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KLA Corporation (KLAC) CEO Rick Wallace on Q1 2020 Results - Earnings Call Transcript

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FQ1: 10-30-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $2.48 beats by $0.28 | Revenue of $1.41B (29.28% Y/Y) beats by $65.58M

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KLA Corporation (NASDAQ:KLAC) Q1 2020 Earnings Conference Call October 30, 2019 5:00 PM ET

Company Participants

Kevin Kessel - VP of Investor Relations

Rick Wallace - President and Chief Executive Officer

Bren Higgins - Executive Vice President and Chief Financial Officer

Conference Call Participants

John Pitzer - Credit Suisse

C.J. Muse - Evercore

Krish Santor - Cowen and Company

Harlan Sur - JP Morgan

Vivek Arya - Bank of America Merrill Lynch

Quinn Bolton - Needham & Company

Joe Quatrochi - Wells Fargo

Patrick Ho - Stifel

Toshiya Hari - Goldman Sachs

Operator

Ladies and gentlemen, thank you for standing by and welcome to the KLA Corporation September 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the call over to Mr. Kevin Kessel, Vice President of Investor Relations for KLA Corporation. Thank you. Sir, please go ahead.

Kevin Kessel

Thank you, Christian, and welcome to today's KLA earnings conference call to discuss the results of the September 2019 quarter and outlook for the December 2019 quarter. I recently joined KLA, and today marks my first KLA earnings call. I'm glad to be here and look forward to meeting and talking with all of you over the quarters and years ahead.

Joining me on our call today are Rick Wallace, our President and Chief Executive Officer; and Bren Higgins, our Executive Vice President and Chief Financial Officer. During today's conference call, we will discuss quarterly results for the period ending September 30, 2019. We released these results this afternoon after the market close and they are also posted on the investor relations section of our website at ir.kla.com.

Today's discussion of our financial results and outlook is presented on a non-GAAP financial basis unless otherwise specified. The detailed reconciliation of GAAP to non-GAAP results is in today's earnings press release and the earnings slide presentation posted on the KLA Investor Relations website. Our IR website also contains a calendar of future Investor Events, Presentations including those from our recent Investor Day and Corporate Governance Information, as well as links the KLA's SEC filings, including our Annual Report on Form 10-K for the year ended June 30, 2019.

Our comments today are subject to risks and uncertainties reflected in the risk factors disclosure in our SEC filings. Any forward-looking statements, including those we make on the call today are also subject to those risks and KLA cannot guarantee those forward-looking statements will come true. Our actual results may differ significantly from those projected in our forward-looking statements.

With that, I'd like to now turn the call over to our Chief Executive Officer, Rick Wallace. Rick?

Rick Wallace

Thank you, Kevin, and welcome to KLA. Good afternoon everyone, and thank you for joining us on today's call. I'll start with a brief strategic overview before I cover the business highlights from the quarter.

Please turn to Slide 4. KLA continues to see strong momentum in our business from the secular trends we articulated at our recent September 17th Investor Day. Our performance this quarter clearly demonstrates how KLA is benefiting from our strategies for growth, technology, leadership and operational excellence. We delivered another solid quarter with revenue in both GAAP and non-GAAP EPS finishing above the range of guidance.

A result of strong customer pool for KLA solutions and focused execution despite a backdrop that still includes some industry headwinds in key segments. As a global leader in process control and supplier of process enabling solutions for the data era, KLA remains at the forefront of the most important industry trends and technology inflections in the electronics industry.

Our deep collaborative customer relationships, broad IP portfolio, and differentiated solutions that address our customer's most complex challenges is the recipe that sustained our market leadership. Our business also continues to benefit from more complexity within semiconductor devices as well as multiple megatrends driving demand across multiple product generations and numerous key industries.

Please turn the Slide 5. Underpinning our success and consistent outperformance is the KLA operating model, which codifies our corporate values and management principles. We have been running the Company this way for a long time, but we discussed it much more extensively at our recent Investor Day to better illustrate its power and impact on the KLA business and explain how it represents critical core competencies that we believe can enhance the long-term performance and profitability of acquired businesses.

The KLA operating model is essential to align the Company on a consistent strategy and execution, heightened accountability and facilitate continuous improvement, while ensuring we always operate with strong financial discipline and rigor.

Please turn to Slide 6. Strategically, we have four objectives that service our guide and drive our high performance culture. I also spoke about this extensively at our recent industry day, but it's worth reinforcing for those who couldn't attend. These four objectives are market leadership, product differentiation, operational excellence and attracting and developing talent. We run all our businesses including acquired ones with the focus on these key four objectives and it shows in our overall results published today.

Please turn to Slide 7 for the September quarter business highlights. Before I cover the business highlights of the quarter, I'd like to provide some high level perspective on the current industry environment. The long-term growth opportunity for the semiconductor markets remains compelling, driven by the proliferation of electronics across more diversified end markets, the introduction of new advanced technology supporting 5G and artificial intelligence, growing semiconductor investment in China and continue device and process innovation to deliver superior performance and return on investment.

