

Wow!: LRCX-KLAC Merger, Huge Value Creation, Just What the Doctor Ordered

October 21, 2015

LRCX Combining with KLAC

Lam Research Corporation (NASDAQ: LRCX) ("Lam") and KLA-Tencor Corporation (NASDAQ: KLAC) ("KLA-Tencor") today announced that they have entered into a definitive agreement, unanimously approved by the boards of directors of both companies, for Lam Research to acquire all outstanding KLA-Tencor shares in a cash and stock transaction.

We think that this is the reason that LRCX had floated the \$1B Senior Notes and also the reason why KLAC had gone through a 10% layoff this year.

Terms?

KLA-Tencor shareholders will be entitled to receive the economic equivalent of \$32.00 in cash and 0.5 of a share of Lam Research common stock, in all-cash, all-stock, or mixed consideration, subject to proration as more fully described in the merger agreement. The transaction values KLA-Tencor at approximately \$67.02 per share, or \$10.6B in equity value based on the closing stock price of LRCX on October 20, 2015.

Combined Company:

The KLA/Lam combined company will have approximately \$8.7 billion in pro forma annual revenue. The transaction will be accretive to Lam's non-GAAP earnings and free cash flow per share during the first 12 months post-closing. The combined company expects to realize \$250 million in annualized cost synergies within 18 to 24 months of closing and anticipates generating approximately \$600 million in incremental annual revenue by 2020 through improved differentiation of each company's products and creation of new capabilities.

Funding: Lam intends to fund the cash consideration for the transaction and repayment of KLA-Tencor's currently outstanding term loan using approximately \$1.9B of cash on hand from the combined companies and approximately \$3.9B in debt financing. The company intends to provide a direct, unconditional guarantee of KLA-Tencor's senior notes upon the closing. Lam has obtained commitment for \$4.2 billion of bridge financing for the transaction from Goldman Sachs Bank USA and Goldman Sachs Lending Partners LLC. Lam is committed to maintaining its investment grade rating. The transaction is not subject to financing.

Closing: The transaction is expected to close in mid-calendar year 2016, pending the receipt of customary regulatory approvals.

Analysis: This is just what the doctor ordered. It removes excessive dependence of LRCX on memory and excessive dependence of KLAC on foundry/logic. We expect minimal opposition to this deal from the various jurisdictions, rather easily handled. Second, this deal is quite negative for Applied Materials (AMAT) and Hermes Microvision and perhaps for ASML also. In the case of AMAT, their process diagnostics and control division being based in Israel does not allow of meshing of capabilities, and product synergies really don't exist. In the case of Hermes Microvision, since etch is the pre-dominant user of e-beam inspection due to testing of contacts, a combination of KLAC and LRCX with both e-beam and etch capabilities can be lethal.

Some more details while we crunch the numbers: GM 49%-50%. Op.M 21-23%, both firms pay dividends, total adds up \$3.28.

We think that both LRCX and KLAC stocks will react positively to the news.

Semiconductor, Semi-cap Equipment

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I, Srinu Sundararajan, hereby certify that the views expressed in the foregoing research report accurately reflect my personal views about the subject securities and issuer(s) as of the date of this report. I further certify that no part of my compensation was, is, or will be directly, or indirectly, related to the specific recommendations or view contained in this research report.

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Summit Research Ratings Distribution/IB Services

	Count	Percent	IB services/Past 12m	
			Count	Percent
BUY	36	62%	0	0%
HOLD	21	36%	0	0%
SELL	1	2%	0	0%
Total	58	100%	0	0%

Summit Research stock ratings:

Buy (BUY): The stock is expected to outperform the broader market by 10% over the next 12 months, in the analyst's opinion.

Sell (SELL): The stock is expected to underperform the broader market by 10% over the next 12 months, in the analyst's opinion.

Hold (HOLD): The stock is expected to perform approximately in line with the broader market in the next 12 months, in the analyst's opinion.

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