warranty costs tends to be larger for new product introductions as there is limited or no historical product performance to estimate warranty expense; more mature products with longer product performance histories tend to be more stable in our warranty charge estimates. Non-standard warranty generally includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is deferred as unearned revenue and is recognized ratably as revenue when the applicable warranty term period commences. See Note 11, “Commitments and Contingencies,” to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

Revenue Recognition We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller’s price is fixed or determinable, and collectibility is reasonably assured. We derive revenue from four sources—system sales, spare part sales, service contracts and software license fees. We typically recognize revenue for system sales upon acceptance by the customer that the system has been installed and is operating according to predetermined specifications. This positive affirmation is generally evidenced by an acceptance document signed by the customer. In certain cases, KLA-Tencor may recognize revenue without a written acceptance from the customer, as follows:

- When system sales to independent distributors have no installation requirement, contain no acceptance agreement, and 100% payment is due upon shipment, revenue is recognized upon shipment;
- When the installation of the system is deemed perfunctory, revenue is recognized upon shipment. The portion of revenue associated with installation is deferred based on estimated fair value, and that revenue is recognized upon completion of the installation;
- When the customer fab has already accepted the same tool, with the same specifications, and it can be objectively demonstrated that it meets all of the required acceptance criteria upon shipment, revenue is recognized upon shipment. The portion of revenue associated with installation is deferred based on estimated fair value, and that revenue is recognized upon completion of the installation;
- When the system is performing in production or R&D and meets all published and contractually agreed specifications, but the customer withholds signature on our acceptance document due to warranty or other issues unrelated to product performance;
- When the system is damaged during transit, revenue is recognized upon receipt of cash payment from the customer.

Total revenue recognized without a written acceptance from the customer was approximately 17.1%, 15.5% and 5.3% of total revenue for the three months ended March 31, 2007, December 31, 2006 and March 31, 2006, respectively, and 13.2% and 3.7% for the nine months ended March 31, 2007 and 2006, respectively. The increase in revenue recognized without a written acceptance is primarily driven by increased shipments of tools that have already met the required acceptance criteria at those customer fabs, and an increase in the revenue of systems with perfunctory installation. Shipping charges billed to customers are included in system revenue and the related shipping costs are included in costs of revenues.

Trade-in rights are occasionally granted to customers to trade in tools in connection with subsequent purchases. We estimate the value of the trade-in right and reduce the revenue of the initial sale. This amount is recognized at the earlier of the exercise of the trade-in right or the expiration of the trade-in right.

Spare parts revenue is recognized when the product has been shipped, risk of loss has passed to the customer, and collection of the resulting receivable is probable.

Service and maintenance revenue is recognized ratably over the term of the maintenance contract. Consulting and training revenue is recognized when the related services are performed.

The deferred system profit balance equals the amount of deferred system revenue that was invoiced and due on shipment less applicable product and warranty costs.

We also defer the fair value of non-standard warranty bundled with equipment sales as unearned revenue. Non-standard warranty includes services incremental to the standard 40-hour per week coverage for twelve months. Non-standard warranty is recognized ratably as revenue when the applicable warranty term period commences.

Stock-Based Compensation Prior to July 1, 2005, we applied APB Opinion No. 25 *Accounting for Stock Issued to Employees* and its related Interpretations and provided the required pro forma disclosures of SFAS No. 123 *Accounting for Stock-Based Compensation*. In accordance with APB Opinion No. 25, a non-cash, stock-based compensation expense was recognized for any options for which the exercise price was below the market price on the actual grant date. The charge for the options with an exercise price below the market price on the actual grant date was equal to the number of options multiplied by the difference between the exercise price and the market price of the option shares on the actual grant date. That expense was amortized over the vesting period of the option.

Beginning July 1, 2005, we have accounted for stock-based compensation using the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R), Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 107. We elected to adopt the modified prospective application method as provided by SFAS No. 123(R). Accordingly, during fiscal year 2006, we recorded stock-based compensation expense totaling the amount that would have been recognized had the fair value method, under SFAS No. 123, been applied since the effective date of SFAS No. 123 for the pre-fiscal year 2006 grants and under SFAS No. 123(R) for the fiscal year 2006 grants.

SFAS No. 123(R) 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. The expected stock price volatility assumption was determined using the implied volatility of the Company's common stock. We determined that implied volatility is more reflective of market conditions and a better indicator of expected volatility than a blended volatility. Prior to the adoption of SFAS No. 123(R), we used a combination of historical and implied volatility in deriving the expected volatility assumption.

In November 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. 123(R)-3 *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Award*s ("FSP 123R-3"). We have elected not to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R). We followed paragraph 81 of SFAS No. 123(R) to calculate the initial pool of excess tax benefits and to determine the subsequent impact on the Additional Paid-in-Capital ("APIC") pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS No. 123(R). See Note 7, "Stock-Based Compensation," to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

Contingencies and Litigation We are subject to the possibility of losses from various contingencies. Considerable judgment is necessary to estimate the probability and amount of any loss from such contingencies. An accrual is made when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We accrue a liability and charge operations for the estimated costs expected to be incurred over the next twelve months of adjudication or settlement of asserted and unasserted claims existing as of the balance sheet date. See Note 10, "Litigation and Other Legal Matters" and Note 11, "Commitments and Contingencies," to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

Income Taxes We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences

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between the book and tax bases of recorded assets and liabilities. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. We have determined that our future taxable income will be sufficient to recover all of our deferred tax assets. However, should there be a change in our ability to recover our deferred tax assets, we could be required to record a valuation allowance against our deferred tax assets. This would result in an increase to our tax provision in the period in which we determined that the recovery was not probable.

On a quarterly basis, we provide for income taxes based upon an estimated annual effective income tax rate. The effective tax rate is highly dependent upon the geographic composition of worldwide earnings, tax regulations governing each region, availability of tax credits and the effectiveness of our tax planning strategies. We carefully monitor the changes in many factors and adjust our effective income tax rate on a timely basis. If actual results differ from these estimates, this could have a material effect on our financial condition and results of operations.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional tax payments are probable. If we ultimately determine that payment of these amounts is unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine that the liability is no longer necessary. We record an additional charge in our provision for taxes in the period in which we determine that the recorded tax liability is less than we expect the ultimate assessment to be.

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.

Revenues, income from operations and net income, cash flow from operations, and diluted earnings per share are some of the key indicators we use to monitor our financial condition and operating performance. The following table sets forth some of the key quarterly unaudited financial information which we use to manage our business.

(In millions)	Fiscal year 2007			Fiscal year 2006			
	First Quarter	Second Quarter	Third Quarter	First Quarter As restated	Second Quarter As restated	Third Quarter As restated	Fourth Quarter
Revenues	$ 629	$ 649	$ 716	$ 484	$ 488	$ 520	$ 579
Income from operations	$ 154	$ 78	$ 183	$ 75	$ 75	$ 85	$ 75
Net income	$ 136	$ 90	$ 155	$ 75	$ 77	$ 97	$ 132

Industry Trends

Industry analysts have predicted that the change in semiconductor revenues and semiconductor equipment revenues will range from -5% to +10% in calendar year 2007. Over the longer term, we expect process control to continue to represent a higher percentage of our customers' capital spending. We believe that this percentage 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 new materials, new devices and circuit architecture, new lithography challenges and fab process innovation. We anticipate that these factors will drive increased demand for our products and services. The key drivers for growth in the semiconductor equipment industry in calendar year 2007 are the transition to 300 millimeter fabs, the increased demand for consumer electronics, and the strength of the NAND flash market.

RESULTS OF OPERATIONS

Revenues and Gross Margin

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated	December 31, 2006	Q3 FY07 vs. Q3 FY06		Q3 FY07 vs. Q2 FY07	
Revenues:							
Product	$ 607	$ 429	$ 544	$ 178	41%	$ 63	12%
Service	109	91	105	$ 18	20%	4	4%
Total revenues	$ 716	$ 520	$ 649	$ 196		$ 67	
Costs of revenues	$ 307	$ 227	$ 298	$ 80	35%	$ 9	3%
Stock-based compensation expense included in costs of revenues	$ 7	$ 6	$ 8	$ 1		$ (1)	
Gross margin percentage	57%	56%	54%	1%		3%	
Stock-based compensation expense included in costs of revenues as a percentage of revenue	1%	1%	1%	0%		0%	

	Nine months ended March 31, 2007	Nine months ended March 31, 2006	Q3 FY07 YTD vs. Q3 FY06 YTD	
Revenues:		As restated		
Product	$1,683	$ 1,230	$ 453	37%
Service	312	262	$ 50	19%
Total revenues	$1,995	$ 1,492	$ 503	
Costs of revenues	$ 875	$ 658	$ 217	33%
Stock-based compensation expense included in costs of revenues	$ 23	$ 20	$ 3	
Gross margin percentage	56%	56%	0%	
Stock-based compensation expense included in costs of revenues as a percentage of revenue	1%	1%	0%	

Product revenues

Product revenue increase primarily due to the result of a higher level of orders received in prior quarters and, to a lesser extent, due to additional revenue related to ADE operations during the second and third quarter of fiscal year 2007.

For the three and nine months ended March 31, 2007, no customer accounted for greater than 10% of revenue, respectively. For the three and nine months ended March 31, 2006, no customer accounted for greater than 10% of revenue. As of March 31, 2007, no customer accounted for greater than 10% of net accounts receivable. As of June 30, 2006, one customer accounted for 13% of net accounts receivable.

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. The increase in service revenue is due to an increase in the number of post-warranty systems installed at our customers' sites and the degree of utilization of those systems. The increase in service revenues also reflected additional revenue related to ADE operations during the second and third quarter of fiscal year 2007.

Revenues by region

Revenues by region for the periods indicated were as follows:

(In millions)	Three months ended						Nine months ended			
	March 31, 2007		March 31, 2006		December 31, 2006		March 31, 2007		March 31, 2006	
United States	$ 199	28%	$ 91	18%	$ 166	26%	$ 495	25%	$ 275	18%
Europe & Israel	82	11%	69	13%	51	8%	204	10%	204	14%
Japan	173	25%	153	29%	135	21%	416	21%	421	28%
Taiwan	144	20%	83	16%	126	19%	408	20%	256	17%
Korea	52	7%	71	14%	74	11%	213	11%	218	15%
Asia Pacific	66	9%	53	10%	97	15%	259	13%	118	8%
Total	$ 716	100%	$ 520	100%	$ 649	100%	$ 1,995	100%	$ 1,492	100%

A significant portion of our revenue continues to be generated in Asia where a substantial portion of the world's semiconductor manufacturing capacity is located.

Gross margin

Our gross margin fluctuates with revenue levels and product mix, and is affected by variations in costs related to manufacturing and servicing our products. The increase in gross margin during the three months ended March 31, 2007 compared to the corresponding period of the prior fiscal year is primarily due to increased revenue. This increase was partially offset by the following charges recorded during the three months ended March 31, 2007:

- $11 million for additional amortization of intangibles related to acquisitions of ADE Corporation, OnWafer Technologies, Inc., and SensArray Corporation,
- $1 million for reimbursement to employees of taxes related to IRC Section 409A, and
- $1 million for alternative financial benefit consisting of cash payments to employees to compensate for lost benefits due to ESPP suspension.