KLA strong results are primarily driven by demand momentum, we see due to support both development and capacity growth in advanced logic. The demand to support advanced logic nodes is expected to remain healthy through the balance of 2019 and into 2020, driven by investment in EUV, competitive dynamics and capacity additions.

Given the recent news of increased CapEx investments in 2019, at leading-edge logic and better-than-expected demand from domestic memory customers in China, our outlook for WFE investment in 2019 has improved since our initial view for the year. We now expect WFE levels to decline by approximately 10% to 15% in 2019. With KLA semi-process control business inclusive of our guidance today, outperforming the broad semiconductor capital equipment market and growing modestly compared to 2018.

Now let me cover some of the product highlights from the quarter. KLA's market leadership is evidence of the successful execution of our portfolio strategy focused on differentiation to address our customers' most critical challenges. We're happy with our product positioning and the strong customer acceptance we are experiencing across our portfolio. We continue to see accelerated growth of our flagship Gen 5 optical inspection platform, with customers now deploying Gen 5 for both technology development and production monitoring at the events notes.

Driven by this expanded use case, we expect Gen 5 shipments to double in 2019 and adoption to continue to grow in 2020 as customers are under intense pressure to ramp quickly and KLA's advanced optical inspection platform is on the critical path to their success. The accelerated adoption of EUV and increased investment in leading-edge foundry and logic will continue to drive strong Gen 5 demand in the near term. Also last month's Investor Day, we announced the first new e-beam inspection platform in several years.

I'm pleased to report that we're receiving very positive feedback from our early customers related to the initial to performance. KLA's differentiate e-beam inspection platform works with Gen 5 optical inspection platform with seamless connectivity to offer customers the best inspection performance combination at the lowest overall cost of ownership to identify and detect yield killer defects at the most advanced nodes. Demand for mask inspection continues to be a highlight for KLA.

In the September quarter, we saw a continuation of the momentum we have experienced over the past several quarters and better than expected demand in the September quarter, helping to contribute to the revenue upsides we experienced in the quarter. We're seeing strong demand from leading foundries for our Teron mask inspection platform for optical and EUV applications and expect this to continue as customers ramp their advanced technology roadmaps.

And finally KLA service business continues to deliver excellent revenue growth performance while simultaneously generating record free cash flow. Semi-process control service revenue is on track to top $1 billion in 2019, with over 70% of the revenue generated from subscription like service contracts. This gives us high confidence that this business can deliver long term revenue growth rates in the range of 9% to 11%.

Several factors drive growth and our service businesses including increased complexity of our systems, expansion of the install base and extended demand at the trailing edge nodes. With high fab utilization in foundry and logic and stable or bottoming in memory, our customers are also looking for opportunities to enhance productivity and extend the life of their installed base. As a result, we see robust service contract penetration and our service businesses providing a steady recurring revenue stream to our business.

Please turn to Slide 8. In summary, the KLA operating model drives our investment thesis. This was accomplished by driving sustained technology leadership with a strong competitive mode, supported by a track record of free cash flow generation and capital return. Despite near-term headwinds in the industry demand environment centered on the timing of memory capacity investment, KLA continues to execute exceptionally well and deliver healthy relative revenue and earnings growth.

Our focused on driving innovation and providing a steady stream of differentiated products and solutions sets the stage for growth in 2020 and positions KLA to achieve the long-term growth targets we established in our September Investor Day. 2019 is turning out to be a banner year for KLA, showcasing the enduring value created by the successful execution of our strategic objectives.

Looking to 2020 and beyond, we're very excited about our process for growth and market leadership, building on the momentum we've established in our process control markets, and capitalizing on the market expansion opportunities from the Orbotech acquisition. We remain impressed with the Orbotech team and excited by market opportunities and technology leadership. Our integration and product synergy programs are on track and progressing well.

With that, I'll turn the call over to Bren for his commentary on the September quarter financial results and our December quarter outlook. Bren?

Bren Higgins

Thank you, Rick, and good afternoon everyone. Please turn to Slide 10 for review of the September quarter financial highlights. This was a very strong quarter for KLA with revenue and EPS each coming in above the high end of our guidance ranges. Our free cash flow results also mark a new record for the Company.

Total revenue for the September 2019 quarter was 1.413 billion, which was above the range of guidance of 1.31 billion to 1.39 billion. Gross margin for the quarter was 16.8% in the upper end of the guided range for the quarter of 50% to 60%, driven by incremental revenue growth and stronger than expected semi-process control product mix. GAAP EPS was $2.16 and non-GAAP EPS was $2.48, both of which were also above the range of guidance of 1.75 to 2.05 and $2.04 to $2.34, respectively.

Our cash flow execution was exceptional this quarter is both capital operations and free cash flow came in at record levels of 496 million and 464 million. We're proud of our financial results this quarter and we remain focused on executing across all markets as we move forward with a focus on our integration and synergy plans for the Orbotech acquisition.

A key element of our investment thesis is KLA's commitment to returning cash to shareholders. On September 17th, we announced a 13% increase in our quarterly dividend level to $0.85 per share. This marks the 10th consecutive annual increase in our quarterly dividend level, reflecting our confidence in our business strategy, the strength of our free cash flow generation and our ability to grow it overtime as well as our commitment to returning value to shareholders.

