

LANE JOSEPH D
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 4

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP

**Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934,
Section 17(a) of the Public Utility Holding Company Act of 1935
or Section 30(h) of the Investment Company Act of 1940**

- Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. See Instruction 1(b)

1. Name and Address of Reporting Person* (Last, First, Middle) Lane, Joseph D. <hr/>	2. Issuer Name and Ticker or Trading Symbol Farmers National Banc Corp./FMNB.OB <hr/>	3. I.R.S. Identification Number of Reporting Person, if an entity (Voluntary) <hr/>
5245 Revere Run <hr/> <p style="text-align: center;"><i>(Street)</i></p> Canfield, OH 44406 <hr/> <p><i>(City) (State) (Zip)</i></p>	4. Statement for (Month/Day/Year) 12/31/02 <hr/>	5. If Amendment, Date of Original (Month/Day/Year) <hr/>
	6. Relationship of Reporting Person(s) to Issuer (Check All Applicable) <input checked="" type="checkbox"/> Director <input type="checkbox"/> 10% Owner <input type="checkbox"/> Officer (give title below) <input type="checkbox"/> Other (specify below) <hr/>	7. Individual or Joint/Group Filing (Check Applicable Line) <input checked="" type="checkbox"/> Form filed by One Reporting Person <input type="checkbox"/> Form filed by More than One Reporting Person

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Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

* If the form is filed by more than one reporting person, *see* instruction 4(b)(v).

Table I Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2a. Deemed Execution Date, if any. (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)	5. Amount of Securities Beneficially Owned Following Reported Transactions(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
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(A)
or
Code V Amount (D) Price

Farmers National Banc Corp. Common Stock	12/31/02		D	60 A \$14.00	5,628	D	
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Farmers National Banc Corp. Common Stock	12/31/02		D	51 A \$14.00	4,797	I	Wife
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Table II Derivative Securities Acquired, Disposed of, or Beneficially Owned
(e.g., puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security <i>(Instr. 3)</i>	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date <i>(Month/Day/Year)</i>	3a. Deemed Execution Date, if any <i>(Month/Day/Year)</i>	4. Transaction Code <i>(Instr. 8)</i>	5. Number of Derivative Securities Acquired (A) or Disposed of (D) <i>(Instr. 3, 4 and 5)</i>
				Code V	(A) (D)

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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2018

2017

2018

2017

Number of shares of common stock repurchased

2,556

388

5,337

822

Total cost of repurchases

\$

242,401

\$

40,868

\$

550,187

\$

81,643

NOTE 11 – NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) 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 shares of common stock underlying our outstanding dilutive restricted stock units had been issued. The dilutive effect of outstanding restricted stock units is reflected in diluted net income (loss) per share by application of the treasury stock method. The following table sets forth the computation of basic and diluted net income (loss) per share:

(In thousands, except per share amounts)

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	Three months ended		Six months ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Numerator:				
Net income (loss)	\$369,100	\$(134,319)	\$765,044	\$146,617
Denominator:				
Weighted-average shares-basic, excluding unvested restricted stock units	152,148	156,587	153,684	156,707
Effect of dilutive restricted stock units and options	500	—	705	981
Weighted-average shares-diluted	152,648	156,587	154,389	157,688
Basic net income (loss) per share	\$2.43	\$(0.86)	\$4.98	\$0.94
Diluted net income (loss) per share	\$2.42	\$(0.86)	\$4.96	\$0.93
Anti-dilutive securities excluded from the computation of diluted net income (loss) per share	341	909	280	11

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NOTE 12 – INCOME TAXES

The following table provides details of income taxes:

(Dollar amounts in thousands)	Three months ended		Six months ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Income before income taxes	\$415,963	\$347,307	\$843,531	\$683,459
Provision for income taxes	\$46,863	\$481,626	\$78,487	\$536,842
Effective tax rate	11.3	% 138.7	% 9.3	% 78.5

As of December 31, 2018, we had completed our accounting for the tax effects of the Act, which was enacted into law on December 22, 2017. We recorded a tax benefit adjustment of \$0.3 million and \$20.1 million for the transition tax liability provided by the Act during the three and six months ended December 31, 2018, respectively. Future guidance of the Act from U.S. federal and state governments may change the tax liability.

In the normal course of business, we are subject to examination by tax authorities throughout the world. We are under United States federal income tax examination for the fiscal year ended June 30, 2016. We are subject to state income tax examinations for all years beginning from the fiscal year ended June 30, 2014. We are also subject to examinations in other major foreign jurisdictions, including Singapore, for all years beginning from the fiscal year ended June 30, 2014.

It is possible that certain examinations may be concluded in the next twelve months. We believe that it may recognize up to \$10.0 million of our existing unrecognized tax benefits within the next twelve months as a result of the lapse of statutes of limitations and the resolution of examinations with various tax authorities.

NOTE 13 – LITIGATION AND OTHER LEGAL MATTERS

We are named from time to time as a party to lawsuits and other types of legal proceedings and claims in the normal course of our business. Actions filed against us include commercial, intellectual property, customer, and labor and employment related claims, including complaints of alleged wrongful termination and potential class action lawsuits regarding alleged violations of federal and state wage and hour and other laws. In general, legal proceedings and claims, regardless of their merit, and associated internal investigations (especially those relating to intellectual property or confidential information disputes) are often expensive to prosecute, defend or conduct and may divert management's attention and other company resources. Moreover, the results of legal proceedings are difficult to predict, and the costs incurred in litigation can be substantial, regardless of outcome. We believe the amounts provided in our condensed consolidated financial statements are adequate in light of the probable and estimated liabilities. However, because such matters are subject to many uncertainties, the ultimate outcomes are not predictable, and there can be no assurances that the actual amounts required to satisfy alleged liabilities from the matters described above will not exceed the amounts reflected in our condensed consolidated financial statements or will not have a material adverse effect on our results of operations, financial condition or cash flows.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Factoring. We have agreements (referred to as "factoring agreements") with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. We do not believe we are at risk for any material losses as a result of these agreements. In addition, we periodically sell certain letters of credit ("LCs"), without recourse, received from customers in payment for goods and services.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs for the indicated periods:

(In thousands)	Three months ended		Six months ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Receivables sold under factoring agreements	\$39,814	\$47,232	\$101,354	\$79,133
Proceeds from sales of LCs	\$8,339	\$—	\$19,231	\$5,571

Factoring and LC fees for the sale of certain trade receivables were recorded in other expense (income), net and were not material for the periods presented.

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Facilities. We lease certain of our facilities under arrangements that are accounted for as operating leases. Rent expense was \$2.4 million and \$2.5 million for the three months ended December 31, 2018 and 2017, respectively and was \$4.7 million and \$5.0 million for the six months ended December 31, 2018 and 2017, respectively

The following is a schedule of expected operating lease payments:

Fiscal year ending June 30,	Amount (In thousands)
2019 (remaining 6 months)	\$ 7,145
2020	8,361
2021	6,016
2022	3,166
2023	2,317
2024 and thereafter	3,078
Total minimum lease payments	\$ 30,083

Purchase Commitments. We maintain commitments to purchase inventory from our suppliers as well as goods, services, and other assets in the ordinary course of business. Our liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among different suppliers. Our estimate of our significant purchase commitments for primarily material, services, supplies and asset purchases is approximately \$489.8 million as of December 31, 2018, 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.

Cash Long-Term Incentive Plan. As of December 31, 2018, we have committed \$129.8 million for future payment obligations under our Cash LTI Plan. The calculation of compensation expense related to the Cash LTI Plan includes estimated forfeiture rate assumptions. Cash LTI awards issued to employees under the Cash LTI Plan vest in three or four equal installments, with one-third or one-fourth of the aggregate amount of the Cash LTI award vesting on each anniversary of the grant date over a three or four-year period. In order to receive payments under a Cash LTI award, participants must remain employed by us as of the applicable award vesting date.

Guarantees and Contingencies. We maintain guarantee arrangements available through various financial institutions for up to \$22.5 million, of which \$18.2 million had been issued as of December 31, 2018, primarily to fund guarantees to customs authorities for value-added tax ("VAT") and other operating requirements of our subsidiaries in Europe and Asia.

Indemnification Obligations. Subject to certain limitations, we are obligated to indemnify our current and former directors, officers and employees with respect to certain litigation matters and investigations that arise in connection with their service to us. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify generally means that we are required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. For example, we have paid or reimbursed legal expenses incurred in connection with the investigation of our historical stock option practices and the related litigation and government inquiries by several of our current and former directors, officers and employees. Although the maximum potential amount of future payments we could be required to make under the indemnification obligations generally described in this paragraph is theoretically unlimited, we believe the fair value of this liability, to the extent estimable, is appropriately considered within the reserve we have established for currently pending legal proceedings.

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We are a party to a variety of agreements pursuant to which we 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 we customarily agree to hold the other party harmless against losses arising from, or provides customers with other remedies to protect against, bodily injury or damage to personal property caused by our products, non-compliance with our product performance specifications, infringement by our products of third-party intellectual property rights and a breach of warranties, representations and covenants related to matters such 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 us is typically subject to the other party making a claim to and cooperating with us pursuant to the procedures specified in the particular contract. This usually allows us 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, our obligations under these agreements may be limited in terms of amounts, activity (typically at our option to replace or correct the products or terminate the agreement with a refund to the other party), and duration. In some instances, we may have recourse against third parties and/or insurance covering certain payments made by us.