Engineering, Research and Development ("R&D")

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated	December 31, 2006	Q3 FY07 vs. Q3 FY06		Q3 FY07 vs. Q2 FY07	
R&D expenses	$106	98	108	$ 8	8%	$ (2)	-2%
Stock-based compensation expense included in R&D expenses	$ 11	$ 12	$ 11	$ (1)	-8%	$ —	0%
R&D expenses as a percentage of total revenues	15%	19%	17%	-4%		-2%	
Stock-based compensation expense included in R&D expenses as a percentage of revenue	2%	2%	2%	0%		0%	

	Nine months ended March 31, 2007	Nine months ended March 31, 2006 As restated	Q3 FY07 YTD vs. Q3 FY06 YTD	
R&D expenses	$314	$ 295	$ 19	6%
Stock-based compensation expense included in R&D expenses	$ 34	$ 38	$ (4)	-11%
R&D expenses as a percentage of total revenues	16%	20%	-4%	
Stock-based compensation expense included in R&D expenses as a percentage of revenue	2%	3%	-1%	

The increase in R&D expenses during the three months ended March 31, 2007 compared to corresponding period of the previous fiscal year primarily reflects additional expenses related to the acquisition of ADE Corporation, OnWafer Technologies, Inc. and SensArray Corporation and the following charges recorded during the three months ended March 31, 2007:

- $2 million for in-process research and development charges associated with the acquisition of OnWafer Technologies, Inc. and SensArray Corporation and

- $2 million for reimbursement to employees of taxes related to IRC Section 409A.

The increase in R&D expenses during the nine months ended March 31, 2007 compared to corresponding period of the previous fiscal year primarily reflects additional expenses related to the acquisition of ADE Corporation, OnWafer Technologies, Inc. and SensArray Corporation and the following charges recorded during the nine months ended March 31, 2007:

- $5 million for in-process research and development charges associated with the acquisition of ADE Corporation, OnWafer Technologies, Inc. and SensArray Corporation and
- $4 million for reimbursement to employees of taxes related to IRC Section 409A.
- $2 million for severance and related benefits related to employee workforce reduction and
- $1 million for alternative financial benefit consisting of cash payments to employees to compensate for lost benefits due to ESPP suspension.

R&D expenses include the benefit of $4 million, $4 million and $2 million of external funding received during the three months ended March 31, 2007, December 31, 2006, and March 31, 2006, respectively, for certain strategic development programs conducted with several of our customers and from government grants. R&D expenses include the benefit of $11 million and $7 million of external funding received during the nine months ended March 31, 2007 and 2006, respectively. We expect our 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 yield challenges our customers face at future technology nodes.

Selling, General and Administrative ("SG&A")

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006 As restated	December 31, 2006	Q3 FY07 vs. Q3 FY06		Q3 FY07 vs. Q2 FY07	
SG&A expenses	$121	111	165	$ 10	9%	$(44)	-27%
Stock-based compensation expense included in SG&A expenses	$ 12	$ 30	$ (3)	$ (18)	-60%	$ 15	500%
SG&A expenses as a percentage of total revenues	17%	21%	25%	-4%		-8%	
Stock-based compensation expense included in SG&A expenses as a percentage of revenue	2%	6%	0%	-4%		2%	

	Nine months ended March 31, 2007	Nine months ended March 31, 2006 As restated	Q3 FY07 YTD vs. Q3 FY06 YTD	
SG&A expenses	$392	$ 304	$ 88	29%
Stock-based compensation expense included in SG&A expenses	$ 25	$ 69	$ (44)	-64%
SG&A expenses as a percentage of total revenues	20%	20%	0%	
Stock-based compensation expense included in SG&A expenses as a percentage of revenue	1%	5%	-4%	

The increase in SG&A expenses during the three months ended March 31, 2007 compared to the corresponding period of the previous fiscal year primarily reflects a net increase in headcount and additional SG&A expenses related to the acquisition of ADE Corporation, OnWafer Technologies, Inc. and SensArray Corporation as well as the following charges recorded during the three months ended March 31, 2007:

- $5 million for additional amortization of intangibles related to the acquisition of ADE Corporation,
- $3 million for reimbursement to employees of taxes related to IRC Section 409A and

- $8 million for legal and other expenses related to the stock options investigation, shareholder litigation and related matters

The increase in SG&A expenses during the nine months ended March 31, 2007 compared to the corresponding period of the previous fiscal year primarily reflects a net increase in headcount and additional SG&A expenses related to the acquisition of ADE Corporation, OnWafer Technologies, Inc. and SensArray Corporation as well as the following charges recorded during the nine months ended March 31, 2007:

- $57 million for impairment charges related to the write-down of buildings,
- $5 million for severance and related benefits related to employee workforce reduction,
- $10 million for additional amortization of intangibles related to the acquisition of ADE Corporation,
- $6 million for reimbursement to employees of taxes related to IRC Section 409A,
- $1 million for alternative financial benefit consisting of cash payments to employees to compensate for lost benefits due to ESPP suspension, and
- $15 million for legal and other expenses related to the stock options investigation, shareholder litigation and related matters.

The cumulative increase was offset by $20 million due to the reversal of stock-based compensation expense related to our former Chief Executive Officer.

During the three months ended December 31, 2006, as part of the long-term business plan, we decided to sell certain real estate properties we own in San Jose, California and Livermore, California. Based on the valuation of these assets, we recorded an asset impairment charge of approximately $57 million, which has been included in SG&A during the three months ended December 31, 2006. In November 2006, we reduced our work-force by approximately 150 people (primarily in San Jose, California and Milpitas, California) and accrued approximately $10 million in severance charges in the quarter ended December 31, 2006. Approximately $3 million of the charges has been recorded as cost of revenues, $2 million in engineering, research and development expenses, and $5 million has been recorded as selling, general and administrative expenses. These severance charges will be paid over the next twelve months. See Note 13 "Asset Impairment and Severance Charges" to Condensed Consolidated Financial Statements (unaudited) for a schedule of the activities of the severance accrual.

During November 2005, we announced that effective January 1, 2006, Kenneth L. Schroeder would cease to be our Chief Executive Officer and would thereafter be employed as a Senior Advisor. The Company and Mr. Schroeder also revised his prior agreement with the Company and defined the salary, bonus payout and equity award vesting during the period of his employment as a Senior Advisor. Effective January 1, 2006, we determined that all service conditions associated with certain prior equity awards under the terms of the revised agreement with Mr. Schroeder had been satisfied; accordingly we recorded an additional non-cash, stock-based compensation charge of approximately $9.8 million relating to these equity awards. The above-mentioned charge is included as a component of Selling, General and Administrative expense during fiscal year 2006. On October 16, 2006, following the Special Committee investigation of our historical stock option practices, we terminated all aspects of Mr. Schroeder's employment relationship and agreement with the Company. As a result, vesting of Mr. Schroeder's then outstanding stock options and restricted stock awards immediately ceased, and the 890,914 unvested option shares and 100,000 unvested restricted stock award shares held by Mr. Schroeder at the time of termination were canceled. Accordingly, in the second quarter of fiscal year 2007 we reversed $20 million of the non-cash, stock-based compensation charges that had been recorded in prior periods related to unvested option shares and restricted stock award shares. In December 2006, we canceled 596,740 vested option shares held by Mr. Schroeder as of the time of termination, representing those shares that had been retroactively priced or otherwise improperly granted.

Interest Income and Other, Net

(In millions)	Three months ended			Nine months ended	
	March 31, 2007	March 31, 2006	December 31, 2006	March 31, 2007	March 31, 2006
Interest income and other, net	$ 21	$ 17	$ 23	$ 66	$ 48
Percentage of total revenues	3%	3%	4%	3%	3%

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. The increase in interest income and other, net compared to the same period in the prior fiscal year is primarily due to the increase in average cash levels and short-term interest rates.

Provision for Income Taxes

Our effective income tax rate was 23.8% and 6.2% for the three months ended March 31, 2007 and 2006, respectively. The current quarter increase in the effective tax rate from 11.5% for the three months ended December 31, 2006 to 23.8% for the three months ended March 31, 2007, is primarily due to the fact that tax effects of reinstatement of the federal research and development tax credit was recognized in the three month period ended December 31, 2006 and the unusual non-recurring items recognized in the three month period ended March 31, 2007 resulted in smaller tax benefit than the amount recognized in the three month period ended December 31, 2007. The unusual and non-recurring items recognized in this quarter consisted primarily of additional compensation expenses related to reimbursing employees for tax liabilities related to IRC Section 409A. The tax rate without these items would have been 24.6%. In general, the effective income tax rate differs from the statutory rate of 35% largely as a function of benefits realized from our extraterritorial income exclusion, research and development tax credits, tax exempt interest and foreign income taxed at rates less than the statutory rate.

Our future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of our pre-tax income, non tax-deductible expenses incurred in connection with acquisitions, amounts of tax-exempt interest income and research and development credits as a percentage of aggregate pre-tax income, and the effectiveness of our tax planning strategies.

Equity Incentive Program

The Company’s equity incentive program is a broad-based, long-term retention program that is intended to attract and retain key 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. For the past several years, except for the retroactively priced stock options, stock options have generally been granted at market price of our common stock on the date of grant, generally have a vesting period of five years and are exercisable for a period not to exceed seven years (ten years for options granted prior to July 1, 2005) from the date of issuance. 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 qualify as key employees participate in our main equity incentive plan.

On October 18, 2004, the Company’s stockholders approved the 2004 Equity Incentive Plan (the “2004 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. Since the adoption of the 2004 Plan, no further grants are permitted under the 1982 Stock Option Plan or 2000 Non-Statutory Stock Option Plan. The 2004 Plan permits the issuance of 12,500,000 shares of common stock, of which 3.2 million shares are available for grant as of March 31, 2007. At that date, awards for 23.7 million shares are outstanding under all plans.

Stock-Based Compensation Expense

Effective July 1, 2005, we adopted the provisions of SFAS No. 123(R)*Share-Based Payment*. SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date, based on the fair value of the award which is computed using a Black-Scholes option valuation model, and is recognized as expense over the employee’s requisite service period. The following table shows stock-based compensation expense by type of award for the three and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Stock-based compensation expense by type of award:				
Employee stock options	$ 26.1	$ 39.8	$ 64.2	$ 107.8
Employee stock purchase plan	0.5	4.4	9.6	12.5
Restricted stock units	2.7	4.2	8.6	6.7
Total stock-based compensation (1)	$ 29.3	$ 48.4	$ 82.4	$ 127.0

(1) Stock-based compensation expense for the nine months ended March 31, 2007 includes a $20 million reversal of stock-based compensation charges for the Company’s former Chief Executive Officer and $9 million of cash compensation related to bonuses payable to the holders of the amended options to compensate them for the increase in their option exercise price.

As of March 31, 2007, the unrecognized stock-based compensation balance related to stock options was $124.2 million and will be recognized over an estimated weighted average amortization period of 2.8 years. As of March 31, 2007, the unrecognized stock-based compensation balance related to restricted stock units was $75.6 million and will be recognized over an estimated weighted average amortization period of 3.5 years.