In terms of returning capital shareholders during the quarter, we were consistent and effective in our execution as we repurchased $220 million of common stock and also paid a $122 million in regular quarterly dividends and dividend equivalents upon investing in restricted stock units. In addition, we reaffirmed our commitments to continuing to return capital to shareholders as we announced as the Board of Directors authorized an additional $1 billion share repurchase program, resulting in $1.6 million available to repurchase under board authorization at quarter end.

Please turn to Slide 11 for review the revenue breakdown by reportable segments and key end markets. Revenue to the semi-process control segment was healthy and a new record at $1.163 billion in the quarter, up 16% sequentially on the backwards strength and foundry logic. As Rick discuss in his opening remarks, our view of the WFE demand environment for 2019 is approved modestly driven by investments and easy and stronger foundry demand.

In addition, increased demand for native China is also contributing to this improvement, where expectations are for this business in 2019 to be relatively flat now versus 2018. As I mentioned founders very strong at approximately 44% of semi-process control revenue up from 36% last quarter. Memory was 43% in September, down from 52% last quarter. Logic was 13% of total semi crosses control revenue versus 12% last quarter.

I'll turn now to the especially semiconductor process segment. SPTS is a leader in PVD and Edge solutions and fast growing specialty semiconductor applications like MEMS, sensors, power and RF devices as well as in advanced packaging markets. Revenue for SPTS was $69 million, up 3% sequentially. While we were encouraged by the market position of these products, SPTS revenue for 2019 has been impacted by ongoing global trade issues and a slowdown in the automotive semiconductor market.

Despite these near term headwinds, we expect SPTS to deliver revenue levels in 2019 that are roughly flat on a pro forma basis the calendar year 2018. Revenue for the PCB display and Component inspection segment was $179 million down 3% sequentially in line with expectations. This segment includes the former PCB and display businesses of Orbotech and KLA's Component inspection business.

Please turn to Slide 12 for a breakdown of revenue by major products in region. The distribution of revenue by major product category in the September quarter was as follows. Wafer inspection was 32%, patterning which includes radical inspection was 27%. Wafer inspection and patterning are part of our semiconductor process control segment. Specialty semiconductor process was 4%. PCB display and Component inspection revenue was 9%.

Other which includes Benchtop analytical instruments in the KLA pro mature product and enhancements business was 3%. Service is 25% of revenue in the quarter. In terms of regional split, Taiwan was 27%, China was 24%, Japan was 15%, Korea was 14%, U.S. was 13%, Europe was 4% with the rest of Asia at 3%.

Please turn now to Slide 13 for other income statement highlights. Total operating expenses were $376 million in the quarter and our operating margin was 34.2%. Other income expense in September quarter was $39 million. The effective tax rate was just under 11%, below our long term tax planning rate at 14% due to a decrease in taxes are related to the resolution of a tax audit in the U.S.

Non-GAAP earnings per share under the 14% planning rate would have been $2.39 per share. Going forward, you should continue to use 14% as a long term planning rate. Net income of $398 million and we had $160 million diluted weighted average shares outstanding.

Please turn to Slide 14. We ended the quarter with $1.8 billion in cash, total data $3.4 billion and a flexible and attractive debt maturity profile supported by investment grade ratings from all three agencies.

Please turn to Slides 15 to review free cash flow. KLA has a history of consistent free cash flow generation and high free cash flow conversion. Over the past five years, we've averaged just over a 100% free cash flow conversion, and over the last 12 months has been 84%. Our innovation and differentiation in the marketplace are what drives our industry leading gross margins and ultimately our free cash flow conversion.

Please turn to Slide 16. KLA continues to execute on its commitments to return capital to shareholders in the form of both dividends and share repurchases. The dividend payout is increased at a compound annual growth rate of 15% since inception. The share repurchase has also increased over the years for the average price paying to repurchase shares been slightly over $66 since 2010. The only exception to the Company's systematic repurchasing activity was during the period when it was blacked out due to merger discussion.

Please turn to Slide 17 for December quarter 2019 guidance. We expect total revenue to grow sequentially roughly 4% of the midpoint in being range of 1.435 billion to 1.515 billion in the December quarter. Foundries forecasted to be about 55% of semi-process control system revenue in the December quarter. To picking this rank we continue to see among our foundry customer base.

We expect memory to be approximately 36% of system revenue in the December quarter, reflecting continued segments we see in the memory market. Logic is expected to be about 9% of semi-process control system revenue next quarter. For the second half of the year, we now expect foundry and logic revenue combined to be up over 50% in the second half of the calendar year versus the first half.

Based on product mix expectations for the December quarter, we forecast gross margin to be in the range of 60% to 61%. In terms of operating expenses, we're modeling them to be approximately 385 million. The higher operating expense level in the December quarters due principally to the timing of non-headcount related product engineering expenses for next generation programs as well as new risk mitigation bubble costs associated with recent actions taken to drive long-term structural cost reduction actions related to leveraging KLA's global footprint to relocate certain manufacturing and engineering activities to lower cost locations. We would expect to see an impact from this activity through 2020 with the return on these investments beginning in 2021.