In addition, we may in limited circumstances enter into agreements that contain customer-specific commitments on pricing, tool reliability, spare parts stocking levels, response time and other commitments. Furthermore, we may give these customers limited audit or inspection rights to enable them to confirm that we are complying with these commitments. If a customer elects to exercise its audit or inspection rights, we may be required to expend significant resources to support the audit or inspection, as well as to defend or settle any dispute with a customer that could potentially arise out of such audit or inspection. To date, we have made no significant accruals in our condensed consolidated financial statements for this contingency. While we have not in the past incurred significant expenses for resolving disputes regarding these types of commitments, we cannot make any assurance that it will not incur any such liabilities in the future.

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

NOTE 15 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The authoritative guidance requires companies to recognize all derivative instruments and hedging activities, including foreign currency exchange contracts and interest rate lock agreements, (collectively “derivatives”) as either assets or liabilities at fair value on the condensed consolidated balance sheets. In accordance with the accounting guidance, we designate foreign currency exchange contracts and interest rate lock agreements as cash flow hedges of certain forecasted foreign currency denominated sales and purchase transactions, and the benchmark interest rate of the corresponding debt financing, respectively.

Our foreign subsidiaries operate and sell our products in various global markets. As a result, we are exposed to risks relating to changes in foreign currency exchange rates. We utilize foreign currency forward exchange contracts and option contracts to hedge against future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions, such as the Japanese yen, the euro, the New Taiwan dollar and the Israeli new shekel. We routinely hedge our exposures to certain foreign currencies with various financial institutions in an effort to minimize the impact of certain currency exchange rate fluctuations. These currency forward exchange contracts and options, designated as cash flow hedges, generally have maturities of less than 18 months. Cash flow hedges are evaluated for effectiveness monthly, based on changes in total fair value of the derivatives. If a financial counterparty to any of our hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material losses.

In October 2014, we entered into a series of forward contracts (“Rate Lock Agreements”) to lock the benchmark rate on a portion of the Senior Notes. The Rate Lock Agreements was matured and terminated in the second quarter of the fiscal year ended June 30, 2015 and we recorded the fair value of \$7.5 million as a gain within accumulated other comprehensive income (loss) (“OCI”) as of December 31, 2014. As of December 31, 2018, the unamortized portion of the fair value of the forward contracts for the Rate Lock Agreements was \$4.4 million. For more details, refer to Note

16, "Derivative Instruments and Hedging Activities" of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

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During the three months ended June 30, 2018, we entered into a series of forward contracts (the “2018 Rate Lock Agreements”) to lock the benchmark interest rate prior to expected debt issuances. The objective of the 2018 Rate Lock Agreements was to hedge the risk associated with the variability in interest rates due to the changes in the benchmark rate leading up to the closing of the intended financing, on the notional amount being hedged. The 2018 Rate Lock Agreement had a notional amount of \$500.0 million in aggregate with contract maturity dates in the first half of the fiscal year ending June 30, 2019. Each forward contract will be closed on the earlier of the completion date of pricing of the portion of the intended debt being hedged or the expiration date. We designated each of the 2018 Rate Lock Agreements as a qualifying hedging instrument to be accounted for as a cash flow hedge. During the six months ended December 31, 2018, the 2018 Rate Lock Agreements were extended with a maturity date in the fiscal quarter ending March 31, 2019 and the realized net loss of \$3.8 million was recorded in OCI.

For derivatives that are designated and qualify as cash flow hedge, the effective portion of the gains or losses is reported in OCI and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Prior to adopting the new accounting guidance for hedge accounting, time value was excluded from the assessment of effectiveness for derivatives designated as cash flow hedges. Time value was amortized on a mark-to-market basis and recognized in earnings over the life of the derivative contract. For derivative contracts executed after adopting the new accounting guidance, the election to include time value for the assessment of effectiveness is made on all forward contracts designated as cash flow hedges. The change in fair value of the derivative are recorded in OCI until the hedged item is recognized in earnings. The assessment of effectiveness of options contracts designated as cash flow hedges continue to exclude time value after adopting the new accounting guidance. The initial value of the component excluded from the assessment of effectiveness are recognized in earnings over the life of the derivative contract. Any difference between change in the fair value of the excluded components and the amounts recognized in earnings are recorded in OCI.

For derivatives that are not designated as cash flow hedges, gains and losses are recognized in other expense (income), net. We use foreign currency forward contracts to hedge certain foreign currency denominated assets or liabilities. The gains and losses on these derivative instruments are largely offset by the changes in the fair value of the assets or liabilities being hedged.

Derivatives in Cash Flow Hedging Relationships: Foreign Exchange and Interest Rate Contracts

The gains (losses) on derivatives in cash flow hedging relationships recognized in OCI for the indicated periods were as follows:

	Three months ended December 31, 2018		Six months ended December 31, 2017	
(In thousands)				
Derivatives Designated as Hedging Instruments:				
Rate lock agreements:				
Amounts included in the assessment of effectiveness	\$(17,752)	\$—	\$(5,396)	\$—
Foreign exchange contracts:				
Amounts included in the assessment of effectiveness	\$(1,201)	\$697	\$237	\$1,141
Amounts excluded from the assessment of effectiveness	\$(29)	\$—	\$(29)	\$—

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The locations and amounts of designated and non-designated derivative's gains and losses reported in the condensed consolidated statements of operations for the indicated periods were as follows:

(In thousands)	Three months ended December 31, 2018				Three months ended December 31, 2017			
	Revenue	Cost of revenues	Interest expense	Other income (expense), net	Revenue	Cost of revenues	Interest expense	Other income (expense), net
Total amounts presented in the condensed consolidated statement of operations in which the effects of cash flow hedges are recorded	\$1,119,898	\$408,260	\$26,538	\$(9,228)	\$975,822	\$347,002	\$27,372	\$(7,824)
Gains (losses) on Derivatives Designated as Hedging Instruments:								
Rate lock agreements:								
Amount of gains (losses) reclassified from accumulated OCI to earnings	\$—	\$—	\$189	\$—	\$—	\$—	\$—	\$—
Amount of gains (losses) reclassified from accumulated OCI to earnings as a result that a forecasted transaction is no longer probable of occurring	\$—	\$—	\$—	\$(108)	\$—	\$—	\$—	\$—
Foreign exchange contracts:								
Amount of gains (losses) reclassified from accumulated OCI to earnings	\$1,705	\$(158)	\$—	\$(3)	\$397	\$377	\$189	\$—
Amount excluded from the assessment of effectiveness recognized in earnings based on an amortization approach	\$80	\$(8)	\$—	\$—	\$—	\$—	\$—	\$—
Amount excluded from the assessment of effectiveness	\$—	\$—	\$—	\$(220)	\$—	\$—	\$—	\$(158)
Gains (losses) on Derivatives Not Designated as Hedging Instruments:								
Amount of gains (losses) recognized in earnings	\$—	\$—	\$—	\$(3,700)	\$—	\$—	\$—	\$3,237

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(In thousands)	Six months ended December 31, 2018				Six months ended December 31, 2017			
	Revenue	Cost of revenues	Interest expense	Other income (expense), net	Revenue	Cost of revenues	Interest expense	Other income (expense), net
Total amounts presented in the condensed consolidated statement of operations in which the effects of cash flow hedges are recorded	\$2,213,158	\$789,647	\$52,900	\$(19,253)	\$1,945,403	\$700,119	\$57,948	\$(12,207)
Gains (losses) on Derivatives Designated as Hedging Instruments:								
Rate lock agreements:								
Amount of gains (losses) reclassified from accumulated OCI to earnings	\$—	\$—	\$377	\$—	\$—	\$—	\$—	\$—
Amount of gains (losses) reclassified from accumulated OCI to earnings as a result that a forecasted transaction is no longer probable of occurring	\$—	\$—	\$—	\$4	\$—	\$—	\$—	\$—
Foreign exchange contracts:								
Amount of gains (losses) reclassified from accumulated OCI to earnings	\$2,688	\$(292)	\$—	\$(18)	\$1,365	\$1,338	\$378	\$—
Amount excluded from the assessment of effectiveness recognized in earnings based on an amortization approach	\$80	\$(8)	\$—	\$—	\$—	\$—	\$—	\$—
Amount excluded from the assessment of effectiveness	\$—	\$—	\$—	\$(88)	\$—	\$—	\$—	\$(229)
Gains (losses) on Derivatives Not Designated as Hedging Instruments:								
Amount of gains (losses) recognized in earnings	\$—	\$—	\$—	\$63	\$—	\$—	\$—	\$3,676
The U.S. dollar equivalent of all outstanding notional amounts of foreign currency hedge contracts, with maximum remaining maturities of approximately ten months as of December 31, 2018 and June 30, 2018, were as follows:								
(In thousands)		As of December 31, 2018	As of June 30, 2018					
Cash flow hedge contracts - foreign currency								
Purchase		\$ 777	\$8,116					
Sell		\$84,302	\$115,032					
Other foreign currency hedge contracts								
Purchase		\$ 163,758	\$130,442					
Sell		\$ 173,793	\$154,442					

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The locations and fair value of our derivatives reported in our Condensed Consolidated Balance Sheets as of the dates indicated below were as follows:

	Asset Derivatives		Liability Derivatives			
	Balance Sheet Location	As of December 31, 2018 Fair Value	As of June 30, 2018 Fair Value	Balance Sheet Location	As of December 31, 2018 Fair Value	As of June 30, 2018 Fair Value
(In thousands)						
Derivatives designated as hedging instruments						
Rate lock contracts	Other current assets	\$ —	\$ 219	Other current liabilities	\$ 10,955	\$ 5,158
Foreign exchange contracts	Other current assets	102	3,259	Other current liabilities	649	312
Total derivatives designated as hedging instruments		102	3,478		11,604	5,470
Derivatives not designated as hedging instruments						
Foreign exchange contracts	Other current assets	1,630	1,907	Other current liabilities	2,714	1,358
Total derivatives not designated as hedging instruments		1,630	1,907		2,714	1,358
Total derivatives		\$ 1,732	\$ 5,385		\$ 14,318	\$ 6,828