LIQUIDITY AND CAPITAL RESOURCES

(In millions)	March 31, 2007	June 30, 2006
Cash and cash equivalents	$ 604	$ 1,129
Marketable securities	981	1,197
Total cash, cash equivalents and marketable securities	$ 1,585	$ 2,326
Percentage of total assets	37%	51%

(In millions)	Nine months ended	
	March 31, 2007	March 31, 2006 As restated
Cash provided by operating activities	$ 455	$ 185
Cash (used in) provided by investing activities	(278)	119
Cash used in financing activities	(709)	(16)
Effect of exchange rate changes on cash and cash equivalents	7	11
Net (decrease) increase in cash and cash equivalents	$ (525)	$ 299

We have historically financed our operations through cash generated from operations. Cash provided by operating activities was $455 million and $185 million for the nine months ended March 31, 2007 and 2006, respectively. Cash provided by operating activities during the nine months ended March 31, 2007 consisted primarily of net income of $381 million increased by non-cash depreciation and amortization of $73 million, non-cash impairment charges of $57 million, and stock-based compensation of $73 million, offset by an increase in accounts receivable of $40 million, increase in inventories of $32 million, and changes in other assets and liabilities of $57 million. Cash provided by operating activities during the nine months ended March 31, 2006 consisted primarily of net income of $249 million increased by non-cash depreciation and amortization of $52 million, stock-based compensation of $127 million, and tax benefit from equity awards of $31 million, partially offset by an increase in accounts receivable of $136 million, an increase in inventories of $78 million, and a decrease in other current liabilities of $64 million.

Cash used in investing activities was $278 million during the nine months ended March 31, 2007 while cash provided by investing activities was $120 million during the nine months ended March 31, 2006. Investing activities typically consist of purchases and sales or maturities of marketable securities, purchases of capital assets to support long-term growth and acquisitions of technology or other companies to allow access to new markets or emerging technologies. Additionally, on October 11, 2006, we acquired all of the shares of ADE Corporation (“ADE”), a supplier of semiconductor process control solutions for $390 million. On January 16, 2007, we acquired OnWafer Technologies, Inc. and SensArray Corporation for a total of $53 million in cash. Both companies design and produce sensors that are embedded in wafers to collect information on the performance of tools used in the semiconductor manufacturing process. The acquisitions were accounted for as a purchase. See Note 4, “Business Combinations,” to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

Cash (used in) provided by financing activities primarily consists of the following:

- quarterly cash dividend paid to common stock, announced on February 2, 2007 and paid on March 1, 2007 to our stockholders of record on February 15, 2007,
- $764 million cash paid for stock repurchases, offset by
- net proceeds from the exercise of employee stock options and activity related to the Employee Stock Purchase Plan.

In February 2007, the Company entered into an Accelerated Share Repurchase program ("ASR") with a third-party investment bank and prepaid $750 million to repurchase its common stock. The program has two separate components. The first component is the purchase of shares, and the second component is the forward contract indexed to the Company's own common stock. The purchase price per share of the common stock repurchased through the ASR will be determined and adjusted based on a discount to the volume-weighted average price of the Company's common stock during a period following the execution of the ASR agreement, subject to a maximum price per share. The exact number of shares repurchased pursuant to the ASR will be determined based on such adjusted price, but is not expected to be less than approximately 13 million shares. During the three months ended March 31, 2007 the Company received approximately 12 million shares under the ASR. The ASR is expected to be completed during the fourth quarter of fiscal year 2007. The shares received were multiplied by the closing stock price on the date of receipt to determine the cost of repurchase. The entire $750 million was recorded in the stockholders' equity section of its Consolidated Condensed Balance Sheet.

The shares repurchased under the Accelerated Share Repurchase will decrease our basic and diluted weighted average shares outstanding. This decrease will be partially offset by additional shares issued for the exercise of employee stock options and activity related to the Employee Stock Purchase Plan.

The following is a schedule summarizing our significant operating lease commitments as of March 31, 2007:

(In millions)	Payments Due by Fiscal Year						
	Total	2007(1)	2008	2009	2010	2011	Thereafter
Operating leases	$35.7	$ 2.4	$8.3	$6.8	$4.5	$3.3	$ 10.4

(1) Remaining 3 months

We have agreements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, from time to time we will discount without recourse, Letters of Credit ("LCs") received from customers in payment of goods.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs and related discounting fees paid for the three months and nine months ended March 31, 2007 and 2006:

(In millions)	Three months ended March 31, 2007	Three months ended March 31, 2006	Nine months ended March 31, 2007	Nine months ended March 31, 2006
Receivables sold under factoring agreements	$ 53.0	$ 70.8	$ 197.6	$ 182.0
Proceeds from sales of LCs	$ 4.3	$ 21.6	$ 43.0	$ 55.3
Discounting fees paid on sales of LCs (1)	$ 0.05	$ 0.3	$ 0.5	$ 0.6

(1) Discounting fees were equivalent to interest expense and were recorded in interest and other income net.

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, 2007 to be approximately $166.3 million which are primarily due within the next 12 months. 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 canceled. Certain agreements provide for potential cancellation penalties.

We provide standard warranty coverage on our systems for 40 hours per week for twelve months, providing labor and parts necessary to repair the systems during the warranty period. We account 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. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty reserves accordingly. The difference between the estimated and actual warranty costs tends to be larger for new product introductions as there is limited or no historical product performance to estimate warranty expense; more mature products with longer product performance histories tend to be more stable in our warranty charge estimates. Non-standard warranty generally includes services incremental to the standard 40 hour per week coverage for twelve months. See Note 11, "Commitments and Contingencies," to Condensed Consolidated Financial Statements (unaudited) for a detailed description.

Because virtually all holders of retroactively priced options issued by the Company were not involved in or aware of the retroactive pricing, the Company has taken certain actions to deal with the adverse tax consequences that may be incurred by the holders of retroactively priced options. The adverse tax consequences are that retroactively priced stock options vesting after December 31, 2004 ("409A Affected Options") subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). One such action by the Company involved offering to amend the 409A Affected Options to increase the exercise price to the market price on the actual grant date or, if lower, the market price at the time of the amendment. The amended options would not be subject to taxation under IRC Section 409A. Under IRS regulations, these option amendments had to be completed by December 31, 2006 for anyone who was an executive officer when he or she received 409A Affected Options; the amendments for non-officers could not be offered until after the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2006 and Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 were filed and do not need to be completed until December 31, 2007.

During the three months ended March 31, 2007, we accrued approximately $20 million payable to non-executive holders of the amended options to compensate them for the resulting increase in their option exercise price. The $20 million is payable in January 2008. Of the $20 million, $9 million was recorded as stock-based compensation expense, and the remaining $11 million was recorded in common stock and capital in excess of par value in the balance sheet. The amount of these bonuses would be effectively repaid to the Company if and when the options are exercised and the increased exercise price is paid. However, there is no assurance that the options will be exercised and the employees will retain the bonuses under all circumstances. During the three months ended March 31, 2007, we also recorded approximately $6 million to compensate certain option holders whose employment terminated or who had already exercised 409A Affected Options for the additional taxes they incur under IRC Section 409A (and, as applicable, similar state tax laws).

We are involved in several litigation cases as described in Note 11 to Condensed Consolidated Financial Statements. We cannot predict the outcome of these cases and we cannot estimate the likelihood or potential dollar amount of any adverse results.

Working capital decreased by $0.6 billion to $1.9 billion as of March 31, 2007, compared to $2.5 billion as of June 30, 2006. This decrease is primarily due to cash payments for Accelerated Share Repurchase and acquisitions. As of March 31, 2007, our principal sources of liquidity consisted of $1.6 billion of cash, cash equivalents, and marketable securities. 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, our management believes 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.

On January 7, 2007, the Company signed a definitive merger agreement to acquire Therma-Wave, Inc. through a cash tender offer of $1.65 per share, or a total of approximately $74 million. Therma-Wave develops, manufactures, markets and services process control metrology systems used in the manufacture of semiconductors. The transaction is subject to customary closing conditions, including regulatory approvals and the acquisition by the Company of a majority of the voting power of Therma-Wave in the tender offer.

Off-Balance Sheet Arrangements

Under our foreign-currency risk management strategy, we utilize derivative instruments to protect our interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates. This financial exposure is monitored and managed as an integral part of our overall risk management program which focuses on the unpredictability of financial markets and seeks to reduce the potentially adverse effects that the volatility of these markets may have on our operating results. We continue our policy of hedging our current and forecasted foreign currency exposures with hedging instruments having tenors of up to 18 months. The outstanding hedge contracts, with maximum maturity of 13 months, were as follows:

(In millions)

	As of March 31, 2007	As of June 30, 2006
Cash flow hedge contracts		
Purchase	$ 21.8	$ 15.2
Sell	(180.3)	(167.5)
Other foreign currency hedge contracts		
Purchase	93.9	128.4
Sell	(272.1)	(260.2)
Net	$ (336.7)	$ (284.1)

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, such as foreign currency hedges. 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 as of March 31, 2007. Actual results may differ materially.

As of March 31, 2007, we had an investment portfolio of fixed income securities of approximately $1.0 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, 2007, the fair value of the portfolio would have declined by $5.4 million.

As of March 31, 2007, we had net forward contracts to sell $336.7 million in foreign currency in order to hedge currency exposures (see Note 12, "Derivative Instruments and Hedging Activities," to Condensed Consolidated Financial Statements (unaudited) for a detailed description). If we had entered into these contracts on March 31, 2007, the U.S. dollar equivalent would be $334.4 million. A 10% adverse move in all currency exchange rates affecting the contracts would decrease the fair value of the contracts by $50.0 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

On May 22, 2006, the Wall Street Journal published an article about stock option backdating that questioned the stock option practices at several companies, including KLA-Tencor. The Board of Directors appointed a Special Committee composed solely of independent directors to conduct a comprehensive investigation of the Company's historical stock option practices. As a result of that investigation, the Company discovered that certain of its stock options, primarily those granted from July 1, 1997 to June 30, 2002, had been retroactively priced for all employees who received these grants, and that the retroactively priced options had not been accounted for correctly. Accordingly, the Company restated its consolidated financial statements in its Annual Report on Form 10-K for the fiscal year ended June 30, 2006 and its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, both of which were filed with the SEC on January 29, 2007, and in its Quarterly Report on Form 10-Q for the quarter ended December 31, 2006, which was filed timely on February 9, 2006. For further details, see those Reports and, in particular, Item 9A in the Form 10-K Report.

Evaluation of Disclosure Controls and Procedures

The Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) under the Exchange Act) (Disclosure Controls) as of the end of the period covered by this Report required by Exchange Act Rules 13a-15(b) or 15d-15b. The controls evaluation was conducted under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Based on this evaluation, the CEO and our CFO have concluded that as of the end of the period covered by this report the Company's disclosure controls and procedures were effective at a reasonable assurance level.

Attached as exhibits to this Quarterly Report are certifications of the CEO and 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 the Company's reports filed under the Exchange Act, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. The Company's Disclosure Controls include components of its internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of its 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 the Company's internal control over financial reporting are included within its Disclosure Controls, they are included in the scope of the Company's annual controls evaluation.

Limitations on the Effectiveness of Controls

The Company's management, including the CEO and CFO, does not expect that the Company's disclosure controls or 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 Control over Financial Reporting

As a result of the Special Committee investigation, in the fall of 2006, the Board of Directors suspended use of the stock option committee and delegated sole authority for granting stock options and restricted stock awards to the full Compensation Committee, subject to ratification by the Board of Directors, with the grant date being the date of the Compensation Committee approval and with the pricing based on the market price on the grant date. The Board of Directors may in the future evaluate the possibility of again using a stock option committee, and, if so, the Company will implement additional controls designed to assure that the stock option committee is properly constituted and acts within the scope of its delegated authority. For further information, see Item 9A in Form 10-K for the fiscal year ended June 30, 2006 filed on January 29, 2007. In addition, on February 14, 2007, the Compensation Committee approved, and the Board of Directors ratified, a new policy regarding equity award grant procedures. which incorporated many existing practices as well as certain new procedures. For further information, see the Form 8-K filed by the Company on March 15, 2007

Except as described above with respect to the approval of a new policy regarding equity award grant procedures, there were no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 10 contained in the Consolidated Condensed Financial Statements in Item 1 of Part 1 is incorporated herein by reference.