As we move forward to the March quarter, our expectation today is that operating expenses will return back into the range of 370 million to 375 million, as product development expenses normalized to run rate levels and acquisition synergies offset other costs. We expect other interest and expense to be approximately 38 million in the December quarter and the tax rate to be about 14%.

For earnings, we expect GAAP diluted of $2.13 to $2.43 per share and non-GAAP diluted EPS of $2.39 to $2.69 per share. Our EPS guidance is based on a fully diluted share account of approximately 159 million shares.

In conclusion, the September quarter result demonstrates strong operating performance and relative strengths for KLA across many critical segments and what remains in environment with some headwinds. With our diversified end markets, continued technology leadership across the broad product portfolio and operational discipline, KLA is delivering strong relative performance and we're encouraged by the momentum we've seen in our business.

Before I turn the call over to Kevin to begin the Q&A, I'd like to make a few qualitative comments on our outlook for the wafer fab equipment market in 2020. While it is too early for us to provide specific guidance or have to have trajectories for the year, we continue to see a strong year for foundry and logic investment with investment levels consistent with what we've experienced in 2019.

As customers continue to progress through technology roadmaps and a strong demand environment, with improving competitive dynamics in diversify in demand. For memory, we expect a better year in 2020 as disciplined supply management in 2019 has approved the overall condition of both segments.

Given the strength of our market position, the purchasing behavior of process control and foundry and logic, improving process control intensity and memory and contributions from new products. Calendar 2020 is setting up another year relative outperformance for KLA. We'll have more to say on this when we reported earnings for the December quarter.

I'll now turn the call back over to Kevin to begin the Q&A. Kevin.

Kevin Kessel

Thank you, Bren. As we begin the Q&A, we request you limit yourself to one question and one follow up question.

With that, Christian, we're ready for the first question.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question is from John Pitzer from Credit Suisse. Your line is open.

John Pitzer

Rick, I want to go back to one of your comments you made in your prepared comments about the Gen 5 optical inspection platform. You mentioned that you expect shipments to double in 2009 and to that still be a good growth driver in 2020. So, I guess I'm trying to get a sense from you where in sort of the potential of that product cycle over time, do you think we are maybe using a baseball analogy might be the right way to look at it? And as you think about logic, foundry being strong next year, to what extent is that just a call or laundry, on logic foundry CapEx versus perhaps a Gen 5 product cycle that's still in the sweet spot and accelerating?

Rick Wallace

Yes, I think, if I thought about Gen 5 right now, and you want to use baseball at third inning, it's relatively early in the life. We were now in the second iteration of that product in terms of a new platform and there is several iterations to follow. Engineering has been dedicated to that, but we're now starting to see broad adoption, and really the beginning of adoption in production where what we really have been dealing with for the most part in the last couple of years, was during the development cycle.

So, we're still early on and we think it will become a primary tool. We always thought it would become an HVM tool once we got to EUV in ramping in production and it definitely feels like it's doing that. The upside to that is we seen more memory adoption in the Gen 5 memory we originally anticipated. So that's probably upside to what we've originally envisioned.

Bren Higgins

John, it's Bren. The only other thing I'd add to that is as we talked about in our Investor Day, there is an application for radical qualification in the fabs for EUV radicals. So, where as we start to progress that use case is how the tool is used for full wafer coverage to be able to qualify reticle as they're being used in the wafer fab. So, the incremental opportunity there that is slowly evolving, but we think it adds another dimension of growth for Gen 5 as it gets adopted.

John Pitzer

And Bren, maybe just for my follow-up, I want to go back to the operating model you shared at the Analysts Day, around op margin sort of bridge between now and 2023. You're already kind of the head of the revenue, op margin targets you gave in that model, both in the September quarter and in the December guide. And it sounds like December OpEx is unusually high for your comments and in general that op margin target that you gave only assumed incremental op margins to low end of your historical guidance. I hate the obsolete the model listen to quarter out, but can you talk a little bit about whether or not you think there's upside of conservatism to that model you gave at the Analyst Day?

Bren Higgins

Yes, John, it's a good question. I think one of the challenges and putting gathers as a model as it reflects a different mix of business that we have today, but also expected moving forward. So clearly in the September quarter and even in December, what's driving our business in terms of incremental growth is the process control part of the business. And that is beginning consistent with we've historical model that we've had out there.

So anytime the mix is shifting in that direction, you're going to see outperformance against the base model. So what we try to reflect was based on our expectations for growth overtime, what the mix of business would do and how that would impact the model. Obviously, there's synergy and other actions that are in embedded in that. But anytime we have an inflection driven by the process control part of the business, we're going to see a period of outperformance. But in terms of your long-term view, I think it's the right way to think about it.

Operator

The next question is from C.J. Muse from Evercore. Your line is open.