The changes in OCI, before taxes, related to derivatives for the indicated periods were as follows:

	Three months ended December 31,		Six months ended December 31,	
	2018	2017	2018	2017
(In thousands)				
Beginning balance	\$15,103	\$6,452	\$2,346	\$8,126
Amount reclassified to earnings	(1,736)	(963)	(2,773)	(3,081)
Net change in unrealized gains or losses	(18,982)	697	(5,188)	1,141
Ending balance	\$(5,615)	\$6,186	\$(5,615)	\$6,186

Offsetting of Derivative Assets and Liabilities

We present derivatives at gross fair values in the Condensed Consolidated Balance Sheets. We have entered into arrangements with each of our counterparties, which reduce credit risk by permitting net settlement of transactions with the same counterparty under certain conditions. The information related to the offsetting arrangements for the periods indicated was as follows (in thousands):

Description	Gross Amounts of Derivatives	Gross Amounts of Derivatives Offset in the Condensed Consolidated	Net Amount of Derivatives Presented in the Condensed	Gross Amounts of Derivatives Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Received	Net Amount
As of December 31, 2018						

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	Balance Sheets	Consolidated Balance Sheets				
Derivatives - Assets	\$1,732	\$	—\$ 1,732	\$ (995)	\$	—\$737
Derivatives - Liabilities	\$(14,318)	\$	—\$ (14,318) \$ 995	\$	—\$(13,323)
				Gross Amounts of Derivatives Not Offset in the Condensed Consolidated Balance Sheets		
As of June 30, 2018						
Description	Gross Amounts of Derivative	Gross Amounts of Derivatives Offset in the Condensed Consolidated Balance Sheets	Net Amount of Derivatives Presented in the Condensed Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives - Assets	\$5,385	\$	—\$ 5,385	\$ (1,888)	\$	—\$3,497
Derivatives - Liabilities	\$(6,828)	\$	—\$ (6,828)	\$ 1,888	\$	—\$(4,940)

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NOTE 16 – RELATED PARTY TRANSACTIONS

During the three and six months ended December 31, 2018 and 2017, we purchased from, or sold to, several entities, where one or more of our executive officers or members of our Board of Directors, or their immediate family members, were, during the periods presented, an executive officer or a board member of a subsidiary, including Citrix Systems, Inc., Integrated Device Technology, Inc., Keysight Technologies, Inc., MetLife Insurance K.K., NetApp, Inc., and Proofpoint, Inc. The following table provides the transactions with these parties for the indicated periods (for the portion of such period that they were considered related):

	Three months ended December 31,		Six months ended December 31,	
(In thousands)	2018	2017	2018	2017
Total revenues	\$11	\$455	\$13	\$457
Total purchases ⁽¹⁾	\$1,603	\$542	\$2,206	\$1,246

During the three months ended June 30, 2018, we acquired a product line from Keysight Technologies, Inc. (“Keysight”) and entered into a transition services agreement pursuant to which Keysight provides certain (1) manufacturing services to us. For additional details refer to Note 6, “Business Combinations”. We recorded the manufacturing services fees under the transition services agreement with Keysight within cost of revenues, which was immaterial for the three and six months ended December 31, 2018.

Our receivable and payable balances from these parties were immaterial as of December 31, 2018 and June 30, 2018.

NOTE 17 – SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

While we operate our business in multiple operating segments, we have only one reportable segment. 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. Our chief operating decision maker is our Chief Executive Officer.

All operating segments 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. Our 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 we operate in one reportable segment, all financial segment information required by the authoritative guidance can be found in the condensed consolidated financial statements.

Our significant operations outside the United States include manufacturing facilities in China, Germany, Israel and Singapore and sales, marketing and service offices in Japan, the rest of the Asia Pacific region and Europe. For geographical revenue reporting, revenues are attributed to the geographic location in which the customer is located. Long-lived assets consist of land, property and equipment, net and are attributed to the geographic region in which they are located.

The following is a summary of revenues by geographic region, based on ship-to location, for the indicated periods (as a percentage of total revenues):

(Dollar amounts in thousands)	Three months ended December 31,				Six months ended December 31,			
	2018		2017		2018		2017	
Revenues:								
China	\$269,878	24 %	\$66,460	7 %	\$610,012	28 %	\$234,799	12 %
Taiwan	266,534	24 %	216,791	22 %	520,971	24 %	355,350	18 %
Japan	180,283	16 %	154,762	16 %	315,861	14 %	301,197	15 %
North America	150,113	13 %	149,042	15 %	252,242	11 %	278,292	14 %
Korea	126,968	11 %	270,184	28 %	280,469	13 %	544,862	28 %

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Europe and Israel	80,618	7 %	82,158	8 %	152,287	7 %	165,663	9 %
Rest of Asia	45,504	5 %	36,425	4 %	81,316	3 %	65,240	4 %
Total	\$1,119,898	100%	\$975,822	100%	\$2,213,158	100%	\$1,945,403	100%

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The following is a summary of revenues by major products for the indicated periods (as a percentage of total revenues):

(Dollar amounts in thousands)	Three months ended December 31,				Six months ended December 31,			
	2018		2017		2018		2017	
Revenues:								
Wafer Inspection	\$505,878	45 %	\$400,584	41 %	\$978,191	44 %	\$790,004	41 %
Patterning	288,997	26 %	274,868	28 %	598,206	27 %	569,218	29 %
Global Service and Support ⁽¹⁾	295,216	26 %	273,805	28 %	568,193	26 %	534,303	27 %
Other	29,807	3 %	26,565	3 %	68,568	3 %	51,878	3 %
Total	\$1,119,898	100 %	\$975,822	100 %	\$2,213,158	100 %	\$1,945,403	100 %

(1) The Global Service and Support revenues includes service revenues as presented in the Condensed Consolidated Statements of Operations as well as certain product revenues, primarily revenues from our K-T Pro business. In the three months ended December 31, 2018, two customers accounted for approximately 14% and 13% of total revenues. In the three months ended December 31, 2017, one customer accounted for approximately 17% of total revenues. In the six months ended December 31, 2018, one customer accounted for approximately 14% of total revenues. In the six months ended December 31, 2017, one customer accounted for approximately 22% of total revenues. Three customers on an individual basis accounted for greater than 10% of net accounts receivables as of December 31, 2018 and June 30, 2018, respectively.

Long-lived assets by geographic region as of the dates indicated below were as follows:

(In thousands)	As of	As of
	December 31, 2018	June 30, 2018
Long-lived assets:		
United States	\$ 205,253	\$ 187,352
Singapore	49,302	47,009
Israel	27,517	26,980
Europe	12,816	12,924
Rest of Asia	11,463	12,041
Total	\$ 306,351	\$ 286,306

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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," "potential," "continue," "thinks," "seeks," 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, forecasts of the future results of our operations, including profitability; orders for our products and capital equipment generally; sales of semiconductors; the investments by our customers in advanced technologies and new materials; the allocation of capital spending by our customers (and, in particular, the percentage of spending that our customers allocate to process control); growth of revenue in the semiconductor industry, the semiconductor capital equipment industry and our business; technological trends in the semiconductor industry; future developments or trends in the global capital and financial markets; our future product offerings and product features; the success and market acceptance of new products; timing of shipment of backlog; our future product shipments and product and service revenues; our future gross margins; our future research and development expenses and selling, general and administrative expenses; our ability to successfully maintain cost discipline; international sales and operations; our ability to maintain or improve our existing competitive position; 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 effective income tax rate; our recognition of tax benefits; future payments of dividends to our stockholders; 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, cash generated from operations and the unfunded portion of our revolving line of credit under a Credit Agreement (the "Credit Agreement") to meet our operating and working capital requirements, including debt service and payment thereof; future dividends, and stock repurchases; our compliance with the financial covenants under the Credit Agreement; the adoption of new accounting pronouncements including ASC 606; the tax liabilities resulting from the enactment of the Tax Cuts and Jobs Act; and our repayment of our outstanding indebtedness.

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 Part II, Item 1A, "Risk Factors" in this report as well as in Item 1, "Business" and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended June 30, 2018, filed with the Securities and Exchange Commission on August 6, 2018. 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, and we expressly assume no obligation and do not intend to update the forward-looking statements in this report after the date hereof.

EXECUTIVE SUMMARY

We are a leading supplier of process control and yield management solutions for the semiconductor and related nanoelectronics industries. Our broad portfolio of inspection and metrology products, and related service, software and other offerings primarily supports integrated circuit ("IC" or "chip") manufacturers throughout the entire semiconductor fabrication process, from research and development to final volume production. We provide leading edge equipment, software and support that enable IC manufacturers to identify, resolve and manage significant advanced technology manufacturing process challenges and obtain higher finished product yields at lower overall cost. In addition to serving the semiconductor industry, we also provide a range of technology solutions to a number of other high technology industries, including advanced packaging, light emitting diode ("LED"), power devices, compound semiconductor, and data storage industries, as well as general materials research.

