

Q4 Fiscal 2020 Earnings Call

PREPARED REMARKS | NOVEMBER 12, 2020



MICHAEL SULLIVAN | Corporate Vice President, Investor Relations

Good afternoon everyone.

And thank you for joining Applied's fourth quarter of fiscal 2020 earnings call. Joining me are Gary Dickerson, our President and CEO, and Dan Durn, our Chief Financial Officer.

Before we begin, I'd like to remind you that today's call contains forward-looking statements which are subject to risks and uncertainties that could cause our actual results to differ. Information concerning the risks and uncertainties is contained in Applied's most recent Form 10-Q and 8-K filings with the SEC. Today's call also includes non-GAAP financial measures. Reconciliations to GAAP measures are found in today's earnings press release and in our quarterly earnings materials, which are available on the IR page of our website at appliedmaterials.com.

And now, I'd like to turn the call over to Gary Dickerson.

GARY DICKERSON | President and Chief Executive Officer

INTRODUCTION

Thanks Mike.

I am very pleased to report that Applied Materials delivered record revenue in our fourth fiscal quarter and earnings hit an annualized run-rate of \$5 per share for the first time. For the fiscal year, we grew revenues 18% and earnings 37% while making significant, strategic investments in new technologies and products to address the industry's highest value problems and position the company for sustained, long-term success. These results are all the more impressive considering the unprecedented disruptions we've navigated this year.

I really want to thank all our employees, suppliers and partners for their resilience and adaptability. Our teams have switched to new ways of working, delivered on our commitments to customers and investors, and kept our technology and product development on track.

While our actions to date are driven by a need to protect the health and safety of our employees while keeping our company strong, I am very excited about the long-term benefits of working in new ways, especially remote support and R&D.

In today's call, I'll begin by sharing our current view of the market environment. Then, as this is the end of our fiscal year, I'll highlight some of our major accomplishments in 2020, before describing the growth drivers and inflections that will shape our markets over the next several years. I'll conclude by outlining our strategy and investments that will drive Applied's long-term profitable growth.

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NEAR-TERM MARKET DYNAMICS

As we adapt to the challenges created by COVID-19 and prepare for the post-pandemic era, we are seeing fundamental changes in many areas of our lives and the world is depending on semiconductors more than ever. Investments in IT and communications infrastructure, combined with the accelerated digital transformation of companies and the economy as a whole, are driving very robust semiconductor and wafer fab equipment demand.

In foundry-logic, we see leading-edge customers building out their fabs and aggressively driving advanced R&D. This gives us confidence that current investment levels are sustainable into 2021 and beyond. In addition, specialty markets underperformed in 2020 due to headwinds in industrial and automotive, and therefore represent an upside for 2021 as these sectors rebound.

In memory, spending is growing faster than foundry-logic this year as customers push forward with their technology roadmaps. We see NAND outgrowing DRAM in 2020, and then DRAM growing significantly faster than NAND in 2021.

Consistent with the perspective we shared on the August call, our outlook remains very positive. We are outperforming the market and we are demonstrating we can grow independent of the spending mix.

KEY ACCOMPLISHMENTS IN 2020 / GROWTH PROOF POINTS

This quarter, semiconductor systems revenues were an all-time record and – at the mid-point of our guidance – will be up another 12% next quarter. For the fiscal year, semi systems revenue grew 26%, with broad-based strength across products and device types.

Our traditional leadership businesses – that provide solutions for creating and modifying materials and structures – are benefiting from innovations that enable leading-edge transistors and interconnects. For example, our metals deposition business – technology that is critical to interconnect performance – grew revenues 42% in fiscal 2020 to nearly \$2.2 billion.

In our businesses that focus on shaping and analyzing materials and structures, we have significant opportunities to grow our share and we're demonstrating our strong momentum. In fiscal 2020, our etch business generated record revenues, growing nearly 30% year-on-year. We are gaining share in conductor etch as we win new applications in DRAM and foundry-logic. Our inspection business also delivered record performance, as systems revenues increased 46% for the year. We have significant traction with leading-edge customers and are winning share in optical wafer inspection and E-beam with new products that are still in early stages of adoption.