C.J. Muse

I guess first question on the foundry logic side of things. Can you speak to whether you're seeing increasing breadth of spending in that category and then really focused on the leading edge? And as part of that, if you could speak to also reuse that clearly was a headwind, basically from 20-nanometer down, but it sounds like 7 non-EUV progressing to 5 EUV, but that's a seismic shift here, but it's driving a real uptick in process control intensity. Would love to hear your thoughts on both of things?

Rick Wallace

I'll take the question and then Bren will add some color to it as well. It's not very broad right now. I think that the foundry logic is, it's not particularly broadly expected to broaden out next year in '20 as it expands. In terms of reuse, there are a couple of dynamics that are quite different from the prior cycles. One is the just very large number of starts, design starts. So there's a lot of demand being driven by the fact there's so many different devices that are being introduced to these advanced nodes.

So, we don't suspect that they'll be that much. The other thing is we have new product cycle which really adding a lot of capability. So obviously, customers are always trying to optimize their capital, and we'll see them be as efficient as possible, but we don't expect a repeat in the way we've seen in some of the prior cycles. And that's based on our early returns, and all some of the additional challenges the advanced nodes are pushing. Even without brought EUV and once you brought out EUV get even more of that.

Bren Higgins

I think that the big difference between this nodes and let's say 20-nanometer, even down to 14, 16, is we're seeing much broader and market adoption that's driving these design starts through the advanced foundry and the leader there. And so all of that is sort of preventing any reuse is that capacity is deploy to support all that activity. And a high mix environment puts more pressure on yield and delivering to tight product window. So it's a good story and we expect this node to have some legs and certainly the investment for N5 is starting to pick up and stronger expectations for that.

C.J. Muse

If I could speak in a quick second question, you talked about a return to 370, 375 OpEx in margin. I just curious, how should we think about potential synergies related to Orbotech as we move through 2020?

Rick Wallace

Yes, CJ, as I outlined at Investor Day is a number of activities that are happening and we'll see those play through as we move through the year. One of the dynamics that I wanted to put a little bit of extra time into in the prepared remarks was some of the investments that we're making to drive longer term structural cost reduction, namely, relocating some operations from subscale or higher cost regions into lower-cost parts of our global footprint.

So as you're ramping up one team and ultimately ramp down another team, there's some incremental investment, but those have returns over time. So as I think about that range, I think we're in that range as we move in, based on how we're sizing the business right now and thinking about top line will be operating in that range as we move through the year with, the usual program development, expenses that could cause from one direction or the other.

I would think it would probably be lower end or slightly below the range, as we move towards the end of the year and begin the year is probably at the higher end.

Operator

The next question is from Krish Santor from Cowen and Company. Your line is open.

Krish Santor

I just have a quick one, Rick. I know you've kind of spoke about how Gen 5 is going to double in 2020. Is that finally coming from foundry 5 nanometer? Or is there a significant chunk coming from DRAM adoption too?

Bren Higgins

So, Krish, that was -- the comments were that we thought a doubling in '19 from '18, although to Rick's earlier point about Gen 5, I mean, we're really encouraged by starting to see that deployed into production use cases and away from just defect discovery and R&D applications. So -- and then the print check, as that rolls in terms of how it supports EUV radical qualification. So we would expect to see further growth as we move into next year in Gen 5. But we haven't quantify you know how much more I mean, we are shipping both generations to support activity goes for 7 nanometer for 5. But you'll see more adoption of Gen 5 when production is Gen 5.

Rick Wallace

And then just add to Bren's point, what happened in '19 also was penetration across almost every customer, major customer in terms of the early evaluation and use as it sets up the case for the longer run. But that was really a proliferation year for '19 where we got it up and established in all the leading jobs.

Bren Higgins

Yes, I mean, certainly, Krish, just one other thing as I look at the order profile, it would imply -- we're going to have growth in the number of unites as we move into next year. I don't know if it will double, but we'll certainly see growth in adoption next year.

Operator

The next question is from Harlan Sur from JP Morgan. Your line is open.

Harlan Sur

On EUV lithography adoption in your mask inspection business from Analyst Day, I think you could gather that your radical inspection franchise is going to grow pretty strongly this year, up about 45%. But if I look at the shipment profile for ASML, let's say, over the next couple of years, it's still a runway for very strong growth around 25%, 30% shipping CAGR. With that in mind, how should we think about the trajectory of your mass inspection business looking into next year?

Rick Wallace

Yes, I mean, I think Harlan, you're right. We've had a very good year and a down WFE and reticle inspection, and that's been adoption for the Teron inspection, and that's been adoption for the Teron platform, both for optical and EUV inspection support. Some of the drivers moving forward is, yes, the number of scanners but also design starts tends to drive reticle inspection demand. So, we would expect to see some incremental demand on the 7-nanometer size as we see incremental capacity there, and then you'll start to see, some activity as we move into next year.

As we talked about at Analyst Day, we do have a new platform that's specific for EUV inspection that will start shipping in 2020 also. So, you'll see a mix and match, but as we stand today, I think given what's out there for 7-nanometer and then for the layers that will be happening in EUV. We believe we've got the market pretty well serve with the capability that we're offering.