ITEM 1A. RISK FACTORS

There have been no material changes to our Risk Factors as previously disclosed in our Form 10-K for the fiscal year ended June 30, 2006.

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

Following is a summary of stock repurchases for the quarter ended March 31, 2007.(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, 2007 to January 31, 2007	—	$ —	**3,826,500**
February 1, 2007 to February 28, 2007	270,000	$ 50.28	**3,556,500**
March 1, 2007 to March 31, 2007	—	$ —	**3,556,500**
Total	270,000	$ 50.28	

(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 put into place in order to reduce the dilution that results from KLA-Tencor's issuance of its shares pursuant to its 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, 2007, the Board of Directors has authorized KLA-Tencor to repurchase a total of 37.8 million shares. The Company's systematic buyback program was suspended in May 2006, and resumed in February 2007. All shares repurchased remain as treasury shares and are retired.

(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 2007 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.

In addition to the above stock repurchases, the Board of Directors authorized a repurchase of up to $750 million of the Company's common stock pursuant to an Accelerated Share Repurchase program ("ASR") in February, 2007. In March 2007, the Company received 11,981,254 million shares under the ASR. The ASR is expected to be completed during the fourth quarter of fiscal year 2007.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders of KLA-Tencor Corporation was held on March 29, 2007 at the Crowne Plaza Hotel in Milpitas, California. Of the 201,014,289 shares of Common Stock outstanding as of February 15, 2007 (the record date), 185,366,022 shares, or 92%, were present or represented by proxy at the meeting. Two proposals were considered at the meeting.

Proposal One. The stockholders elected the Company's four nominees to its Board of Directors. The table below presents the results of the election.

Name	Director Class	For	Withheld
H. Raymond Bingham	Class II	183,127,128	2,238,894
Robert T. Bond	Class II	145,807,486	39,558,536
David C. Wang	Class II	183,873,586	1,492,436
Robert M. Calderoni	Class I	183,913,360	1,451,662

Proposal Two. The stockholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2007. This proposal received 180,026,054 votes for, 4,301,621 votes against and 1,038,347 abstentions.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

10.27 Letter Agreement by and between KLA-Tencor Corporation and Merrill Lynch International+

10.28 Letter Agreement by and between KLA-Tencor Corporation and Brian M. Martin

31.1 Certification of Chief Executive Officer Under Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of Chief Financial Officer Under Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.

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

\+ Confidential treatment has been requested as to a portion of this exhibit.

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 4, 2007	/s/ RICHARD P. WALLACE
(Date)	Richard P. Wallace Chief Executive Officer (Principal Executive Officer)
May 4, 2007	/s/ JEFFREY L. HALL
(Date)	Jeffrey L. Hall Senior Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

Table of Contents

KLA-TENCOR CORPORATION
EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit Number	Filing Date
10.27	Letter Agreement by and between KLA-Tencor Corporation and Merrill Lynch International+				
10.28	Letter Agreement by and between KLA-Tencor Corporation and Brian M. Martin				
31.1	Certification of Chief Executive Officer under Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934				
31.2	Certification of Chief Financial Officer under Rule 13a-14(a) /15d-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				

+ Confidential treatment has been requested as to a portion of this exhibit.

NOTE: PORTIONS OF THIS EXHIBIT ARE THE SUBJECT OF A CONFIDENTIAL TREATMENT REQUEST BY THE REGISTRANT TO THE SECURITIES AND EXCHANGE COMMISSION. SUCH PORTIONS HAVE BEEN REDACTED AND ARE MARKED WITH A “[***]” IN PLACE OF THE REDACTED LANGUAGE.

EXECUTION COPY

Merrill Lynch International
Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

February 22, 2007

KLA-Tencor Corporation 160 Rio Robles
San Jose, California 95134
Ladies and Gentlemen:

The purpose of this letter agreement (this “**Confirmation**”) is to confirm the terms and conditions of the Transaction entered into between KLA-Tencor Corporation, a Delaware corporation (the “**Purchaser**”), Merrill Lynch International (the “**Seller**”) and Merrill Lynch, Pierce, Fenner & Smith Incorporated, solely in its capacity as agent for the Seller (as provided for herein), on the Trade Date specified below (the “**Transaction**”). This Confirmation constitutes a “Confirmation” as referred to in the Agreement (as defined below).

This Confirmation evidences a complete and binding agreement between the Seller and the Purchaser as to the terms of the Transaction to which this Confirmation relates. This Confirmation shall supplement, form a part of, and be subject to an agreement in the form of the 2002 ISDA Master Agreement (the “**Agreement**”) as if the Seller and the Purchaser had executed an agreement in such form (but without any Schedule except for the election of the laws of the State of New York as the governing law) on the Trade Date. In the event of any inconsistency between provisions of the Agreement and this Confirmation, this Confirmation will prevail for the purpose of the Transaction to which this Confirmation relates. The parties hereby agree that no Transaction other than the Transaction to which this Confirmation relates shall be governed by the Agreement.

ARTICLE 1
DEFINITIONS

Section 1.01. *Definitions.* (a) As used in this Confirmation, the following terms shall have the following meanings:

“**10b-18 VWAP**” means, (A) for any Trading Day described in clause (x) of the definition of Trading Day hereunder, the volume-weighted average price at which the Common Stock trades as reported in the composite transactions for the principal United States securities exchange on which such Common Stock is then listed (or, if applicable, the Successor Exchange on which the Common Stock has been listed in accordance with Section 7.01(c)), on such Trading Day, excluding (i) trades that do not settle regular way, (ii) opening (regular way) reported trades in the consolidated system on such Trading Day, (iii) trades that occur in the last ten minutes before the scheduled close of trading on the Exchange on such Trading Day and ten minutes before the scheduled close of the primary trading in the market where the trade is effected, and (iv) trades on such Trading Day that do not satisfy the requirements of Rule 10b-18(b)(3), as determined in good faith by the Calculation Agent, or (B) for any Trading Day that is described in clause (y) of the definition of Trading Day hereunder, an amount determined in good faith by the Calculation Agent as 10b-18 VWAP. The Purchaser acknowledges that the Seller may refer to the Bloomberg Page "KLAC.UQ <Equity> AQR SEC" (or any successor thereto), in its judgment, for such Trading Day to determine the 10b-18 VWAP.

"**Additional Termination Event**" has the meaning set forth in Section 7.01.

"**Agent**" means Merrill Lynch, Pierce, Fenner & Smith Incorporated.

"**Agreement**" has the meaning set forth in the second paragraph of this Confirmation.

"**Affected Party**" has the meaning set forth in Section 14 of the Agreement.

"**Affected Transaction**" has the meaning set forth in Section 14 of the Agreement.

"**Affiliated Purchaser**" means any "affiliated purchaser" (as such term is defined in Rule 10b-18) of the Purchaser.

"**Alternative Termination Delivery Unit**" means (i) in the case of a Termination Event (other than a Merger Event or Nationalization) or Event of Default for which the Purchaser is the Defaulting Party or sole Affected Party, one share of Common Stock and (ii) in the case of a Merger Event or Nationalization, a unit consisting of the number or amount of each type of property received by a holder of one share of Common Stock in such Merger Event or Nationalization; *provided* that if such Merger Event involves a choice of consideration to be received by holders of the Common Stock, an Alternative Termination Delivery Unit shall be deemed to include the amount of cash received by a holder who had elected to receive the maximum possible amount of cash as consideration for his shares.

"**Averaging Period**" means the period of consecutive Trading Days from and including the first Trading Day following the Hedging Completion Date to and including the Valuation Completion Date.

"**Bankruptcy Code**" has the meaning set forth in Section 9.06.

"**Business Day**" means any day on which the Exchange is open for trading.

"**Calculation Agent**" means Merrill Lynch International.

"**Common Stock**" has the meaning set forth in Section 2.01.

"**Communications Procedures**" has the meaning set forth in Annex A hereto.

"**Confirmation**" has the meaning set forth in the first paragraph of this letter agreement.

"**Contract Period**" means the period commencing on and including the Trade Date and ending on and including the date all payments or deliveries of shares of Common Stock pursuant to Article 3 or Section 7.03 have been made.

"**Default Notice Day**" has the meaning set forth in Section 7.02(a).

"**Deliverable Shares**" has the meaning set forth in Section 4.01(a).

"**De-Listing**" has the meaning set forth in Section 7.01(c).

"**Early Termination Date**" has the meaning set forth in Section 14 of the Agreement.

"**Employee Stock Option Tender Offer**" means the issuer tender offer proposed to be conducted by the Purchaser for certain of its employee stock options, as described in preliminary communications filed by the Purchaser with the SEC on January 29, 2007.

"**Event of Default**" has the meaning set forth in Section 14 of the Agreement.

"**Excess Ordinary Cash Dividend**" has the meaning set forth in Section 7.01(f).

"**Exchange**" means the NASDAQ Global Select Market.

"**Exchange Act**" means the Securities Exchange Act of 1934, as amended.

"**Extraordinary Cash Dividend**" means the per share cash dividend or distribution, or a portion thereof, declared by the Purchaser on shares of Common Stock that is classified by the board of directors of the Purchaser as an "extraordinary" dividend.

"**Hedging Completion Date**" means the Trading Day on which the Seller completes the establishment of its initial hedge position with respect to this Transaction.

"**Hedging Price**" means the volume weighted average of the per share prices at which the Seller (or an affiliate of the Seller) purchases shares of Common Stock during the Hedging Period to establish Seller's initial hedge position with respect to this Transaction.

"**Hedging Period**" has the meaning set forth in Section 2.03(a).

"**Merger Event**" has the meaning set forth in Section 7.01(d).

"**Minimum Delivery Number**" means the number of shares of Common Stock, rounded down to the nearest integer, equal to (A) the Purchase Price *divided by* (B) the Upside Threshold.

"**Nationalization**" has the meaning set forth in Section 7.01(e).

"**Ordinary Cash Dividend**" means a cash dividend by the Purchaser on shares of Common Stock that is not an Extraordinary Cash Dividend.

"**Purchase Price**" has the meaning set forth in Section 2.01.

"**Purchaser**" has the meaning set forth in the first paragraph of this Confirmation.

"**Regulation M**" means Regulation M under the Exchange Act.

"**Rule 10b-18**" means Rule 10b-18 promulgated under the Exchange Act (or any successor rule thereto).

"**SEC**" means the Securities and Exchange Commission.

"**Securities Act**" means the Securities Act of 1933, as amended.

"**Seller**" has the meaning set forth in the first paragraph hereto.

"**Seller Termination Share Purchase Period**" has the meaning set forth in Section 7.03.

"**Settlement Number**" means the number of shares of Common Stock equal to (i) the Valuation Number *minus* (ii) 90% of the Minimum Delivery Number.

"**Share De-listing Event**" has the meaning set forth in Section 7.01(c).

"**Successor Exchange**" has the meaning set forth in Section 7.01(c).

"**Tender Offer Acceptance Date**" has the meaning set forth in Section 4.02(b).

"**Termination Amount**" has the meaning set forth in Section 7.02(a).

"**Termination Event**" has the meaning set forth in Section 14 of the Agreement.

"**Termination Price**" means the value of an Alternative Termination Delivery Unit to the Seller, as determined by the Calculation Agent.

"**Trade Date**" has the meaning set forth in Section 2.01.