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Our products and services are used by the vast majority of bare wafer, IC, lithography reticle (“reticle” or “mask”) and hard disk drive manufacturers around the world. Our products, services and expertise are used by our customers to measure, detect, analyze and resolve critical product defects that arise in that environment in order to control nanometric level manufacturing processes. Our revenues are driven largely by our customers’ spending on capital equipment and related maintenance services necessary to support key transitions in their underlying product technologies, or to increase their production volumes in response to market demand or expansion plans. Our semiconductor customers generally operate in one or more of the three major semiconductor markets - memory, foundry and logic. All three of these markets are characterized by rapid technological changes and sudden shifts in end-user demand, which influence the level and pattern of our customers’ spending on our products and services. Although capital spending in all three semiconductor markets has historically been very cyclical, the demand for more advanced and lower cost chips used in a growing number of consumer electronics, communications, data processing, and industrial and automotive products has resulted over the long term in a favorable demand environment for our process control and yield management solutions, particularly in the foundry and logic markets, which have higher levels of process control adoption than the memory market.

As we are a supplier to the global semiconductor and semiconductor-related industries, our customer base continues to become more highly concentrated over time, thereby increasing the potential impact of a sudden change in capital spending by a major customer on our revenues and profitability. As our customer base becomes increasingly more concentrated, large orders from a relatively limited number of customers account for a substantial portion of our sales, which potentially exposes us to more volatility for revenues and earnings. In the global semiconductor related industries, China is emerging as a major region for manufacturing of logic and memory chips, adding to its role as the world’s largest consumer of ICs. Government initiatives are propelling China to expand its domestic manufacturing capacity and attracting semiconductor manufacturers from Taiwan, Korea, Japan and the US. China is currently seen as an important long-term growth region for the semiconductor capital equipment sector. We are also subject to the cyclical capital spending that has historically characterized the semiconductor and semiconductor-related industries. The timing, length, intensity and volatility of the capacity-oriented capital spending cycles of our customers are unpredictable.

The semiconductor industry has also been characterized by constant technological innovation. Currently, there are multiple drivers for growth in the industry with increased demand for chips providing computation power and connectivity for Artificial Intelligence (“AI”) applications and support for mobile devices at the leading edge of foundry and logic chip manufacturing. Qualification of early extreme ultraviolet (“EUV”) lithography processes and equipment is driving growth at leading logic/foundry and dynamic random-access memory (“DRAM”) manufacturers. Expansion of the Internet of Things (“IoT”) together with increasing acceptance of advanced driver assistance systems (“ADAS”) in anticipation of the introduction of autonomous cars have begun to accelerate legacy-node technology conversions and capacity expansions. Intertwined in these areas, spurred by data storage and connectivity needs, is the growth in demand for memory chips. On the other hand, higher design costs for the most advanced ICs could economically constrain leading-edge manufacturing technology customers to focus their resources on only the large technologically advanced products and applications. We believe that, over the long term, our customers will continue to invest in advanced technologies and new materials to enable smaller design rules and higher density applications that fuel demand for process control equipment, although the growth for such equipment may be adversely impacted by higher design costs for advanced ICs, reuse of installed products, and delays in production ramps by our customers in response to higher costs and technical challenges at more advanced technology nodes.

The demand for our products and our revenue levels are driven by our customers’ needs to solve the process challenges that they face as they adopt new technologies required to fabricate advanced ICs that are incorporated into sophisticated mobile devices. The timing for our customers in ordering and taking delivery of process control and yield management equipment is also determined by our customers’ requirements to meet the next generation production ramp schedules, and the timing for capacity expansion to meet end customer demand. During the three months ended December 31, 2018, revenues for our process control equipment had a modest increase compared to the three months ended September 30, 2018. Our earnings will depend not only on our revenue levels, but also on the

amount of research and development spending required to meet our customers' technology roadmaps. We have maintained production volumes and capacity to meet anticipated customer requirements and remain at risk of incurring significant inventory-related and other restructuring charges if business conditions deteriorate. Over the past year, our customers have taken delivery of higher volumes of process control equipment than they did in the previous year. However, any delay or push out by our customers in taking delivery of process control and yield management equipment may cause earnings volatility, due to increases in the risk of inventory related charges as well as timing of revenue recognition.

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Our view of the current wafer fab equipment demand climate is aligned with consensus industry analyst expectations for the calendar year 2019, which reflects a decline in capital equipment spending by memory customers. In contrast to the memory business, capital equipment spending by foundry and logic customers at the leading edge has begun to ramp, and the momentum is expected to continue in calendar year 2019. We have already seen our mix of business begin to shift toward increased purchases by logic and foundry customers as a percentage of total sales, and we expect spending from these customers to continue to remain strong. Because of a more diversified semiconductor device-end demand, and disciplined capacity planning by wafer fab equipment customers, we believe the long-term growth dynamics for the industry remain strong.

The following table sets forth some of our key quarterly unaudited financial information⁽¹⁾:

(In thousands, except net income (loss) per share)	Three months ended					
	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017
Total revenues	\$1,119,898	\$1,093,260	\$1,070,004	\$1,021,294	\$975,822	\$969,581
Gross margin	\$711,638	\$711,873	\$692,106	\$652,606	\$628,488	\$616,132
Net income (loss) ⁽²⁾	\$369,100	\$395,944	\$348,767	\$306,881	\$(134,319)	\$280,936
Diluted net income (loss) per share ⁽³⁾	\$2.42	\$2.54	\$2.22	\$1.95	\$(0.86)	\$1.78

On July 1, 2018, we adopted ASC 606 using the modified retrospective transition approach. Results for reporting (1) periods beginning after July 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the previous revenue guidance in ASC 605.

Our net income (loss) decreased to a loss of \$134.3 million during the three months ended December 31, 2017, (2) primarily as a result of the income tax effects from the enacted tax reform legislation through the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017.

Diluted net income (loss) per share are computed independently for each of the quarters presented based on the (3) weighted-average fully diluted shares outstanding for each quarter. Therefore, the sum of quarterly diluted net income (loss) per share information may not equal annual (or other multiple-quarter calculations of) diluted net income (loss) per share.

Proposed Merger with Orbotech, Ltd.

On March 18, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Orbotech, Ltd. (“Orbotech”) pursuant to which we would acquire Orbotech for \$38.86 in cash and 0.25 of a share of our common stock in exchange for each ordinary share of Orbotech, which at the time of announcement valued Orbotech at \$3.2 billion in enterprise value. The merger contemplated by the Merger Agreement (the “Orbotech Merger”) is subject to receipt of required regulatory approvals and satisfaction of the other customary closing conditions. KLA continues to have advanced discussions with the State Administration for Market Regulation of the People’s Republic of China (SAMR) regarding clearance of the proposed merger with a goal of obtaining clearance as soon as practicable in 2019. We intend to fund the cash portion of the purchase price with cash from the combined company’s balance sheet.

In addition, we announced a share repurchase authorization up to \$2 billion. The share repurchase program is targeted to be completed within 12 to 18 months following the close of this transaction. We intend to raise approximately \$1 billion in new long-term debt financing to complete the share repurchase program. For additional details, refer to Note 10, “Stock Repurchase Program.” to the condensed consolidated financial statements.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of our condensed 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 base these estimates and assumptions on historical experience and evaluate them on an ongoing 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 our related disclosure in this Quarterly Report on Form 10-Q.

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We updated our accounting policies for Revenue Recognition, Business Combinations, Global Intangible Low-Taxed Income (“GILTI”), and Derivative Financial Instruments. There have been no other material changes in our critical accounting estimates and policies since our Annual Report on Form 10-K for the fiscal year ended June 30, 2018. Refer to Note 1 “Basis of Presentation” to the condensed consolidated financial statements for additional details. In addition, please refer to Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended June 30, 2018 for a more complete discussion of our critical accounting policies and estimates.

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including those recently adopted and the expected dates of adoption as well as estimated effects, if any, on our condensed consolidated financial statements of those not yet adopted, see Note 1, “Basis of Presentation” to the condensed consolidated financial statements for additional details.

RESULTS OF OPERATIONS

On July 1, 2018, we adopted ASC 606 using the modified retrospective transition approach. Results for reporting periods beginning after July 1, 2018 are presented under the ASC 606, while prior period amounts are presented under legacy guidance. For additional details, refer to Note 2 “Revenue” to the condensed consolidated financial statements.

Revenues and Gross Margin

(Dollar amounts in thousands)	Three months ended			Q2 FY19		Q2 FY19	
	December 31, 2018	September 30, 2018	December 31, 2017	vs. Q1 FY19	vs. Q2 FY18		
Revenues:							
Product	\$852,201	\$829,227	\$761,587	\$22,974	3%	\$90,614	12%
Service	267,697	264,033	214,235	3,664	1%	53,462	25%
Total revenues	\$1,119,898	\$1,093,260	\$975,822	\$26,638	2%	\$144,076	15%
Costs of revenues	\$408,260	\$381,387	\$347,002	\$26,873	7%	\$61,258	18%
Gross margin percentage	64	% 65	% 64		%		

(Dollar amounts in thousands)	Six months ended			Q2 FY19 YTD	
	December 31, 2018	December 31, 2017		vs. Q2 FY18 YTD	
Revenues:					
Product	\$1,681,428	\$1,522,374	\$159,054	10%	
Service	531,730	423,029	108,701	26%	
Total revenues	\$2,213,158	\$1,945,403	\$267,755	14%	
Costs of revenues	\$789,647	\$700,119	\$89,528	13%	
Gross margin percentage	64	% 64	%		

Product revenues

Our business is affected by the concentration of our customer base and our customers’ capital equipment procurement patterns as a result of their investment plans. Our product revenues in any particular period are significantly impacted by the amount of new orders that we receive during that period and, depending upon the duration of manufacturing and installation cycles, in the preceding period.