Harlan Sur

And then on the specialty semiconductor segment, you drove pretty good quarterly results despite given the trade headwinds. And so, again, if I look at the trends heading into next year, you've got a big step up in RF content in 5G smartphones and infrastructure. You've got more power products in auto and industrial and of course all these events, packaging and things like system in package. All of this should provide a pretty good backdrop for growth next year, but I wanted to get your initial views in terms of how you're thinking about 2020 for SPTS?

Rick Wallace

Right, well, obviously we're newer to that business, but as we spend more time with the team and spend more time with customers. It does -- it is well positioned to grow. And as you pointed out, we had some headwinds that happened in '19, but still managed to get some traction. 20 looks like a good year for SPTS and our current modeling of it based on what we see for the, as you say for RF supporting 5G. It looks like a, hopefully a 10% to 20% range of growth for that business as we go into next year. So, we feel good about it and we're continuing to learn more about those customers.

Operator

The next question is from Timothy Arcuri from UBS. Your line is open.

Timothy Arcuri

Rick, so if I look at your WFE share this year, you're going to gain about 50 bps of WFE share. But I think a lot of people are looking at fabric FX, and they're sort of worried that this is a near-term peak, at least here in the back half of the year. And if you look at the capital intensity numbers, like we haven't seen these kind of quarterly numbers only really once in the past 20 years from kind of a quarterly capital intensity, point of view for non-memory. So, also people are looking at TSMC CapEx, and it's kind of 5 billion in Q4 and that's kind of $20 billion run rate. So, how do you respond to concerns that this is sort of the near-term peak in foundry and logic shipments? Is that not what you see? Do you see the quarterly shipping rates continuing to grow in foundry and logic next year? Thanks.

Rick Wallace

Well, it is true that we have strength as we mentioned the year half on half, considerable strength, but really not in a lot of customers, there are other customers that will broaden out in next year. And so we feel pretty good about how we're position. We think that the actual mix between foundry and logic and memory for this year is about equivalent to what we see for next year and that's driving some of the capacity or the intensity that we're seeing.

So we feel pretty good about next year. Obviously, we had a good second half of this year. But we're counting on some broadening and again, some of what we're seeing this year is ordering that will actually have deliveries in next year. So we'll see some of the benefits of that revenue next year. Bren, do you want to add any color to that?

Bren Higgins

No, I think Rick covered it. I mean, look, if you think most of the investment we've seen this year is from the leader. And so the broadening out across a pretty diversified in demand environment into next year. We feel comfortable with given the comments we may in the prepared remarks that we see some sustainability and foundry and logic is moving to 2020.

Timothy Arcuri

And then I guess I had a question on Orbotech, if you look at systems revenue, it was pretty flat. It looked like display was still pretty weak. What's assumed for December brand for Orbotech shipments? And what's the outlook for the flat panel display in the PCB business? I guess the real question is, why is the flat panel business still interesting to you? Because it seems like it's kind of on its lows and it would be arguably accretive if you sold it because it has much, much lower margin. So just, can you just kind of talk through all that?

Rick Wallace

Well, so we didn't guide the individual segments. I mean, I will say that, it looks like we'll have an uptick sequentially in FPD next quarter in terms of overall planning. That does tend to be lumpy, but based on the order profile we saw in the June quarter lead time there that those deliveries happen in December and that business is a bill to order business for us and when we get the orders that the schedules hold pretty well.

So I would expect it to uptick. I think, as we think about next year, I don't think we'll see any real recovery in the flat panel business. And I think that after six years of growth, we saw 2020, our 2019 was a difficult year. I don't think it's going to grow much in 2020, either. So, we're focused on the business. I mean, I hear your point. And we're some of the actions we're taking that I refer to in terms of cost structure, cost reduction actions are particular to that business.

And so the first thing we're going to do is get that business in a place that we believe is an acceptable level of profitability, these truck levels and position that we can, as the business recovers, that we can scale it and drive operating leverage through that model.

But we're taking these actions first, I hear your point and we'll see how it plays out over time.

Operator

The next question is from Vivek Arya from Bank of America Merrill Lynch. Your line is open.

Vivek Arya

I had two questions as well. For the first one, I'm curious what is the right way to think about process control intensity in EUV versus non-EUV? I imagine EUV was not as big of a factor this year, do you think it is a bigger factor?

Rick Wallace

Yes, process control intensity for EUV is higher than it is for non-EUV. In spite of the fact that there are fewer layers I mean, obviously the value of the EUV is reduction in layers. And so we would see that that has some mitigating effect on the increased intensity around EUV but you really get process control intensity in a couple ways. One, you get it in the mash off because you have to do more inspection to ensure that you have a high quality mask and we're still as an industry trying to work out some of the challenges, pellicle, non-pellicle and getting mask to be good in the lifetime of the mask.

The other thing is in print check to verify and validate that the Bren mentioned in earlier question, we see rather than opportunity and that's been driving process control intensity around Gen5. So overall it's a plus for some of our businesses, it is a minus for some, but the net-net of it all is process control intensity ticks up in an EUV world as the industry goes forward. And on balance, it's a net positive for KLA.

Vivek Arya

And my follow-up, how large was domestic China's plans for you this year? And just conceptually, how are you thinking about it going into next year?