"**Trading Day**" means (x) any day (i) other than a Saturday, a Sunday, a day on which the Exchange is not open for business or the Tender Offer Acceptance Date, (ii) during which trading of any securities of the Purchaser on any national securities exchange has not been suspended, (iii) during which there has not been, in the Seller's reasonable judgment, a material limitation in the trading of Common Stock or any options contract or futures contract related to the Common Stock, and (iv) during which there has been no suspension pursuant to Section 4.02 of this Confirmation, or (y) any day that, notwithstanding the occurrence of events contemplated in clauses (ii), (iii) and (iv) of this definition, the Calculation Agent determines to be a Trading Day.

"**Transaction**" has the meaning set forth in the first paragraph of this Confirmation.

"**Upside Threshold**" means, subject to the proviso contained in Section 2.03(b), ***% of the Hedging Price.

"**Valuation Completion Date**" means the earlier of (x) the *** Trading Day following the Hedging Completion Date and (y) such earlier Trading Day, but no earlier than the *** Trading Day following the Hedging Completion Date, validly elected by the Seller as the Valuation Completion Date by delivery of a notice to the Purchaser of such election by no later than 5:00 P.M. (New York City time) on the Business Day immediately following such elected Trading Day.

"**Valuation Number**" means the number of shares of Common Stock, rounded down to the nearest integer, equal to the Purchase Price *divided by* the Valuation Price; *provided, however,* that if such number of shares of Common Stock is less than the Minimum Delivery Number, the Valuation Number shall be equal to such Minimum Delivery Number.

"**Valuation Price**" means the average for all Trading Days in the Averaging Period of the excess of (x) the 10b-18 VWAP for such Trading Day over (y) $***.

ARTICLE 2
PURCHASE OF THE STOCK

Section 2.01. *Purchase of the Stock.* Subject to the terms and conditions of this Confirmation, the Purchaser agrees to purchase from the Seller, and the Seller agrees to sell to the Purchaser, on February 22, 2007 or on such other Business Day as the Purchaser and the Seller shall otherwise agree (the "**Trade Date**"), a number of shares of the Purchaser's common stock, par value $0.001 per share ("**Common Stock**"), for a purchase price equal to $750,000,000 (the "**Purchase Price**"). The number of shares of Common Stock purchased by the Purchaser hereunder shall be determined in accordance with the terms of this Confirmation.

*** Certain information on this page has been omitted and filed separately with the Commission pursuant to a request for Confidential Treatment.

Section 2.02. *Initial Payment.* On the Trade Date, the Purchaser shall deliver the Purchase Price to the Seller. Payment pursuant to this Section 2.02 shall be effected in accordance with the Seller's customary procedures.

Section 2.03. *Hedging Period.* (a) On each Trading Day beginning on the third Trading Day immediately following the Trade Date and ending on the Hedging Completion Date, an affiliate of the Seller shall effect, for the account of the Seller, purchases of shares of Common Stock to establish Seller's initial position to hedge the Seller's price and market risk in connection with this Transaction (the period of consecutive Trading Days on which such purchases for this Transaction are effected being collectively referred to as the "**Hedging Period**" for this Transaction). In no event shall the Hedging Period be more than seven Trading Days.

(b) At the conclusion of the Hedging Period, based on the amounts and prices at which an affiliate of the Seller effects purchases of shares of Common Stock during the Hedging Period to establish Seller's initial hedge position in connection with this Transaction, the Calculation Agent shall determine the Hedging Price, the Upside Threshold and the Minimum Delivery Number for this Transaction.

(c) On the first Business Day following the Hedging Completion Date, in addition to satisfying its obligations under Section 3.01(a), the Seller shall deliver to the Purchaser a pricing supplement, substantially in the form of Exhibit A attached hereto, setting forth the Hedging Price, the Upside Threshold, the Minimum Delivery Number and the first day of the Averaging Period for this Transaction.

ARTICLE 3
SHARE DELIVERIES

Section 3.01. *Deliveries of Shares.* (a) On the first business day immediately following the Hedging Completion Date, the Seller shall deliver to the Purchaser the number of shares of Common Stock equal to 90% of the Minimum Delivery Number.

(b) On the third Business Day immediately following the Valuation Completion Date, the Seller shall deliver to the Purchaser the number of shares of Common Stock equal to the Settlement Number, if any.

(c) Delivery pursuant to this Article 3 shall be effected in accordance with the Seller's customary procedures.

ARTICLE 4
MARKET TRANSACTIONS

Section 4.01. *Transactions by the Seller.* (a) The parties agree and acknowledge that:

(i) During the Hedging Period, the Averaging Period and any Seller Termination Share Purchase Period, the Seller (or its agent or affiliate) may effect transactions in shares of Common Stock in connection with this Confirmation. The timing of such transactions by the Seller, the price paid or received per share of Common Stock pursuant to such transactions and the manner in which such transactions are made, including without limitation whether such transactions are made on any securities exchange or privately, shall be within the sole judgment of the Seller; *provided* that the Seller shall make all such purchases of Common Stock during the Hedging Period and any Seller Termination Share Purchase Period and all such purchases of Deliverable Shares during the Averaging Period in a manner that would comply with the limitations set forth in clauses (b)(2), (b)(3), (b)(4) and (c) of Rule 10b-18 as if such rule were applicable to such purchases. "**Deliverable Shares**" shall mean shares of Common Stock purchased by Seller for delivery to Buyer or for repayment of shares borrowed by Seller for delivery to Buyer.

(ii) In the event that any of the Purchaser or its Affiliated Purchasers conducts any Rule 10b-18 purchases of blocks of Common Stock pursuant to the once-a-week block exception set forth in Rule 10b-18(b)(4) during the four calendar weeks preceding the first day of either the Hedging Period or the Seller Termination Share Purchase Period, or during the calendar week in which either such day occurs, the Purchaser shall provide written notice thereof setting forth the total number of shares purchased. In the absence of such notice, the Purchaser shall be deemed to have advised the Seller that no such blocks were purchased by any of the Purchaser or its Affiliated Purchasers during such periods. For purposes of this Section 4.01(a)(ii), the terms "**Rule 10b-18 purchase**" and "**block**" shall have the meanings given to them in Rule 10b-18.

(b) The Purchaser acknowledges and agrees that (i) all transactions effected pursuant to Section 4.01 hereunder shall be made in the Seller's sole judgment and for the Seller's own account and (ii) the Purchaser does not have, and shall not attempt to exercise, any influence over how, when or whether to effect such transactions, including, without limitation, the price paid or received per share of Common Stock pursuant to such transactions whether such transactions are made on any securities exchange or privately. It is the intent of the Seller and the Purchaser that this Transaction comply with the requirements of Rule 10b5-1(c) of the Exchange Act and that this Confirmation shall be interpreted to comply with the requirements of Rule 10b5-1(c)(1)(i)(B) and the Seller shall take no action that results in the Transaction not so complying with such requirements.

Section 4.02. *Suspension of Transactions in Common Stock.* (a) If the Seller, in its reasonable judgment, determines that it is necessary with regard to any legal, regulatory or self-regulatory requirements or related policies and procedures (whether or not such requirements, policies or procedures are imposed by law or have been voluntarily adopted by the Seller) for the Seller to refrain from effecting transactions in Common Stock on any Business Day during the Contract Period or to effect such transactions on such Business Day at a volume lower than that otherwise effected by the Seller hereunder, the Seller (or its agent or affiliate) shall not effect transactions in shares of Common Stock with respect to this Transaction on such day or effect such transactions at a volume determined by the Seller in its reasonable judgment; *provided* that if the Seller decides to effect any transaction hereunder at such lower volume, the Calculation Agent shall be entitled to make appropriate adjustments to the term of this Transaction under Section 8.02 to reflect the effect of such diminished volume. The Seller shall notify the Purchaser of the exercise of the Seller's rights pursuant to this Section 4.02(a) upon such exercise and shall subsequently notify the Purchaser on the day the Seller believes that the Seller may resume purchasing or selling or purchasing at the volume level anticipated at the outset of this Transaction, as applicable, Common Stock. The Seller shall not be obligated to communicate to the Purchaser the reason for the Seller's exercise of its rights pursuant to this Section 4.02(a).

(b) Seller agrees that neither it nor any of its agents or affiliates shall effect transactions in Common Stock with respect to this Transaction on the date on which securities tendered pursuant to the Employee Stock Option Tender Offer are to be accepted (the "**Tender Offer Acceptance Date**"). Purchaser agrees to provide written notice to Seller of the Tender Offer Acceptance Date no later than five Trading Days prior to the Tender Offer Acceptance Date.

(c) The Purchaser agrees that, during the Contract Period, neither the Purchaser nor any of its affiliates or agents shall make any distribution (as defined in Regulation M) of Common Stock, or any security for which the Common Stock is a reference security (as defined in Regulation M), or take any other action that would preclude purchases by the Seller of the Common Stock, in each case such as would cause Seller's purchases of Common Stock to violate Regulation M; *provided*, *however*, that notwithstanding the foregoing, nothing in this Confirmation shall prohibit the Purchaser from making any distribution of Common Stock or any security for which the Common Stock is a reference security (i) to qualified institutional buyers in transactions pursuant to Rule 144A under the Securities Act or (ii) in connection with the Employee Stock Option Tender Offer.

Section 4.03. *Purchases of Common Stock by the Purchaser.* Without the prior written consent of the Seller, the Purchaser shall not, and shall cause its affiliates and affiliated purchasers (each as defined in Rule 10b-18) not to, directly or indirectly (including, without limitation, by means of a derivative instrument) purchase, offer to purchase, place any bid or limit order that would effect a purchase of, or commence any tender offer relating to, any shares of Common Stock (or equivalent interest, including a unit of beneficial interest in a trust or limited partnership or a depository share) or any security convertible into or exchangeable for shares of Common Stock during the Contract Period; *provided*, *however*, that notwithstanding the foregoing, nothing in this Confirmation shall prohibit the Purchaser from purchasing or offering to purchase any such securities in connection with the Employee Stock Option Tender Offer.

ARTICLE 5
REPRESENTATIONS, WARRANTIES AND AGREEMENTS

Section 5.01. *Repeated Representations, Warranties and Agreements of the Purchaser.* The Purchaser represents and warrants to, and agrees with, the Seller, on the date hereof and on any date on which the Purchaser elects to receive any delivery or payment pursuant to this Confirmation, that:

(a) **Disclosure; Compliance with Laws**. The reports and other documents filed by the Purchaser with the SEC pursuant to the Exchange Act when considered as a whole (with the more recent such reports and documents deemed to amend inconsistent statements contained in any earlier such reports and documents), do not contain any untrue statement of a material fact or any omission of a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances in which they were made, not misleading. The Purchaser is not in possession of any material nonpublic information regarding the Purchaser or the Common Stock.

(b) **Rule 10b5-1**. The Purchaser acknowledges that (i) the Purchaser does not have, and shall not attempt to exercise, any influence over how, when or whether to effect purchases of Common Stock by the Seller (or its agent or affiliate) in connection with this Confirmation and (ii) the Purchaser is entering into the Agreement and this Confirmation in good faith and not as part of a plan or scheme to evade compliance with federal securities laws including, without limitation, Rule 10b-5 promulgated under the Exchange Act. The Purchaser also acknowledges and agrees that any amendment, modification, waiver or termination of this Confirmation must be effected in accordance with the requirements for the amendment or termination of a “plan” as defined in Rule 10b5-1(c) under the Exchange Act. Without limiting the generality of the foregoing, any such amendment, modification, waiver or termination shall be made in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5 under the Exchange Act, and no amendment, modification or waiver shall be made at any time at which the Purchaser or any officer or director of the Purchaser is aware of any material nonpublic information regarding the Purchaser or the Common Stock.