Product revenue increased during the three months ended December 31, 2018 compared to the three months ended September 30, 2018 and December 31, 2017, primarily due to a strong demand from our customers in the memory business resulting in the increased next generation and capacity-related investments.

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Product revenues increased during the six months ended December 31, 2018 compared to the six months ended December 31, 2017, primarily due to a strong demand from our customers in the memory and wafer inspection businesses resulting in the increased next generation and capacity-related investments, and a favorable impact from the adoption of ASC 606 due to our assessment of timing of transfer of control.

Service revenues

Service revenues are generated from product maintenance and support services, as well as billable time and material service calls made to our customers. The amount of our service revenues is typically a function of the number of systems installed at our customers' sites and the utilization of those systems, but it is also impacted by other factors, such as our rate of service contract renewals, the types of systems being serviced and fluctuations in foreign exchange rates.

Service revenues during the three months ended December 31, 2018 increased compared to the three months ended September 30, 2018, primarily due to an increase in the number of systems installed at our customers' sites.

Service revenues during the three and six months ended December 31, 2018 increased compared to the three and six months ended December 31, 2017, primarily due an increase in the number of systems installed at our customers' sites, and the impact of adoption of ASC 606 whereby revenue from the standard warranty represents a separate performance obligation and included in our services revenue.

Revenues by region

The following is a summary of revenues by geographic region, based on ship-to location, for the indicated periods (as a percentage of total revenues):

(Dollar amounts in thousands)	Three months ended					
	December 31, 2018		September 30, 2018		December 31, 2017	
China	\$269,878	24 %	\$340,134	31 %	\$66,460	7 %
Taiwan	266,534	24 %	254,437	23 %	216,791	22 %
Japan	180,283	16 %	135,578	12 %	154,762	16 %
North America	150,113	13 %	102,129	9 %	149,042	15 %
Korea	126,968	11 %	153,501	14 %	270,184	28 %
Europe and Israel	80,618	7 %	71,669	7 %	82,158	8 %
Rest of Asia	45,504	5 %	35,812	4 %	36,425	4 %
Total	\$1,119,898	100 %	\$1,093,260	100 %	\$975,822	100 %

A significant portion of our revenues continues to be generated in Asia, where a substantial portion of the world's semiconductor manufacturing capacity is located, and we expect that trend to continue.

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, including our ability to scale our operations efficiently and effectively in response to prevailing business conditions.

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The following table summarizes the major factors that contributed to the changes in gross margin percentage:

	Gross Margin Percentage		Gross Margin Percentage
	Three months ended		Three Six months months ended ended
September 30, 2018	65.1 %	December 31, 2017	64.4 % 64.0 %
Revenue volume of products and services	0.1 %	Revenue volume of products and services	(0.1)%(0.2)%
Mix of products and services sold	(1.9)%	Mix of products and services sold	0.5 % 1.7 %
Manufacturing labor, overhead and efficiencies	0.1 %	Manufacturing labor, overhead and efficiencies	(0.3)%(0.4)%
Other service and manufacturing costs	0.1 %	Other service and manufacturing costs	(1.0)%(0.8)%
December 31, 2018	63.5 %	December 31, 2018	63.5 % 64.3 %

Changes in gross margin percentage driven by revenue volume of products and services reflect our ability to leverage existing infrastructure to generate higher revenues. It also includes the effect of fluctuations in foreign exchange rates, average customer pricing and customer revenue deferrals associated with volume purchase agreements. Changes in gross margin percentage from mix of products and services sold reflect the impact of changes in the composition within product and service offerings. Changes in gross margin percentage from manufacturing labor, overhead and efficiencies reflect our ability to manage costs and drive productivity as we scale our manufacturing activity to respond to customer requirements; this includes the impact of capacity utilization, use of overtime and variability of cost structure. Changes in gross margin percentage from other service and manufacturing costs include the impact of customer support costs, including the efficiencies with which we deliver services to our customers, and the effectiveness with which we manage our production plans and inventory risk.

Our gross margin decreased to 63.5% for three months ended December 31, 2018 from 65.1% during the three months ended September 30, 2018, primarily due to an unfavorable mix of products and services sold.

Our gross margin decreased to 63.5% for three months ended December 31, 2018 from 64.4% during the three months ended December 31, 2017, primarily due to an increase in service and manufacturing costs, partially offset by a favorable mix of products and services sold.

Our gross margin increased to 64.3% during the six months ended December 31, 2018, from 64.0% during the six months ended December 31, 2017, primarily due to a favorable mix of products and services sold, partially offset by an increase in service and manufacturing costs.

Research and Development (“R&D”)

(Dollar amounts in thousands)	Three months ended			Q2 FY19 vs. Q1 FY19	Q2 FY19 vs. Q2 FY18
	December 31, 2018	September 30, 2018	December 31, 2017		
R&D expenses	\$ 165,903	\$ 153,530	\$ 156,700	\$ 12,373 8%	\$ 9,203 6%
R&D expenses as a percentage of total revenues	15 %	14 %	16 %		

(Dollar amounts in thousands)	Six months ended			Q2 FY19 YTD vs. Q2 FY18 YTD
	December 31, 2018	December 31, 2017	December 31, YTD	
R&D expenses	\$ 319,433	\$ 303,387	\$ 16,046	5%
R&D expenses as a percentage of total revenues	14 %	16 %		

R&D expenses may fluctuate with product development phases and project timing as well as our focused R&D efforts that are aligned with our overall business strategy. As technological innovation is essential to our success, we may

incur significant costs associated with R&D projects, including compensation for engineering talent, engineering material costs, and other expenses.

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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 and focused investments in our R&D. We remain committed to product development in new and emerging technologies as we address the yield challenges our customers face at future technology nodes.

R&D expenses during the three months ended December 31, 2018 increased compared to the three months ended September 30, 2018, primarily due to an increase in engineering materials and supplies expenses of \$12.5 million, an increase in depreciation expense of \$1.2 million offset by a decrease in employee-related expenses of \$2.2 million as a result of lower variable compensation.

R&D expenses during the three months ended December 31, 2018 increased compared to the three months ended December 31, 2017, primarily due to an increase in employee-related expenses of \$5.3 million as a result of additional engineering headcount and higher employee benefit costs, an increase in engineering materials and supplies expenses of \$2.2 million, and an increase in depreciation expense of \$2.1 million.

R&D expenses during the six months ended December 31, 2018 increased compared to the six months ended December 31, 2017, primarily due to an increase in employee-related expenses of \$12.2 million as a result of additional engineering headcount and higher employee benefit costs, an increase in depreciation expenses of \$3.2 million, and an increase in travel-related expenses of \$1.3 million.

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Selling, General and Administrative (“SG&A”)

(Dollar amounts in thousands)	Three months ended			Q2 FY19	Q2 FY19
	December 31,	September 30,	December 31,	vs.	vs.
	2018	2018	2017	Q1 FY19	Q2 FY18
SG&A expenses	\$112,462	\$114,438	\$105,265	\$(1,976)	(2)% \$7,197 7%
SG&A expenses as a percentage of total revenues	10	% 10	% 11	%	

(Dollar amounts in thousands)	Six months ended			Q2 FY19
	December 31,	December 31,	YTD vs.	Q2 FY18
	2018	2017	YTD	YTD
SG&A expenses	\$226,900	\$212,697	\$14,203	7%
SG&A expenses as a percentage of total revenues	10	% 11	%	

SG&A expenses during the three months ended December 31, 2018 decreased compared to the three months ended September 30, 2018, primarily due to a decrease in merger-related expense of \$1.1 million.

SG&A expenses during the three months ended December 31, 2018 increased compared to the three months ended December 31, 2017, primarily due to an increase in employee-related expenses of \$4.2 million as a result of additional headcount and higher employee benefit costs, and an increase in merger-related expenses of \$3.0 million pertaining primarily to the pending merger with Orbotech, partially offset by a decrease in consulting expense of \$3.1 million.

SG&A expenses during the six months ended December 31, 2018 increased compared to the six months ended December 31, 2017, primarily due to an increase in merger-related expenses of \$5.6 million, an increase in employee-related expenses of \$4.4 million as a result of additional headcount and higher employee benefit costs, and an increase in travel-related expenses of \$4.6 million.

Interest Expense and Other Expense (Income), Net

(Dollar amounts in thousands)	Three months ended		
	December 31,	September 30,	December 31,
	2018	2018	2017
Interest expense	\$26,538	\$26,362	\$27,372
Other expense (income), net	\$(9,228)	\$(10,025)	\$(7,824)
Interest expense as a percentage of total revenues	2	% 2	% 3
Other expense (income), net as a percentage of total revenues	1	% 1	% 1

(Dollar amounts in thousands)	Six months ended		
	December 31,	December 31,	
	2018	2017	
Interest expense	\$52,900	\$57,948	
Other expense (income), net	\$(19,253)	\$(12,207)	
Interest expense as a percentage of total revenues	2	% 3	%
Other expense (income), net as a percentage of total revenues	1	% 1	%

Interest expense during the three months ended December 31, 2018 remained relatively unchanged compared to the three months ended September 30, 2018, and December 31, 2017.

Decrease in interest expense during the six months ended December 31, 2018 compared the six months ended December 31, 2017 was primarily due to lower outstanding debt.

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Other expense (income), net is comprised primarily of realized gains or losses on sales of marketable securities, gains or losses from revaluations of certain foreign currency denominated assets and liabilities as well as foreign currency contracts, and interest-related accruals (such as interest and penalty accruals related to our tax obligations) and interest income earned on our invested cash, cash equivalents and marketable securities.