Rick Wallace

Yes, it's a good question. Actually, as I said the remarks I mean, at the beginning year, we thought it'd be down 10% to 15% from a very solid number in '18 and it turned out with some projects that came back into the year, one major one in particular, we're going to end up with about flat.

And as I look at our preliminary scoping into 2020, and you do have some mix on what kind of projects are going to be invested in. But it looks relatively flat to me again. So I don't see it changing much as we move into 2020. So it's in the $650 million range plus or minus in terms of revenue level for the Company. And I would expect that to stay, it's relatively consistent based on what I see today for 2020.

Vivek Arya

That is not part of outperformance assumption for next year?

Rick Wallace

No, I think, look, it is, I don't think it's going to fall off. I mean, certainly it improved the performance in with a factor and performance improvement in 2019. So as I think about next year. No, I don't, I'm not banking on a lot of extra business in China to deliver the year in terms of our planning. I expect a flattish environment in China.

Operator

The next question is from Quinn Bolton with Needham & Company. Your line is open.

Quinn Bolton

I just wanted to follow up on the question for our Vivek about EUV driving higher process intensity. I assumed that's true in the memory side of the business as well. So, as we look at EUV insertion in 1Z and then 1 Alpha processes. Do you see a meaningfully higher process control intensity in those steps, as we see EUV coming into high volume manufacturing? And then I've got a quick follow-up.

Rick Wallace

Yes, I mean, it's early for memory. As you know, they're still trying to figure out what role EUV will play and how many layers, but that is definitely a driver for us in a positive sense again for the same reasons you have the mask shop and you have on the wafer and you have a reduction of layers counter balancing it. I don't think there's a huge change in the intensity. It's a nudge up, but it's not a big change in the overall intensity, maybe on the order of, if you're going to be at an average of say, 10% process control intensity, you might get half a point to a point of increase in terms of overall process control intensity on that. So it depends, but it will depend how much it's deployed. And ultimately, it'll also depend on what the strategy is relative to what people are going to do with pellicles or not do, have pellicles. It will change a little bit how it plays out for us.

Quinn Bolton

And then follow up question just it sounds like, you're getting a little bit more optimistic in the memory side of the business, and that might be somewhat driven by the indigenous Chinese guide. But just wondering, if you could comment based on sort of orders for the Surfscan business. Are you seeing and starting to see better activity in the NAND business? Or is it fairly isolated to sort of the customers at this point, you wouldn't call it kind of the mitigating of a broader base recovery?

Rick Wallace

No, I wouldn't call it that. I mean, certainly that business inflected pretty strongly through calendar '18. And so it's been down this year. And I would expect to see a little bit of recovery in the wafer part of that, which ultimately supports memory in 2020. But right now, I think it's too early to see that that impacts. So I wouldn't say it that isn't a leading indicator of new business. But certainly given the market position and that products and how memory drives wafers, it easy to pick up in memory, we will see, will do so that will see that business impacted.

Operator

The next question is from Joe Quatrochi from Wells Fargo. Your line is open.

Joe Quatrochi

As it relates to your service business, I was wondering if you could give us an update on some of the capacity idling that you've seen particularly on the memory side and your installed base, and maybe how do we think about that relative to the gross margin guide for the December quarter?

Rick Wallace

Yes, I know, it's a good question. I mean, one of the things that we are seeing and drove an uptick in the revenue level for service, quarter-to-quarter was a reduction in reduction in idling, so more of that capacity being utilized. And so that drove some incremental revenue to the service line for the semiconductor side of the business. So, look you do have a gross margin impact to growth in service on the overall model, which is contemplated in the guidance that we give generally.

And I think you keep in mind is with our service business as it grows, the profitability stream, we believe is in a creative stream to the overall total. So, it's not affecting I think quarter-to-quarter, it has very little effect on the overall gross margin, in terms of the guidance. So it's really -- when I think about guidance quarter-to-quarter it's mostly around some of the product dynamics and how that plays through our model.

Joe Quatrochi

And then on the specialty semi side, now I think you're calling for flat this year. Can you help us understand it -- was there any incremental impact indirectly from Huawei or is this more related to weakness that you're seeing in just general demand?

Bren Higgins

Yes, I would say, the incremental effect that we talked about last quarter, so we continue to see that and we talked about, if I recall in $40-ish million impact for the year related to that one in particular, there are broader trade issues. Certainly, there's the issue with Korea and Japan and how that's affecting Korean and Osats. So there are a number of trade issues beyond Huawei that's affecting that business down the long run, as those customers in that area or the any customer, the customers customer service to redesign around some of these issues, it creates opportunities for us

So, but in this year, it's affecting that business. Also automotive has been on the margin a little bit weaker, so that's so that's affected that business as well. So it's still showing I think a decent result this year against the backdrop of the WFE environment we're in, and we'd expect to see it recover next year in terms of growth, as Rick suggested earlier. But, business has really good market position, I think the long term drivers around 5G, advanced packaging power and so on, are good ones. And so we're encouraged by what we see and we like the business models of that business.