(c) **No Facilitation of Distribution**. The Purchaser is not entering into this Confirmation to facilitate a distribution of the Common Stock (or any security convertible into or exchangeable for Common Stock) or in connection with a future issuance of securities.

(d) **No Manipulation**. The Purchaser is not entering into this Confirmation to create actual or apparent trading activity in the Common Stock (or any security convertible into or exchangeable for Common Stock) or to manipulate the price of the Common Stock (or any security convertible into or exchangeable for Common Stock).

(e) **Regulation M**. The Purchaser is not engaged in a distribution, as such term is used in Regulation M, that would preclude purchases by the Purchaser or the Seller of the Common Stock or cause the Seller to violate any law, rule or regulation with respect to such purchases.

(f) **Board Authorization**. The Purchaser is entering into this Transaction in connection with its share repurchase program, which was approved by its board of directors and which will be publicly disclosed prior to the first day of the Hedging Period. There is no internal policy of the Purchaser, whether written or oral, that would prohibit the Purchaser from entering into any aspect of this Transaction, including, but not limited to, the purchases of shares of Common Stock to be made pursuant hereto.

(g) **Due Authorization and Good Standing**. The Purchaser is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware. This Confirmation has been duly authorized, executed and delivered by the Purchaser and (assuming due authorization, execution and delivery thereof by the Seller) constitutes a valid and legally binding obligation of the Purchaser. The Purchaser has all corporate power to enter into this Confirmation and to consummate the transactions contemplated hereby and to purchase the Common Stock in accordance with the terms hereof.

(h) **Certain Transactions.** There has not been any public announcement (as defined in Rule 165(f) under the Securities Act) of any merger, acquisition, or similar transaction involving a recapitalization relating to the Purchaser that would fall within the scope of Rule 10b-18(a)(13)(iv).

Section 5.02. *Initial Representations, Warranties and Agreements of the Purchaser.* The Purchaser represents and warrants to, and agrees with the Seller, as of the date hereof, that:

(a) **Solvency**. The assets of the Purchaser at their fair valuation exceed the liabilities of the Purchaser, including contingent liabilities; the capital of the Purchaser is adequate to conduct the business of the Purchaser and the Purchaser has the ability to pay its debts and obligations as such debts mature and does not intend to, or does not believe that it will, incur debt beyond its ability to pay as such debts mature.

(b) **No Conflict.** The execution and delivery by the Purchaser of, and the performance by the Purchaser of its obligations under, this Confirmation and the consummation of the transactions herein contemplated do not conflict with or violate (i) any provision of the certificate of incorporation, by-laws or other constitutive documents of the Purchaser, (ii) any statute or order, rule, regulation or judgment of any court or governmental agency or body having jurisdiction over the Purchaser or any of its subsidiaries or any of their respective assets or (iii) any contractual restriction binding on or affecting the Purchaser or any of its subsidiaries or any of its assets.

(c) **Consents.** All governmental and other consents that are required to have been obtained by the Purchaser with respect to performance, execution and delivery of this Confirmation have been obtained and are in full force and effect and all conditions of any such consents have been complied with.

(d) **Investment Company Act**. The Purchaser is not and, after giving effect to the transactions contemplated in this Confirmation, will not be required to register as an "investment company" as such term is defined in the Investment Company Act of 1940, as amended.

(e) **Commodity Exchange Act**. The Purchaser is an "eligible contract participant", as such term is defined in Section 1(a)(12) of the Commodity Exchange Act, as amended.

Section 5.03. *Additional Representations, Warranties and Agreements*. The Purchaser and the Seller represent and warrant to, and agree with, each other that:

(a) **Non-Reliance**. Each party has entered into this Transaction solely in reliance on its own judgment. Neither party has any fiduciary obligation to the other party relating to this Transaction. In addition, neither party has held itself out as advising, or has held out any of its employees or agents as having the authority to advise, the other party as to whether or not the other party should enter into this Transaction, any subsequent actions relating to this Transaction or any other matters relating to this Transaction. Neither party shall have any responsibility or liability whatsoever in respect of any advice of this nature given, or views expressed, by it or any such persons to the other party relating to this Transaction, whether or not such advice is given or such views are expressed at the request of the other party. The Purchaser has conducted its own analysis of the legal, accounting, tax and other implications of this Transaction and consulted such advisors, accountants and counsel as it has deemed necessary.

(b) **Agency**. Merrill Lynch, Pierce, Fenner & Smith Incorporated shall act as "agent" for Seller and Buyer within the meaning of Rule 15a-6 under the Exchange Act. The Agent is not a principal to this Confirmation and shall have no responsibility or liability to Seller or Buyer to pay or perform under this Confirmation. Each of Seller and Buyer agrees to proceed solely against the other to collect or recover any securities or money owing to it in connection with or as a result of this Confirmation. The Agent shall otherwise have no liability in respect of this Confirmation, except for its gross negligence or willful misconduct in performing its duties as Agent hereunder. As a broker-dealer registered with the Securities and Exchange Commission, Merrill Lynch, Pierce, Fenner & Smith Incorporated, in its capacity as Agent, will be responsible for (i) effecting the Transaction, (ii) issuing all required notices, confirmations and statements to Seller and Buyer and (iii) maintaining books and records relating to this Confirmation.

(c) **Tax Matters**. (i) For the purpose of Section 3(e) of the Agreement, each party represents to the other party that it is not required by any applicable law, as modified by the practice of any relevant governmental revenue authority, of any Relevant Jurisdiction to make any deduction or withholding for or on account of any Tax from any payment (other than interest under Section 2(e), 6(d)(ii), or 6(e) of the Agreement, or under Section 8.01 of this Confirmation) to be made by it to the other party under the Agreement. In making this representation, each party may rely on (i) the accuracy of any representations made by the other party pursuant to Section 3(f) of the Agreement, (ii) the satisfaction of the agreement contained in Section 4(a)(i) or 4(a)(iii) of the Agreement, and the accuracy and effectiveness of any document provided by the other party pursuant to Section 4(a)(i) or 4(a)(iii) of the Agreement, and (iii) the satisfaction of the agreement of the other party contained in Section 4(d) of the Agreement; *provided* that it will not be a breach of this representation where reliance is placed on clause (ii) above and the other party does not deliver a form or document under Section 4(a)(iii) of the Agreement by reason of material prejudice to its legal or commercial position.

(ii) For the purpose of Section 3(f) of the Agreement, (A) Seller represents that it is a company organized under the laws of England and Wales and (ii) Buyer represents that it is a corporation incorporated under the laws of Delaware.

Section 5.04. *Representations and Warranties of the Seller*. The Seller represents and warrants to the Purchaser that:

(a) **Due Authorization**. This Confirmation has been duly authorized, executed and delivered by the Seller and (assuming due authorization, execution and delivery thereof by the Purchaser) constitutes a valid and legally binding obligation of the Seller. The Seller has all corporate power to enter into this Confirmation and to consummate the transactions contemplated hereby and to deliver the Common Stock in accordance with the terms hereof.

(b) **Right to Transfer**. The Seller will, as of each date on which it delivers shares of Common Stock to the Purchaser pursuant to Article 3, transfer the shares of Common Stock that it delivers free and clear of any security interest, mortgage, pledge, lien, charge, claim, equity or encumbrance of any kind.

ARTICLE 6
ADDITIONAL COVENANTS

Section 6.01. *Purchaser's Further Assurances.* The Purchaser hereby agrees with the Seller that the Purchaser shall cooperate with the Seller, and execute and deliver, or use its reasonable efforts to cause to be executed and delivered, all such other instruments, and to obtain all consents, approvals or authorizations of any person, and take all such other actions as the Seller may reasonably request from time to time, consistent with the terms of this Confirmation, in order to effectuate the purposes of this Confirmation and the Transaction contemplated hereby.

Section 6.02 *Purchaser's Hedging Transactions.* The Purchaser hereby agrees with the Seller that the Purchaser shall not, during the Contract Period, enter into or alter any corresponding or hedging transaction or position with respect to the Common Stock (including, without limitation, with respect to any securities convertible or exchangeable into the Common Stock) and agrees not to alter or deviate from the terms of this Confirmation.

Section 6.03. *No Communications.* The Purchaser hereby agrees with the Seller that the Purchaser shall not, directly or indirectly, communicate any information relating to the Common Stock or this Transaction (including any notices required by Section 6.04) to any employee of the Seller or Merrill Lynch, Pierce, Fenner & Smith Incorporated, other than as set forth in the Communications Procedures attached as Annex A hereto.

Section 6.04. *Notice of Certain Transactions.* If at any time during the Contract Period, the Purchaser makes, or expects to be made, or has made, any public announcement (as defined in Rule 165(f) under the Securities Act) of any merger, acquisition, or similar transaction involving a recapitalization relating to the Purchaser (other than any such transaction in which the consideration consists solely of cash and there is no valuation period, or as to which the completion of such transaction or the completion of the vote by target shareholders has occurred), then the Purchaser shall (i) notify the Seller prior to the opening of trading in the Common Stock on any day on which the Purchaser makes, or expects to be made, or has made any such public announcement, (ii) notify the Seller promptly following any such announcement (or, if later, prior to the opening of trading in the Common Stock on the first day of any Seller Termination Share Purchase Period) that such announcement has been made and (iii) promptly deliver to the Seller following the making of any such announcement (or, if later, prior to the opening of trading in the Common Stock on the first day of any Seller Termination Share Purchase Period) a certificate indicating (A) the Purchaser's average daily Rule 10b-18 purchases (as defined in Rule 10b-18) during the three full calendar months preceding the date of such announcement and (B) the Purchaser's block purchases (as defined in Rule 10b-18) effected pursuant to paragraph (b)(4) of Rule 10b-18 during the three full calendar months preceding the date of such announcement. In addition, the Purchaser shall promptly notify the Seller of the earlier to occur of the completion of such transaction and the completion of the vote by target shareholders.

Section 6.05. *Determinations by the Calculation Agent.* All determinations made by the Calculation Agent shall be made in good faith and in a reasonable manner. Following any calculation by the Calculation Agent hereunder, at the request of the Purchaser, the Calculation Agent shall provide to the Purchaser by electronic mail a report (in a commonly used file format for the storage and manipulation of financial data) setting forth in reasonable detail the basis for such calculation.

ARTICLE 7
TERMINATION

Section 7.01. *Additional Termination Events.* (a) An Additional Termination Event shall occur in respect of which the Purchaser is the sole Affected Party and this Transaction is the sole Affected Transaction if, on any day, the Seller determines, in its reasonable judgment, that it is unable to establish, re-establish or maintain in an economically efficient manner any hedging transactions reasonably necessary in the normal course of such party's business of hedging the price and market risk of entering into and performing under this Transaction, due to market illiquidity, illegality, lack of availability of hedging transaction market participants or any other factor.

(b) An Additional Termination Event shall occur in respect of which the Purchaser is the sole Affected Party and this Transaction is the sole Affected Transaction if (i) a Share De-listing Event occurs; (ii) a Merger Event occurs; (iii) a Nationalization occurs, (iv) an Excess Ordinary Cash Dividend is declared, (v) any event described in Section 8.02 occurs with respect to which, the Calculation Agent determines in its reasonable judgment, that it is impracticable to effect any adjustment contemplated by Section 8.02 in order to preserve the fair value of the Transaction to the Seller or (vi) an event described in paragraph III of Annex A occurs.