The decrease in other expense (income), net during the three months ended December 31, 2018 compared to the three months ended September 30, 2018 was primarily due to a lower net foreign currency gain of \$0.9 million.

The increase in other expense (income), net during the three months ended December 31, 2018 compared to the three months ended December 31, 2017 was primarily due to an increase in interest income of \$2.9 million.

The increase in other expense (income), net during the six months ended December 31, 2018 compared to the six months ended December 31, 2017 was primarily due to an increase in interest income of \$5.4 million and a higher net foreign currency gain of \$1.5 million.

Provision for Income Taxes

The following table provides details of income taxes:

	Three months ended December 31,		Six months ended December 31,	
(Dollar amounts in thousands)	2018	2017	2018	2017
Income before income taxes	\$415,963	\$347,307	\$843,531	\$683,459
Provision for income taxes	\$46,863	\$481,626	\$78,487	\$536,842
Effective tax rate	11.3	% 138.7	% 9.3	% 78.5

Tax expense was lower as a percentage of income before taxes during the three months ended December 31, 2018 compared to the three months ended December 31, 2017 primarily due to the impact of the following items:

Tax expense increased by \$442.0 million during the three months ended December 31, 2017 due to changes to the U.S. corporate income tax system provided by the Tax Cuts and Jobs Act (the "Act"), which did not take place during the three months ended December 31, 2018;

Tax expense decreased by \$5.5 million during the three months ended December 31, 2018 relating to an increase in the proportion of our earnings generated in jurisdictions with tax rates lower than the U.S. statutory rate during the three months ended December 31, 2018;

Tax expense decreased by \$16.8 million during the three months ended December 31, 2018 relating to the Foreign-Derived Intangible Income deduction provided by the Act; partially offset by

Tax expense increased by \$14.0 million during the three months ended December 31, 2018 relating to the Global Intangible Low-Taxed Income ("GILTI") provided by the Act.

Tax expense was lower as a percentage of income before taxes during the six months ended December 31, 2018 compared to the six months ended December 31, 2017 primarily due to the impact of the following items:

Tax expense increased by \$421.9 million during the six months ended December 31, 2017 due to changes to the U.S. corporate income tax system from the Act, which did not take place during the six months ended December 31, 2018;

Tax expense decreased by \$11.1 million during the six months ended December 31, 2018 relating to an increase in the proportion of our earnings generated in jurisdictions with tax rates lower than the U.S. statutory rate during the three months ended December 31, 2018;

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Tax expense decreased by \$34.1 million during the six months ended December 31, 2018 relating to the Foreign-Derived Intangible Income deduction provided by the Act; partially offset by

Tax expense increased by \$28.3 million during the six months ended December 31, 2018 relating to the GILTI provided by the Act.

As of December 31, 2018, we have completed our accounting for the tax effects of the Act, which was enacted into law on December 22, 2017. We recorded a tax benefit adjustment of \$0.3 million and \$20.1 million for the transition tax liability provided by the Act during the three and six months ended December 31, 2018, respectively. Future guidance of the Act from U.S. federal and state governments may change the tax liability.

Our future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of our pre-tax income, the amount of our pre-tax income as business activities fluctuate, non-deductible expenses incurred in connection with acquisitions, research and development credits as a percentage of aggregate pre-tax income, the domestic manufacturing deduction, non-taxable or non-deductible increases or decreases in the assets held within our Executive Deferred Savings Plan, the tax effects of employee stock activity and the effectiveness of our tax planning strategies.

In the normal course of business, we are subject to examination by tax authorities throughout the world. We are under United States federal income tax examination for the fiscal year ended June 30, 2016. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material adverse effect on our results of operations or cash flows in the period or periods for which that determination is made.

LIQUIDITY AND CAPITAL RESOURCES

(Dollar amounts in thousands)	As of December 31, 2018	As of June 30, 2018
Cash and cash equivalents	\$1,793,982	\$1,404,382
Marketable securities	900,112	1,475,936
Total cash, cash equivalents and marketable securities	\$2,694,094	\$2,880,318
Percentage of total assets	48	% 51 %

(In thousands)	Six months ended December 31,	
	2018	2017
Cash flows:		
Net cash provided by operating activities	\$663,577	\$503,000
Net cash provided by investing activities	523,482	138,949
Net cash used in financing activities	(797,144)	(726,429)
Effect of exchange rate changes on cash and cash equivalents	(315)	4,823
Net increase (decrease) in cash and cash equivalents	\$389,600	\$(79,657)

Cash and Cash Equivalents and Marketable Securities:

As of December 31, 2018, our cash, cash equivalents and marketable securities totaled \$2.69 billion, which represents a decrease of \$186.2 million from June 30, 2018. The decrease is mainly due to stock repurchases of \$550.2 million, and cash used for payment of dividends and dividend equivalents of \$237.3 million, partially offset by our cash generated from operations and net proceeds from marketable securities transactions.

As of December 31, 2018, \$2.15 billion of our \$2.69 billion of cash, cash equivalents and marketable securities were held by our foreign subsidiaries and branch offices. We currently intend to indefinitely reinvest \$1.94 billion of the cash, cash equivalents and marketable securities held by our foreign subsidiaries. If, however, a portion of these funds were to be repatriated to the United States, we would be required to accrue and pay state and foreign taxes of approximately 1%-22% of the funds repatriated. The amount of taxes due will depend on the amount and manner of the repatriation, as well as the location from which the funds are repatriated. We have accrued state and foreign tax on the remaining cash of \$203.8 million of the \$2.15 billion held by our foreign subsidiaries and branch offices. As such,

these funds can be returned to the U.S. without accruing any additional U.S. tax expense.

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Quarterly Cash Dividends and Special Cash Dividend:

During the three months ended December 31, 2018, our Board of Directors declared a regular quarterly cash dividend of \$0.75 per share on our outstanding common stock, which was paid on December 4, 2018 to our stockholders of record as of the close of business on November 17, 2018. During the same period in fiscal year 2017, our Board of Directors declared and paid a regular quarterly cash dividend of \$0.59 per share on our outstanding common stock. The total amount of regular quarterly cash dividends and dividend equivalents paid during the three months ended December 31, 2018 and December 31, 2017 was \$114.5 million and \$92.6 million, respectively. The total amount of regular quarterly cash dividends and dividend equivalents paid during the six months ended December 31, 2018 and December 31, 2017 was \$234.4 million and \$186.7 million, respectively. The amount of accrued dividends payable for regular quarterly cash dividends on unvested restricted stock units (RSUs) with dividend equivalent rights as of December 31, 2018 and June 30, 2018 was \$5.4 million and \$6.7 million, respectively. These amounts will be paid upon vesting of the underlying unvested RSU as described in Note 9, "Equity and Long-term Incentive Compensation Plans," to the condensed consolidated financial statements.

On November 19, 2014, our Board of Directors declared a special cash dividend of \$16.50 per share on our outstanding common stock. The declaration and payment of the special cash dividend was part of our leveraged recapitalization transaction under which the special cash dividend was financed through a combination of existing cash and proceeds from the debt financing disclosed in Note 8 "Debt" to the condensed consolidated financial statements that was completed during the three months ended December 31, 2014. The total amount of the special cash dividend accrued by us at the declaration date was substantially paid out during the three months ended December 31, 2014, except for the aggregate special cash dividend of \$43.0 million that was accrued for the unvested RSUs and to be paid when such underlying unvested RSUs vest. During the three months ended December 31, 2018 and 2017, the total special cash dividends paid with respect to vested RSUs were immaterial. During the six months ended December 31, 2018 and 2017, the total special cash dividends paid with respect to vested RSUs were \$2.9 million and \$6.2 million, respectively. As of December 31, 2018, all of the special cash dividends accrued with respect to outstanding RSUs were vested and paid in full. Other than the special cash dividend declared during the three months ended December 31, 2014, we historically have not declared any special cash dividends. For details of the special cash dividend, refer to Note 8 "Equity and Long-Term Incentive Compensation Plans," of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

Stock Repurchases:

The shares repurchased under our stock repurchase program have reduced our basic and diluted weighted-average shares outstanding for the six months ended December 31, 2018 and 2017. The stock repurchase program is intended, in part, to offset shares issued in connection with the purchases under our ESPP program and the vesting of employee restricted stock units.

Cash Flows from Operating Activities:

We have historically financed our liquidity requirements through cash generated from our operations. Net cash provided by operating activities during the six months ended December 31, 2018 increased by \$160.6 million compared to the six months ended December 31, 2017 primarily as a result of the following factors:

- An increase in collections of approximately \$233.0 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017, mainly driven by higher shipments;
- A decrease in income tax payments/ refunds of approximately \$35.0 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017;
- A decrease in debt interest payments of approximately \$7.0 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017; and partially offset by
 - An increase in accounts payable payments of approximately \$98.0 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017; and
 - An increase in payments for employee-related expenses of approximately \$14.0 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017.

Cash Flows from Investing Activities:

Net cash provided by investing activities during the six months ended December 31, 2018 was \$523.5 million compared to cash provided by investing activities of \$138.9 million during the six months ended December 31, 2017. This change was mainly due to cash received from sale and maturity of marketable securities of \$578.7 million during the six months ended December 31, 2018, compared to \$172.4 million during the six months ended December 31, 2017.