Rick Wallace

Yes, and more specifically, I think on Huawei it's not about. The reactions of the suppliers to Huawei, it was -- there was uncertainty when the first came and trying to figure out, and I think everybody froze. So, the baseball analogy would be there was a rain delay in terms of trying to figure out what the next step was. And now there is more activity going on in the supply chain, so we think that business ultimately comes back, but it was impacted probably more and longer in the year because just uncertainty around that. Now, I think people are dealing with it and that'll actually cause the business to resume its growth.

Operator

The next question is from Patrick Ho from Stifel. Your line is open.

Patrick Ho

Maybe first off, in the past, you talked about increasing metrology intensity on the NAND flash side, things particularly latest increase, as the industry starts shifting to 128 layers, do you see any potential new opportunities on the inspection side, given the complexity of layers then the increased number of layers for next generation devices?

Rick Wallace

I think the main opportunity. It's good question, Patrick. The main opportunity for inspection is really and what's happening on the bear wafer on Surfscan and dealing with the flatness requirements as the wafers get higher both cleanliness and flatness. So it may be less obvious at first. I mean, we've talked in the past about being hopeful about finding defects in the trenches, but it's probably more flatness driven and desire to have clean wafer. So that's where I've really been where we see it. Metrology has some opportunities we talked about at the end of this day with the work we have on CD Sacks in terms of great opportunity there. But specifically for inspection is more about Surfscan.

Patrick Ho

My follow up question in terms of the domestic China opportunity, obviously we're seeing some of this capacity built again and you're benefiting from new capacity build up. But giving some of it is also trailing edge logic type of capacity, those is simply because their new capacity, or are there opportunities within the, I guess the foundry and logic segment of that region that you see new opportunities both for years, especially in metrology products?

Rick Wallace

Yes, I think there are a number of players that are small, maybe subscale in terms of what you think about it's a larger. So there's actually some inefficiency in that supply chain, if you're starting smaller companies in terms of trying to support for a strategic region, reasons. So that kind of creates additional demand for us and we're benefiting from that.

Also, I think that as they're trying to figure out some of these capabilities, then there's opportunity for us to help them and that drives both good share, but also good intensity. And then lastly, I think the move for auto is China's important auto market. There are more specialty semiconductors and there's more opportunity for us there as a result.

Bren Higgins

Patrick, I mean, look, I think this year is a heavier memory year in China, not by much, I'd say probably of our mix semiconductor business is 55, 45 to memory. And look at calendar '20 and it's pretty balanced. So, to your point, there's a lot of activity around IoT, we're talking about automotive. And so the yields learning challenges and logic are more complicated. The tools that we are shipping are configurable in terms of helping customers meet their requirements, also providing some upgrade path as they start to progress, some of their technology.

So, and they're serving, I think real markets, ultimately. And so I think they're designing for specific opportunities, which is good just in terms of the long-term trajectory of that investment in their viability. So we feel pretty good about all of it. And I think it's a mix across both segments there.

Operator

Your final question is from the Toshiya Hari from Goldman Sachs. Your line is open.

Toshiya Hari

I just wanted to go back to the half over half kind of cadence for your business going into next year. You guys accurately called your core process control business being up, I guess, every quarter on a sequential basis, this year, a couple quarters ago. So I guess the question is based on, customer projects based on customer conversations. What are your thoughts into the first half of 2020 relative to the second half of '19? Do you think you can grow your business or should we be expecting more of a flattish outlook on half over half basis? Thank you.

Rick Wallace

Well, like I said, I think we're a little early guide second half or have to have trajectories and obviously I think that this part of how we do in the fourth quarter will impact how the March quarter lines up. I mean, across the segments again, as we said earlier, we feel that there's broadening and sustainability investment in logic and foundry.

I mean, if you just take a step back and look at the second half of 20-ish% over the first half, it does obviously imply, the WFE is higher in the first half or the second half versus first half. So the run rate of this WFE is probably 10% to 15% kind of growth into next year of these levels. So it does imply that you've got a second half, you have to have that kind of growth to sort of sustain at this level of business, but I think that's probably as far as I can go with this point.

Bren Higgins

Yes, I guess what I would add to that is, we feel pretty good about understanding our position relative to WFE. We're now in a great position to predict WFE.

Toshiya Hari

Yes, it does. As a quick follow-up, on China, on native China WFE, I think Bren, you talked about 2020. At least at this point kind of looking kind of flattest relative to 2019, when you think about the mix of spend on process control, does that move higher or what are your preliminary thoughts on that?

Bren Higgins

Yes, I know, as I said earlier, I think it's balanced across the business and we expect them expect a flattish level of business in 2020. So not expecting, at least for our business, not expecting growth and not expecting decline in 2020 at this point, we'll see how it plays out, but that's where we where we stand today.

Operator

Thank you and that concludes the Q&A session. I would now like to turn the call over back to Mr. Kessel for closing remarks.

Kevin Kessel

Yes. Thank you, Christian, and thank you everyone for your time today and interest in KLA. Christian, please conclude the call.

Operator

Ladies and gentlemen, that concludes today's conference call. Thank you for participating and you may now disconnect. Have a good day everyone.