(c) A "**Share De-listing Event**" means that at any time during the Contract Period, the Common Stock ceases to be listed, traded or publicly quoted on the Exchange for any reason (other than a Merger Event, a "**De-Listing**") and are not immediately re-listed, traded or quoted as of the date of such de-listing, on another U.S. national securities exchange or a U.S. automated interdealer quotation system (a "**Successor Exchange**"), *provided* that it shall not constitute an Additional Termination Event if the Common Stock is immediately re-listed on a Successor Exchange upon its De-Listing from the Exchange, and the Successor Exchange shall be deemed to be the Exchange for all purposes. In addition, in such event, the Seller shall make any commercially reasonable adjustments it deems necessary to the terms of the Transaction.

(d) A "**Merger Event**" means the public announcement, including any public announcement as defined in Rule 165(f) of the Securities Act (by the Purchaser or otherwise) at any time during the Contract Period of any (i) planned recapitalization, reclassification or change of the Common Stock that will, if consummated, result in a transfer of more than 50% of the outstanding shares of Common Stock, (ii) planned consolidation, amalgamation, merger or similar transaction of the Purchaser with or into another entity (other than a consolidation, amalgamation or merger in which the Purchaser will be the continuing entity and which does not result in any such recapitalization, reclassification or change of more than 50% of such shares outstanding), (iii) other takeover offer for the shares of Common Stock that is aimed at resulting in a transfer of more than 50% of such shares of Common Stock (other than such shares owned or controlled by the offeror) or (iv) irrevocable commitment to any of the foregoing.

(e) A "**Nationalization**" means that all or substantially all of the outstanding shares of Common Stock or assets of the Purchaser are nationalized, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

(f) An "**Excess Ordinary Cash Dividend**" means an Ordinary Cash Dividend that (i) is not an Extraordinary Cash Dividend, (ii) has a record date during the Contract Period and (iii) is in an amount that, together with all prior declared Ordinary Cash Dividends that have a record date during the same regular dividend period of the Purchaser, exceeds the amount set forth in this Section 7.01(f) for such regular dividend period.

Ordinary Dividend Amount	Dividend Period
$0.12 per share of Common Stock	January 1, 2007 – March 31, 2007
$0.12 per share of Common Stock	April 1, 2007 – June 30, 2007
$0.00 per share of Common Stock	Any quarterly period after June 30, 2007

Section 7.02. *Consequences of Additional Termination Events.* (a) In the event of the occurrence or effective designation of an Early Termination Date under the Agreement, in lieu of payment of the amount payable in respect of this Transaction pursuant to Section 6(d)(ii) of the Agreement (the "**Termination Amount**"), the Seller shall be obligated to deliver to the Purchaser the Alternative Termination Delivery Units pursuant to Section 7.03, unless the Purchaser elects cash settlement (which election shall be binding), as set forth in Section 7.02(b), and notifies the Seller of such election by delivery of written notice to the Seller on the Business Day immediately following the Purchaser's receipt of a notice (as required by Section 6(d) of the Agreement following the designation of an Early Termination Date in respect of this Transaction or in respect of all transactions under the Agreement) setting forth the amounts payable by the Seller with respect to such Early Termination Date (the date of such delivery, the "**Default Notice Day**"); *provided* that the Purchaser's election to receive the Alternative Termination Delivery Units pursuant to Section 7.03 shall not be valid and cash settlement shall apply if the representations and warranties made by the Purchaser to the Seller in Section 5.01 are not true and correct as of the date the Seller makes such election, as if made on such date.

(b) If cash settlement applies in respect of an Early Termination Date, Section 6 of the Agreement shall apply; *provided*, *however*, that notwithstanding any cash settlement election by the

Purchaser, upon such election the Seller's obligation to deliver the Termination Amount shall be satisfied by delivery to the Purchaser of (i) on or as early as practicable following the applicable Early Termination Date, Alternative Termination Delivery Units acquired by or on behalf of the Seller in connection with its hedging activity under this Transaction (whose value shall be based on the Termination Price) and (ii) cash for the remainder, if any, of the Termination Amount.

Section 7.03. *Alternative Termination Settlement.* Subject to Section 7.02(a), unless the Purchaser elects cash settlement pursuant to Section 7.02(b), (i) the Seller shall, beginning on the first Trading Day following the Default Notice Day and ending when the Seller shall have satisfied its obligations under this clause (the "**Seller Termination Share Purchase Period**"), purchase (subject to the provisions of Section 4.01 and Section 4.02 hereof) a number of Alternative Termination Delivery Units equal to (x) (A) the Termination Amount *divided by* (B) the Termination Price *less* (y) any Alternative Termination Delivery Units already held by or on behalf of the Seller in connection with its hedging activity under this Transaction; and (ii) the Seller shall deliver such Alternative Termination Delivery Units (for the avoidance of doubt, in an aggregate number equal to the Termination Amount divided by the Termination Price) to the Purchaser on the settlement dates relating to such purchases (or, with respect to Alternative Termination Delivery Units described in (i)(y) above, on or as soon as practicable following the applicable Early Termination Date).

Section 7.04. *Notice of Default.* If an Event of Default occurs in respect of the Purchaser, the Purchaser will, promptly upon becoming aware of it, notify the Seller specifying the nature of such Event of Default.

ARTICLE 8
ADJUSTMENTS

Section 8.01. *Extraordinary Cash Dividends.* (a) If the Purchaser declares any Extraordinary Cash Dividend that has a record date during the Contract Period, then prior to or on the date on which such Extraordinary Cash Dividend is paid by the Purchaser to holders of record, the Purchaser shall pay to the Seller an amount in cash equal to the product of (i) the amount of such Extraordinary Cash Dividend and (ii) the theoretical short delta number of shares, as determined by the Calculation Agent, required for the Seller to hedge its exposure to the Transaction.

Section 8.02. *Other Dilution Adjustments.* If (x) any corporate event occurs involving the Purchaser or the Common Stock (other than an Extraordinary Cash Dividend or an Ordinary Cash Dividend but including, without limitation, a stock split, stock or other dividend or distribution, recapitalization or any other event having a dilutive or concentrative effect on the Common Stock) or (y) as a result of the definition of Trading Day (whether because of a suspension of transactions pursuant to Section 4.02 or otherwise), any day that would otherwise be a Trading Day during the Contract Period is not a Trading Day or on such Trading Day, pursuant to Section 4.02, the Seller effects transactions with respect to shares of Common Stock at a volume lower than originally anticipated with respect to this Transaction, then in any such case, the Calculation Agent shall make corresponding adjustments with respect to any one or more of the Minimum Delivery Number, the Upside Threshold and the Settlement Number as the Calculation Agent determines appropriate to preserve the fair value of the Transaction to the Seller, and shall determine the effective date of such adjustment.

ARTICLE 9
MISCELLANEOUS

Section 9.01. *Successors and Assigns.* All covenants and agreements in this Confirmation made by or on behalf of either of the parties hereto shall bind and inure to the benefit of the respective successors and assigns of the parties hereto whether so expressed or not.

Section 9.02. *Assignment and Transfer*. Notwithstanding the Agreement, the Seller may assign any of its rights or duties hereunder to any one or more of its affiliates without the prior written consent of the Purchaser. Notwithstanding any other provision in this Confirmation to the contrary requiring or allowing Seller to purchase, sell, receive or deliver any shares of Common Stock or other securities to or from the Purchaser, Seller may designate any of its affiliates to purchase, sell, receive or deliver such shares of Common Stock or other securities and otherwise to perform the Seller's obligations in respect of this Transaction and any such designee may assume such obligations. The Seller shall be discharged of its obligations to the Purchaser only to the extent of any such performance.

Section 9.03. *Calculation Agent*. Whenever the Calculation Agent is required to act or to exercise judgment in a any way with respect to this Transaction, it will do so in good faith and in a commercially reasonable manner.

Section 9.04. *Non-Confidentiality*. The Seller and the Purchaser hereby acknowledge and agree that subject to Section 6.03 each is authorized to disclose every aspect of this Confirmation and the transactions contemplated hereby to any and all persons, without limitation of any kind, and there are no express or implied agreements, arrangements or understandings to the contrary.

Section 9.05. *Unenforceability and Invalidity*. To the extent permitted by law, the unenforceability or invalidity of any provision or provisions of this Confirmation shall not render any other provision or provisions herein contained unenforceable or invalid.

Section 9.06. *Securities Contract*. The parties hereto agree and acknowledge as of the date hereof that (i) the Seller is a "financial institution" within the meaning of Section 101(22) of Title 11 of the United States Code (the "**Bankruptcy Code**") and a "swap participant" within the meaning of Section 101(53C) of the Bankruptcy Code and (ii) this Confirmation is a "securities contract," as such term is defined in Section 741(7) of the Bankruptcy Code, and a "swap agreement," as such term is defined in Section 101(53B) of the Bankruptcy Code, entitled to the protection of, among other Sections, Sections 362(b)(6), 362(b)(17), 546(e), 546(g), 555 and 560 of the Bankruptcy Code.

Section 9.07. *No Collateral, Netting or Setoff*. Notwithstanding any provision of the Agreement, or any other agreement between the parties, to the contrary, the obligations of the Purchaser hereunder are not secured by any collateral. Obligations under this Transaction shall not be netted, recouped or set off (including pursuant to Section 6 of the Agreement) against any other obligations of the parties, whether arising under the Agreement, this Confirmation, under any other agreement between the parties hereto, by operation of law or otherwise, and no other obligations of the parties shall be netted, recouped or set off (including pursuant to Section 6 of the Agreement) against obligations under this Transaction, whether arising under the Agreement, this Confirmation, under any other agreement between the parties hereto, by operation of law or otherwise, and each party hereby waives any such right of setoff, netting or recoupment.

Section 9.08 *Notices*. Unless otherwise specified herein, any notice, the delivery of which is expressly provided for in this Confirmation, may be made by telephone, to be confirmed in writing to the address below. Changes to the information below must be made in writing.

(a) If to the Purchaser:

KLA-Tencor Corporation
160 Rio Robles
San Jose, California 95134
Attention: Jeffrey L. Hall, Chief Financial Officer
Telephone: (408) 875-6800
Facsimile: (408) 875-3030

(b) If to the Seller:

Merrill Lynch International
c/o Merrill Lynch & Co., Inc.
Merrill Lynch World Headquarters
4 World Financial Center, 5th Floor
New York, New York 10080
Attention: Equity Linked COO
Telephone: (212) 449-8637
Facsimile: (212) 738-1801

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Confirmation enclosed for that purpose and returning it to us.

Yours sincerely,

Merrill Lynch, Pierce, Fenner & Smith Incorporated, as agent for Merrill Lynch International

By: /s/ BRIAN CARROLL
Name: Brian Carroll
Title: Authorized Signatory

Merrill Lynch International

By: /s/ WILLIAM MORLEY
Name: William Morley
Title: Authorized Signatory

Confirmed as of the date first above written:

KLA-TENCOR CORPORATION

By: /s/ JEFFREY L. HALL
Name: Jeffrey L. Hall
Title: Chief Financial Officer

ANNEX A

COMMUNICATIONS PROCEDURES

February 22, 2007

I. Introduction

KLA-Tencor Corporation, a Delaware corporation (the "**Purchaser**"), Merrill Lynch International (the "**Seller**") and Merrill Lynch, Pierce, Fenner & Smith Incorporated, solely in its capacity as agent for the Seller have adopted these communications procedures (the "**Communications Procedures**") in connection with entering into the Confirmation (the "**Confirmation**") dated as of February 22, 2007 between Purchaser and Seller relating to the sale by Seller to Purchaser of common stock, par value $0.001 per share, or security entitlements in respect thereof (the "**Common Stock**") of the Purchaser. These Communications Procedures supplement, form part of, and are subject to the Confirmation.

