

## KLA Corporation

# Keep calm and compound on: management mtg. highlights, top semicap, PO now \$850

Reiterate Rating: BUY | PO: 850.00 USD | Price: 688.71 USD

## Resilient in downturn, well prepared for upturn

We were pleased to host KLA CEO Rick Wallace, CFO Bren Higgins and IR head Kevin Kessel for well attended investor meetings in Boston and Toronto this week. Overall the message was solid on long-term compounding themes: 1) intimately levered to next decade of complexity changes in leading edge chip manufacturing and packaging, and to reshoring trends with new fabs dependent on KLAC gear to improve yield; 2) leading 57% share in yield enhancing process control industry (4x nearest rival), 3) leading industry 61% gross margins (vs peer average 47%), 4) under-appreciated services business (25% of sales) compounding double digit annually, and 5) consistent outgrowth vs. wafer fab equipment (WFE), with core semi sales growing 15% CAGR vs WFE 9% CAGR over the past five years. Near-term we believe the WFE industry is bouncing at the bottom, with potential 1H trough and 2H recovery led by leading edge investments. We expect KLA sales to accelerate into CY25/26 and raise our PO to \$850 on higher confidence in KLA expanding its industry leading margins in the coming upturn. Our new PO is based on 29x CY25E, vs 25x prior, but within peer group range of 21x-31x.

## Improving demand tone in leading edge investments

Longer-term, management expects WFE intensity to trend to 15% or \$150bn total opportunity as semi-industry reaches \$1tn likely by CY30E. Near-term, WFE investments are likely to be flat to slightly up towards high \$80bn in CY24E. However, per KLAC, there are green shoots in discussions with leading edge logic/foundry customers in terms of intentions to spend later in CY24 and into CY25/26E. Mgmt. highlighted: 1) improving utilization of leading-edge nodes driven by proliferation of design starts and faster product cadence of AI silicon; 2) accelerating competition between leading foundries (TSMC, Samsung, Intel) especially as industry heads to the 2nm node with inflection in transistor shape (gate all around, nanosheets); 3) modest but still notable recovery in smartphone and PC demand, with potential upside from new AI features. We note KLAC's process control intensity is highest (14-15%) in high mix, low volume leading edge transistors versus current mix that is tilted more towards trailing edge. Adoption of high NA EUV likely limited until end of the decade or whenever foundries can justify cost (TSMC adoption more likely at later 1.4nm rather than 2nm node). Last, any China trailing-edge over-capacity should not influence leading-edge recovery.

## High quality recurring services business = higher multiple

Much like other recurring services/software businesses, we believe KLAC's services business deserves a higher multiple in a sum of the parts valuation approach. Unlike peers whose services businesses include more cyclical spares dependent on fab utilization, KLAC's services segment, around \$2.2bn or 23% of sales in CY23, is pure services driven (75% contracted, 25% billings). Even during downturns, customers are ensured higher tool uptime and yield improvement, driving steady demand for maintenance services on proprietary, expensive KLAC tools. Management expects services growth to accelerate to 12-14% YoY in CY24E vs 7% last year, driven by strong contract renewal activity.

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13 March 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	740.00	850.00

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### Stock Data

Price	688.71 USD
Price Objective	850.00 USD
Date Established	13-Mar-2024
Investment Opinion	B-1-7
52-Week Range	355.88 USD - 729.15 USD
Mkt Val (mn) / Shares Out (mn)	93,137 USD / 135.2
Free Float	99.7%
Average Daily Value (mn)	675.85 USD
BofA Ticker / Exchange	KLAC / NAS
Bloomberg / Reuters	KLAC US / KLAC.OQ
ROE (2024E)	98.0%
Net Dbt to Eqty (Jun-2023A)	90.7%
ESGMeter™	High

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### Glossary:

KLAC: KLA Corporation  
WFE: Wafer Fab Equipment  
CAGR: Compounded Annual Growth Rate  
TSMC: Taiwan Semiconductor Manufacturing Company

## Price objective basis & risk

### KLA Corporation (KLAC)

Our PO of \$850 is based on 29x CY25E P/E, at the higher end KLAC's historical range of 10x-30x. KLAC's leading profit margin and less cyclical topline supports a slightly higher multiple vs. semicap peers, in our view.

Downside risks to our PO are the cyclical nature of the semiconductor capital spending and its impact on earnings, competitive price and market share issues, ability to get new products and technologies into the market in a timely manner.

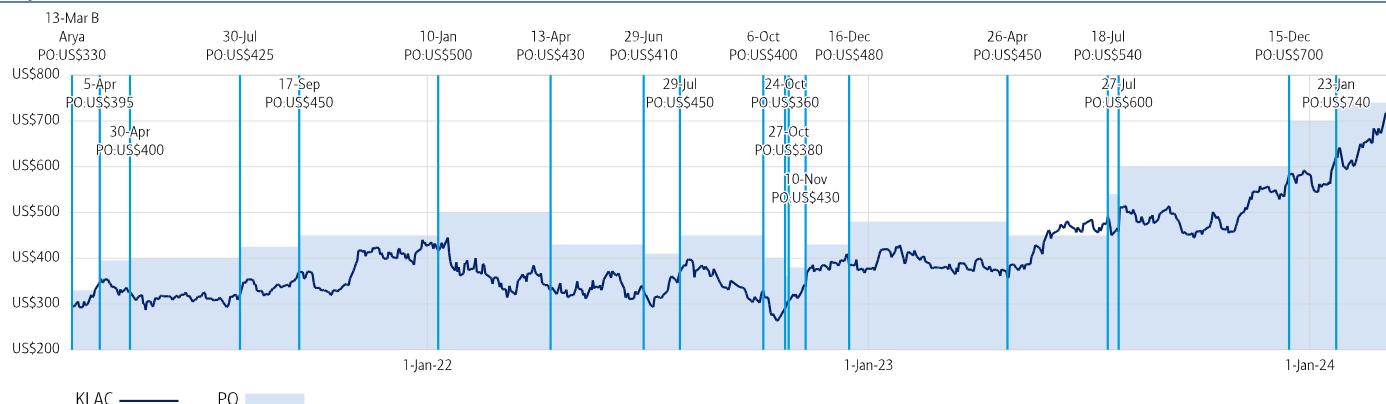
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### KLA Corp (KLAC) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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### Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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