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Cash Flows from Financing Activities:

Net cash used in financing activities during the six months ended December 31, 2018 increased by \$70.7 million compared to the six months ended December 31, 2017. Net cash used in financing activities was mainly impacted by:

• An increase in common stock repurchases of \$469.8 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017; and

An increase in dividend and dividend equivalent payments of \$44.4 million during the six months ended December 31, 2018 compared to the six months ended December 31, 2017, due to an increase in our quarterly dividend from \$0.59 to \$0.75 per share; and

A decrease in the net repayment of debt of \$447.6 million mainly as a result of the term loan principal payments of \$696.3 million offset by \$248.7 million borrowings under the revolving credit facility during the six months ended December 31, 2017. There was no repayment or borrowing of debt during the six months ended December 31, 2018.

Senior Notes:

In November 2014, we issued \$2.50 billion aggregate principal amount of senior, unsecured long-term notes (collectively referred to as “Senior Notes”) as part of the leveraged recapitalization plan.

The interest rate specified for each series of the Senior Notes will be subject to adjustments from time to time if Moody’s Investor Service, Inc. (“Moody’s”) or Standard & Poor’s Ratings Services (“S&P”) or, under certain circumstances, a substitute rating agency selected by us as a replacement for Moody’s or S&P, as the case may be (a “Substitute Rating Agency”), downgrades (or subsequently upgrades) its rating assigned to the respective series of Senior Notes such that the adjusted rating is below investment grade. In October 2014, we entered into a series of forward contracts to lock the 10-year treasury rate (“benchmark rate”) on a portion of the Senior Notes with a notional amount of \$1.00 billion in aggregate. For additional details, refer to Note 15, “Derivative Instruments and Hedging Activities” of this report, and Note 7 “Debt” of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

The original discount on the Senior Notes amounted to \$4.0 million and is being amortized over the life of the debt. Interest is payable semi-annually on May 1 and November 1 of each year. The debt indenture (the “Indenture”) includes covenants that limit our ability to grant liens on our facilities and enter into sale and leaseback transactions, subject to certain allowances under which certain sale and leaseback transactions are not restricted.

In certain circumstances involving a change of control followed by a downgrade of the rating of a series of Senior Notes by at least two of Moody’s, S&P and Fitch Inc., unless we have exercised our rights to redeem the Senior Notes of such series, we will be required to make an offer to repurchase all or, at the holder’s option, any part, of each holder’s Senior Notes of that series pursuant to the offer described below (the “Change of Control Offer”). In the Change of Control Offer, we will be required to offer payment in cash equal to 101% of the aggregate principal amount of Senior Notes repurchased plus accrued and unpaid interest, if any, on the Senior Notes repurchased, up to, but not including, the date of repurchase.

As of December 31, 2018, we were in compliance with all of our covenants under the Indenture associated with the Senior Notes.

Revolving Credit Facility:

In November 2017, we entered into a Credit Agreement (the “Credit Agreement”) providing for a \$750.0 million five-year unsecured Revolving Credit Facility (the “Revolving Credit Facility”), which replaced our prior Credit Facility. Subject to the terms of the Credit Agreement, the Revolving Credit Facility may be increased in an amount up to \$250.0 million in the aggregate. In November 2018, we entered into an Incremental Facility, Extension and Amendment Agreement (the “Amendment”), which amends the Credit Agreement to (a) extend the Maturity Date (the “Maturity Date”) from November 30, 2022 to November 30, 2023, (b) increase the total commitment by \$250.0 million and (c) effect certain other amendments to the Credit Agreement as set forth in the Amendment. After giving effect to the Amendment, the total commitments under the Credit Agreement are \$1.00 billion.

We may borrow, repay and reborrow funds under the Revolving Credit Facility until the Maturity Date, at which time such Revolving Credit Facility will terminate, and all outstanding loans under such facility, together with all accrued and unpaid interest, must be repaid. We may prepay the outstanding borrowings under the Revolving Credit Facility at any time without a prepayment penalty.

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Borrowings under the Revolving Credit Facility will bear interest, at our option, at either: (i) the Alternative Base Rate (“ABR”) plus a spread, which ranges from 0 bps to 75 bps, or (ii) the London Interbank Offered Rate (“LIBOR”) plus a spread, which ranges from 100 bps to 175 bps. The spreads under ABR and LIBOR are subject to adjustment in conjunction with credit rating downgrades or upgrades. We are also obligated to pay an annual commitment fee on the daily undrawn balance of the Revolving Credit Facility, which ranges from 10 bps to 25 bps, subject to an adjustment in conjunction with changes to our credit rating. As of December 31, 2018, we pay an annual commitment fee of 12.5 bps on the daily undrawn balance of the Revolving Credit Facility.

The Revolving Credit Facility requires us to maintain an interest expense coverage ratio as described in the Credit Agreement, on a quarterly basis, covering the trailing four consecutive fiscal quarters of no less than 3.50 to 1.00. In addition, we are required to maintain the maximum leverage ratio as described in the Credit Agreement, on a quarterly basis of 3.00 to 1.00, covering the trailing four consecutive fiscal quarters for each fiscal quarter, which can be increased to 4.00 to 1.00 for a period of time in connection with a material acquisition or a series of material acquisitions.

We were in compliance with the financial covenants under the Credit Agreement as of December 31, 2018 (the interest expense coverage ratio was 17.12 to 1.00 and the leverage ratio was 1.20 to 1.00) and had no outstanding borrowings under the unfunded Revolving Credit Facility. Considering our current liquidity position, short-term financial forecasts and ability to prepay the Revolving Credit Facility, if necessary, we expect to continue to be in compliance with our financial covenants at the end of our fiscal year ending June 30, 2019.

Contractual Obligations:

The following is a schedule summarizing our significant obligations to make future payments under contractual cash obligations as of December 31, 2018:

(In thousands)	Fiscal year ending June 30,							
	Total	2019 ⁽²⁾	2020	2021	2022	2023	2024 and thereafter	Other
Debt obligations ⁽¹⁾	\$2,250,000	\$—	\$250,000	\$—	\$500,000	\$—	\$1,500,000	\$—
Interest payment associated with all debt obligations ⁽³⁾	651,295	51,285	98,365	94,142	83,830	73,517	250,156	—
Purchase commitments ⁽⁴⁾	489,848	449,122	38,862	672	995	197	—	—
Income taxes payable ⁽⁵⁾	75,052	—	—	—	—	—	—	75,052
Operating leases	30,083	7,145	8,361	6,016	3,166	2,317	3,078	—
Cash long-term incentive program ⁽⁶⁾	129,832	26,074	49,080	39,256	15,412	10	—	—
Pension obligations ⁽⁷⁾	25,463	742	1,668	1,481	2,194	1,945	17,433	—
Executive Deferred Savings Plan ⁽⁸⁾	181,976	—	—	—	—	—	—	181,976
Transition tax payable ⁽⁹⁾	300,584	26,138	26,138	26,138	26,138	49,008	147,024	—
Other ⁽¹⁰⁾	5,404	482	2,991	1,117	663	151	—	—
Total obligations	\$4,139,537	\$560,988	\$475,465	\$168,822	\$632,398	\$127,145	\$1,917,691	\$257,028

(1) Represents \$2.25 billion aggregate principal amount of Senior Notes due from fiscal year 2020 to fiscal year 2035.

(2) For the remaining six months of fiscal year 2019.

The interest payments associated with the Senior Notes obligations included in the table above are based on the principal amount multiplied by the applicable interest rate for each series of Senior Notes. Our future interest payments are subject to change if our then effective credit rating is below investment grade as discussed above.

(3) The interest payment under the Revolving Credit Facility for the undrawn balance is payable at 12.5 bps as a commitment fee based on the daily undrawn balance and we utilized the existing rate for the projected interest payments included in the table above. Our future interest payments for the Revolving Credit Facility is subject to change due to any upgrades or downgrades to our then effective credit rating.

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Represents an estimate of significant commitments to purchase inventory from our suppliers as well as an estimate of significant purchase commitments associated with goods, services and other assets in the ordinary course of business. Our liability under these purchase commitments is generally restricted to a forecasted time-horizon as (4) mutually agreed upon between the parties. This forecasted time-horizon can vary among different suppliers. 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 the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

Represents the estimated income tax payable obligation related to uncertain tax positions as well as related accrued (5) interest. We are unable to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes.

Represents the amount committed under our cash long-term incentive program. The expected payment after (6) estimated forfeitures is approximately \$105.7 million.

Represents an estimate of expected benefit payments up to fiscal year 2028 that was actuarially determined and (7) excludes the minimum cash required to contribute to the plan. As of December 31, 2018, our defined benefit pension plans do not have material required minimum cash contribution obligations.

Represents the amount committed under our non-qualified executive deferred compensation plan. We are unable to (8) make a reasonably reliable estimate of the timing of payments in individual years due to the uncertainties in the timing around participant's separation and any potential changes that participants may decide to make to the previous distribution elections.

Represents the tax amount for the transition tax liability associated with our deemed repatriation of accumulated (9) foreign earnings as a result from the enactment of the Tax Cuts and Jobs-Act into law on December 22, 2017.

Represents amounts committed for accrued dividends payable for quarterly cash dividends for unvested restricted (10) stock units granted with dividend equivalent rights. For additional details, refer to Note 9, "Equity and Long-term Incentive Compensation Plans," to the condensed consolidated financial statements.

We have adopted a cash-based long-term incentive ("Cash LTI") program for many of our employees as part of our employee compensation program. Cash LTI awards issued to employees under the Cash Long-Term Incentive Plan ("Cash LTI Plan") generally vest in three or four equal installments. For additional details, refer to Note 9, "Equity and Long-term Incentive Compensation Plans," to the condensed consolidated financial statements.