II. Communications Rules

1. From the date hereof until the end of the Contract Period, neither Purchaser, nor any Employee of Purchaser, nor any Designee of Purchaser shall (a) engage in any Program Related Communication with any Equity Derivatives Personnel, other than any of the Permitted Contact, or (b) in any event disclose any Material Non-Public Information to any Equity Derivatives Personnel, other than any of the Permitted Contact, and

2. Subject to the preceding provision, the Purchaser, any Employee of Purchaser and any Designee of Purchaser may at any time engage in any Non-Program Related Communication.

III. Termination

If, in the sole judgment of any Equity Derivatives Personnel or any affiliate or Employee of Seller participating in any Communication with Purchaser or any Designee of Purchaser, such Communication would not be permitted by these Communications Procedures, such Equity Derivatives Personnel or such affiliate or Employee of Seller shall immediately terminate such Communication. In such case, or if such Equity Derivatives Personnel or such affiliate or Employee of Seller determines following completion of any Communication with Purchaser, or any Designee of Purchaser, that such Communication was not permitted by these Communications Procedures, such Equity Derivatives Personnel or such affiliate or Employee of Seller shall promptly consult with his or her supervisors and with counsel for Seller regarding such Communication. If, in the reasonable judgment of Seller's counsel following such consultation, there is more than an insignificant risk that such Communication could materially jeopardize the availability of the affirmative defenses provided in Rule 10b5-1 under the 1934 Act with respect to any ongoing or contemplated activities of Seller or its affiliates in respect of the Confirmation, it shall be an Additional Termination Event with respect to the Confirmation.

IV. Definitions

Capitalized terms used and not otherwise defined herein shall have the meanings ascribed to them in the Confirmation. As used herein, the following words and phrases shall have the following meanings:

"**Communication**" means any contact or communication (whether written, electronic, oral or otherwise) between Purchaser, any Employee of Purchaser or one or more Designees of Purchaser, on the one hand, and Seller or any of its affiliates or Employees, on the other hand.

"**Designee**" means a person designated, in writing or orally, by Purchaser to communicate with Seller on behalf of Purchaser.

"**Equity Derivatives Personnel**" means Dariush Maanavi, Brian Lehman, Kevin Tyler, Charles Hill, Usman Khan and any other Employee of the public side of the Equity Derivatives Group of Seller; *provided* that Seller may amend the list of Equity Derivatives Personnel by delivering a revised list of Equity Derivatives Personnel to Purchaser.

"**Employee**" means, with respect to any entity, any owner, principal, officer, director, employee or other agent or representative of such entity, and any affiliate of any of such owner, principal, officer, director, employee, agent or representative.

"**Material Non-Public Information**" means information relating to the Purchaser or the Common Stock that (a) has not been widely disseminated by wire service, in one or more newspapers of general circulation, by communication from the Purchaser to its shareholders or in a press release, or contained in a public filing made by the Purchaser with the Securities and Exchange Commission and (b) a reasonable investor might consider to be of importance in making an investment decision to buy, sell or hold shares of Common Stock. For the avoidance of doubt and solely by way of illustration, information should be presumed "material" if it relates to such matters as dividend increases or decreases, earnings estimates, changes in previously released earnings estimates, significant expansion or curtailment of operations, a significant increase or decline of orders, significant merger or acquisition proposals or agreements, significant new products or discoveries, extraordinary borrowing, major litigation, liquidity problems, extraordinary management developments, purchase or sale of substantial assets and similar matters.

"**Non-Program Related Communication**" means any Communication other than a Program Related Communication.

"**Permitted Contact**" means any of Gary Rosenblum or any of his designees.

"**Program Related Communication**" means any Communication the subject matter of which relates to the Confirmation or any Transaction under the Confirmation or any activities of Seller (or any of its affiliates) in respect of the Confirmation or any Transaction under the Confirmation.

EXHIBIT A

FORM OF PRICING SUPPLEMENT

Merrill Lynch International
Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

March 8, 2007

KLA-Tencor Corporation
160 Rio Robles
San Jose, California 95134

Ladies and Gentlemen:

This letter is a Pricing Supplement within the meaning of Section 2.04(c) of the Confirmation dated as of February 22, 2007 (the "**Confirmation**") between KLA-Tencor Corporation, a Delaware corporation (the "**Purchaser**"), Merrill Lynch International (the "**Seller**") and Merrill Lynch, Pierce, Fenner & Smith Incorporated, solely in its capacity as agent for the Seller. Capitalized terms used herein have the meanings set forth in the Confirmation.

This Pricing Supplement relates to the Transaction described in the Confirmation. Upon the terms and subject to the conditions of the Confirmation, the terms of the Transaction shall be as follows:

1. Hedging Price:	$***
2. Upside Threshold:	$***
3. Minimum Delivery Number:	***
4. First Day of the Averaging Period:	***

The expected last day of the Averaging Period is ***.

Very truly yours,

Merrill Lynch, Pierce, Fenner & Smith Incorporated, as agent for Merrill Lynch International

By: /s/ BRIAN CARROLL
Name: Brian Carroll
Title: Authorized Signatory

Merrill Lynch International

By: /s/ WILLIAM MORLEY
Name: William Morley
Title: Authorized Signatory

*** Certain information on this page has been omitted and filed separately with the Commission pursuant to a request for Confidential Treatment.

Acknowledged and Confirmed:

KLA-TENCOR CORPORATION

By:	/s/ JEFFREY L. HALL
Name:	Jeffrey L. Hall
Title:	Chief Financial Officer

Exhibit 10.28

February 15, 2007

Mr. Brian M. Martin
160 Rio Robles
San Jose, CA 95134

Dear Brian:

I am pleased to offer you the opportunity and challenge to join the KLA-Tencor team. As Senior Vice President, General Counsel and Corporate Secretary, you will work under my direction. The details of your employment offer are as follows:

SALARY: $12,500.00 bi-weekly, equivalent to $325,000.00 annually.

RESTRICTED STOCK UNITS: It will be recommended at the next meeting of the Compensation Committee of the Board of Directors, pursuant to the Company Stock Option Plan, that you be granted 28,000 restricted stock units (RSUs) of KLA-Tencor stock per the company's normal vesting schedule (yesterday the Compensation Committee indicated it's approval of the size of this award, but the award will not be granted until the next regular meeting of the Committee after your start date, which is scheduled for May 8, 2007).

SIGN-ON BONUS: You will receive a one-time sign-on bonus of $100,000.00 to be paid within two weeks of your first day of employment.

MANAGER'S INCENTIVE BONUS: You will be eligible to receive up to 50% of your annual salary, paid on an annual basis, as an incentive bonus based on performance to plans established at the beginning of each fiscal year. You will also be eligible to participate in the Outstanding Corporate bonus plan with an annual payout of up to 50% of your base salary. You must be an employee on the date of payout to be eligible to receive bonus payout(s).

FOCAL POINT REVIEW PROGRAM: Employee performance is measured and evaluated based on KLA-Tencor's fiscal year on a prorated basis with an effective date in September.

EXECUTIVE SEVERANCE PLAN: Subject to Compensation Committee approval (which was received yesterday), You will participate in the Company's Executive Severance Plan with the same level of coverage as the Company's Chief Operating Officer (as described in the Company's recently filed Form 10-K for the fiscal year ended June 30, 2006). The current COO-level coverage is summarized as follows:

(a) Upon a termination of employment without cause (as defined in the plan) or a resignation for good reason (as defined in the plan) before the occurrence of a change of control (as defined in the plan), (i) you would receive severance pay equal to your salary, payable for 24 months, (ii) you would receive your current year annual incentive on a pro-rated basis, (iii) your equity awards would vested on a pro-rated basis through the end of the month of termination, and (iv) you would get one year post termination to exercise any options (but not beyond the end of their term).

(b) Upon a termination of employment without cause (as defined in the plan) or a resignation for good reason (as defined in the plan) within two years after a change of control (as defined in the plan), (i) you would receive severance pay equal to your salary plus annual target bonus plus an additional $2,000/month, payable for 24 months, (ii) you would receive your current year incentive on a pro-rated basis, (iii) your equity awards would accelerate and be fully vested, (iv) you would get one-year post termination to exercise any options (but not beyond the end of their term), and (v) you would get reimbursed for any golden parachute excise taxes on a grossed-up basis.

The Immigration Law, effective November 6, 1986, requires that all employers verify each individual's eligibility to work in the United States, including U.S. citizens. Your employment offer is contingent upon your providing satisfactory proof of identity and authorization to work in the United States. Please bring the appropriate regional documentation on your first day of work.

Brian, I am convinced that you will be an extremely valuable asset to KLA-Tencor and hope you will find many opportunities to grow both professionally and personally.

This offer is contingent upon completion of a satisfactory background and reference check, and it will expire on February 19, 2007. In addition, please be advised that during your employment, you may be subject to additional background checks as required by certain customers of KLA-Tencor and/or as required by any new information or circumstances discovered by KLA-Tencor during your employment. To indicate acceptance of this employment offer, please sign both copies of this letter, keep one for your records, and return one in the enclosed self-addressed envelope (or as otherwise arranged).

You should be aware that your employment with KLA-Tencor is at will, except as otherwise provided in this letter. Therefore, you are free to resign at any time, for any reason or for no reason, and KLA-Tencor is free to conclude its employment relationship with you at any time, with or without cause, and with or without notice, provided that the Company must satisfy any applicable obligations with respect to your coverage in the Company's Executive Severance Plan following a termination of your employment by the Company without "cause" (as defined in such plan) or a resignation by you for "good reason" (as defined in such plan).

In order to expeditiously deal with any disputes relating to or arising out of our employment relationship, you and KLA-Tencor agree that any such disputes including but not limited to claims of harassment, discrimination, breach of contract, and wrongful termination, shall be fully and finally resolved by binding arbitration conducted by the American Arbitration Association in Santa Clara, California, pursuant to the Arbitration Rules set forth in California Code of Civil Procedure Section 1280, et seq., including Section 1283.05 (the 'Rules') and pursuant to the Federal Arbitration act. KLA-Tencor will pay the costs as provided in the American Arbitration Association's National Rules for the Resolution of Employment Disputes.

If you have any questions concerning this offer of employment, please feel free to contact me. We look forward to you joining KLA-Tencor.

Sincerely,

Rick Wallace
Chief Executive Officer
KLA-Tencor Corporation

Acceptance & Acknowledgment:

I agree to and accept employment with KLA-Tencor Corporation on the terms and conditions set forth in this letter.

Accepted by:	Date:	Start Date:

Enclosures

EXHIBIT 31.1

Certification of Chief Executive Officer
Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) As Adopted
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Richard P. Wallace, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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 4, 2007	/s/ RICHARD P. WALLACE
(Date)	Richard P. Wallace
	Chief Executive Officer
	(Principal Executive Officer)

EXHIBIT 31.2

Certification of Chief Financial Officer
Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) As Adopted
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jeffrey L. Hall, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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 4, 2007
(Date)

/s/ JEFFREY L. HALL
Jeffrey L. Hall
Senior Vice President and Chief Financial Officer
(Principal Financial Officer and 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, Richard P. Wallace, 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, 2007 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 4, 2007	By:	/s/ Richard P. Wallace
Dated	Name:	Richard P. Wallace
	Title:	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, Jeffrey L. Hall, 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, 2007 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 4, 2007	By:	/s/ Jeffrey L. Hall
Dated	Name:	Jeffrey L. Hall
	Title:	Senior Vice President and Chief Financial Officer