We have agreements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, we periodically sell certain letters of credit ("LCs"), without recourse, received from customers in payment for goods and services.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs for the indicated periods:

	Three months ended		Six months ended	
	December 31,		December 31,	
(In thousands)	2018	2017	2018	2017
Receivables sold under factoring agreements	\$39,814	\$47,232	\$101,354	\$79,133
Proceeds from sales of LCs	\$8,339	\$—	\$19,231	\$5,571

Factoring and LC fees for the sale of certain trade receivables were recorded in other expense (income), net and were not material for the periods presented.

We maintain guarantee arrangements available through various financial institutions for up to \$22.5 million, of which \$18.2 million had been issued as of December 31, 2018, primarily to fund guarantees to customs authorities for VAT and other operating requirements of our subsidiaries in Europe and Asia.

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Working Capital:

Working capital was \$3.00 billion as of December 31, 2018, which is a decrease of \$327.9 million compared to our working capital of \$3.33 billion as of June 30, 2018. As of December 31, 2018, our principal sources of liquidity consisted of \$2.69 billion of cash, cash equivalents and marketable securities. Our liquidity may be affected by many factors, some of which are based on the normal ongoing operations of the business, spending for business acquisitions including the pending acquisition of Orbotech, and other factors such as uncertainty in the global and regional economies and the semiconductor equipment industries. Although cash requirements will fluctuate based on the timing and extent of these factors, we believe that cash generated from operations, together with the liquidity provided by existing cash and cash equivalents balances and our \$1.00 billion Revolving Credit Facility, will be sufficient to satisfy our liquidity requirements associated with working capital needs, capital expenditures, cash dividends, stock repurchases and other contractual obligations, including repayment of outstanding debt, for at least the next 12 months.

Our credit ratings as of December 31, 2018 are summarized below:

Rating Agency	Rating
Fitch	BBB+
Moody's	Baa1
Standard & Poor's	BBB

Factors that can affect our credit ratings include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, material acquisitions and changes in our business strategy.

Off-Balance Sheet Arrangements

As of December 31, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, that have or are reasonably likely to have a current or future effect on our financial position, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors. Refer to Note 14 "Commitments and contingencies" to the condensed consolidated financial statements for information related to indemnification obligations.

Table of Contents**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. All of the potential changes noted below are based on sensitivity analysis performed on our financial position as of December 31, 2018. Actual results may differ materially.

As of December 31, 2018, we had an investment portfolio of fixed income securities of \$1.57 billion. These securities, as with all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 100 bps from levels as of December 31, 2018, the fair value of the portfolio would have declined by \$7.3 million.

In November 2014, we issued \$2.50 billion aggregate principal amount of fixed rate senior, unsecured long-term notes (collectively referred to as “Senior Notes”). The fair market value of long-term fixed interest rate notes is subject to interest rate risk. Generally, the fair market value of fixed interest rate notes will increase as interest rates fall and decrease as interest rates rise. As of December 31, 2018, the fair value and the book value of our Senior Notes were \$2.30 billion and \$2.25 billion, respectively, due in various fiscal years ranging from 2020 to 2035. Additionally, the interest expense for the Senior Notes is subject to interest rate adjustments following a downgrade of our credit ratings below investment grade by the credit rating agencies. Following a rating change below investment grade, the stated interest rate for each series of Senior Notes may increase between 25 bps to 100 bps based on the adjusted credit rating. Refer to Note 8, “Debt,” to the condensed consolidated financial statements in Part I, Item 1 and Management’s Discussion and Analysis of Financial Condition and Results of Operations, “Liquidity and Capital Resources,” in Part I, Item 2 for additional details. Factors that can affect our credit ratings include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, and changes in our business strategy. As of December 31, 2018, if our credit rating was downgraded below investment grade by Moody’s and S&P, the maximum potential increase to our annual interest expense on the Senior Notes, considering a 200 bps increase to the stated interest rate for each series of our Senior Notes, is estimated to be approximately \$44.2 million.

In November 2017, we entered into a Credit Agreement (the “Credit Agreement”) for a \$750.0 million five-year unsecured Revolving Credit Facility (the “Revolving Credit Facility”), which replaced our prior Credit Agreement. Subject to the terms of the Credit Agreement, the Revolving Credit Facility may be increased in an amount up to \$250.0 million in the aggregate. In November 2018, we entered into an Incremental Facility, Extension and Amendment Agreement (the “Amendment”), which amends the Credit Agreement to (a) extend the Maturity Date (the “Maturity Date”) from November 30, 2022 to November 30, 2023, (b) increase the total commitment by \$250.0 million and (c) effect certain other amendments to the Credit Agreement as set forth in the Amendment. After giving effect to the Amendment, the total commitments under the Credit Agreement are \$1.00 billion. As of December 31, 2018, we do not have any outstanding floating rate debts that are subject to an increase in interest rates. We are obligated to pay an annual commitment fee of 12.5 bps on the daily undrawn balance of the Revolving Credit Facility which is subject to an adjustment in conjunction with our credit rating downgrades or upgrades. The annual commitment fee ranges from 10 bps to 25 bps on the daily undrawn balance of the Revolving Credit Facility, depending upon the then effective credit rating. As of December 31, 2018, if our credit ratings were downgraded to be below investment grade, the maximum potential increase to our annual commitment fee for the Revolving Credit Facility, using the highest range of the ranges discussed above, is estimated to be approximately \$0.6 million.

See Note 5, “Marketable Securities,” to the condensed consolidated financial statements in Part I, Item 1; Management’s Discussion and Analysis of Financial Condition and Results of Operations, “Liquidity and Capital Resources,” in Part I, Item 2; and Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for a description of recent market events that may affect the value of the investments in our portfolio that we held as of December 31, 2018.

As of December 31, 2018, we had net forward and option contracts to sell \$93.6 million in foreign currency in order to hedge certain currency exposures (see Note 15, “Derivative Instruments and Hedging Activities,” to the condensed consolidated financial statements for additional details). If we had entered into these contracts on December 31, 2018,

the U.S. dollar equivalent would have been \$106.1 million. A 10% adverse move in all currency exchange rates affecting the contracts would decrease the fair value of the contracts by \$28.2 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, as a result of the hedging of certain of our foreign currency exposure, changes in most relevant foreign currency exchange rates should have no material impact on our results of operations or cash flows.

As of December 31, 2018, we had forward contracts to sell \$500.0 million in treasury securities in order to hedge certain interest rate exposures (see Note 15, “Derivative Instruments and Hedging Activities,” to the condensed consolidated financial statements for additional details). A 10% adverse move in interest rates affecting the contracts would decrease the fair value of the contracts by \$29.9 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, as a result of the hedging of certain of our interest rate exposure, changes in most relevant interest rates should have no material impact on our results of operations or cash flows.

ITEM 4 CONTROLS AND PROCEDURES

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

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) (“Disclosure Controls”) as of the end of the period covered by this Quarterly Report on Form 10-Q (this “Report”) required by Exchange Act Rules 13a-15(b) or 15d-15(b). The controls evaluation was conducted under the supervision and with the participation of our management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”). Based on this evaluation, the CEO and CFO have concluded that as of the end of the period covered by this Report our Disclosure Controls were effective at a reasonable assurance level.

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

Definition of Disclosure Controls

Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this 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 our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our Disclosure Controls include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the United States. To the extent that components of our internal control over financial reporting are included within our Disclosure Controls, they are included in the scope of our annual controls evaluation.

Limitations on the Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our 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 our 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

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the most recent fiscal quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 13, "Litigation and Other Legal Matters," to the condensed consolidated financial statements in Item 1 of Part 1 is incorporated herein by reference.

ITEM 1A. RISK FACTORS

A description of factors that could materially affect our business, financial condition or operating results is provided below.

Risks Associated with Our Industry

Ongoing changes in the technology industry, as well as the semiconductor industry in particular, could expose our business to significant risks.

The semiconductor equipment industry and other industries that we serve are constantly developing and changing over time. Many of the risks associated with operating in these industries are comparable to the risks faced by all technology companies, such as the uncertainty of future growth rates in the industries that we serve, pricing trends in the end-markets for consumer electronics and other products (which place a growing emphasis on our customers' cost of ownership), changes in our customers' capital spending patterns and, in general, an environment of constant change and development, including decreasing product and component dimensions; use of new materials; and increasingly complex device structures, applications and process steps. If we fail to appropriately adjust our cost structure and operations to adapt to any of these trends, or, with respect to technological advances, if we do not timely develop new technologies and products that successfully anticipate and address these changes, we could experience a material adverse effect on our business, financial condition and operating results.

In addition, we face a number of risks specific to ongoing changes in the semiconductor industry, as the significant majority of our sales are made to semiconductor manufacturers. Some of the trends that our management monitors in operating our business include the following:

- the potential for reversal of the long-term historical trend of declining cost per transistor with each new generation of technological advancement within the semiconductor industry, and the adverse impact that such reversal may have upon our business;
- the increasing cost of building and operating fabrication facilities and the impact of such increases on our customers' investment decisions;
- differing market growth rates and capital requirements for different applications, such as memory, logic and foundry;
- lower level of process control adoption by our memory customers compared to our foundry and logic customers;
- our customers' reuse of existing and installed products, which may decrease their need to purchase new products or solutions at more advanced technology nodes;
- the emergence of disruptive technologies that change the prevailing semiconductor manufacturing processes (or the economics associated with semiconductor manufacturing) and, as a result, also impact the inspection and metrology requirements associated with such processes;
- the higher design costs for the most advanced integrated circuits, which could economica