As the benefits of traditional 2D Moore's Law scaling slow down, leading companies are describing how the industry is transitioning to a new playbook to drive Performance, Power, Area-Cost and Time-to-Market of new devices. This PPACT playbook includes new architectures, new structures, new materials, new ways to shrink geometries and new packaging technology.

Applied is uniquely positioned to accelerate this playbook. The breadth of our product portfolio is a key advantage because it allows us to combine technologies in innovative new ways. For example, in

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patterning – where we generated nearly \$1.1 billion of revenue in fiscal 2020 – we have been winning new applications across multiple customers with a new product that delivers a novel hard-mask material combined with a co-optimized etch solution to open the hard-mask. This is a great example of a new class of highly differentiated products we call Integrated Materials Solutions or IMS. We have numerous IMS engagements with our leading customers and I'm very excited about the IMS products we'll be bringing to market in the next several years.

Another area where we are creating value using our broad capabilities is advanced packaging that enables chips to be connected in new ways. Our packaging business is scaling, generating record revenues of half a billion dollars for the year, up over 20% from fiscal 2019. We are also expanding our eco-system footprint through a combination of organic investments and partnerships.

Moving to service, AGS also delivered record revenues for the quarter and the year. The portion of AGS revenue generated from subscription-style business also grew to record levels. In fiscal 2020, we increased the number of tools covered by long-term service agreements by 13%. As a result, 60% of our service and spare parts business now comes from these stickier and more predictable recurring revenue streams. Our renewal rates for long-term agreements are also very high, at more than 90%. This illustrates the value customers see in our advanced service products.

Rounding out our portfolio with Display, we hit our 2020 revenue target in a challenging market. Our outlook for 2021 is similar to this year – with no significant changes to the view we shared in our last call. However, we are starting to see some encouraging leading indicators of future growth that we'll be watching closely in 2021. These include: increasing adoption of Organic LED displays – OLED – for IT applications, higher OLED adoption in the smartphone market with more than 70% of the 5G handsets launched to date equipped with OLED screens and foldable OLED handsets approaching a price point that could spur volume adoption. As I've said before, we are optimistic about the long-term opportunities for Applied in the display market as we focus on addressing the OLED inflection and expanding our available market.

Finally, as I look back on our accomplishments this year, I am also very proud of our new 10-year roadmap for environmental and social responsibility that we announced over the summer. This roadmap lays out the detailed actions behind our vision to 'Make Possible a Better Future' for everyone. We've taken a holistic approach to these plans that considers our operations, how we work with customers and suppliers, and how our technology can be used to advance sustainability on a global scale. We call our framework 1x–100x–10,000x, and we've used it to rally the company around challenging new goals and commitments.

FUTURE GROWTH DRIVERS

Before I conclude, I'll take a few minutes to describe the longer-term growth drivers we see for Applied. As I look ahead to the next decade, our opportunities have never been better. There are numerous, trillion-dollar inflections that can be enabled by advances in materials engineering – from next generation displays and AR/VR, to electrification of transport and personalized healthcare. However, the one inflection that really stands out is AI. AI has the potential to change everything and it will touch every major industry and area of the economy.

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AI also has major implications for the electronics and semiconductor eco-system: First, we are moving from an application-centric to a data-first world where almost all data will be generated and consumed by machines. This means that the industry's growth will no longer be limited by humans' ability to create or consume data. Second, the new computing approaches needed to make sense of the massive volumes of data available will work best with workload-specific hardware built from customized and entirely new types of silicon. This diversification of designs and devices is great for the industry. And third, training neural networks for AI computing is incredibly power intensive – so there is a huge imperative for the industry to drive improvements in the performance-per-watt of computing solutions.

The advances in technology needed to unlock the potential of AI create tremendous opportunities for Applied Materials. We have aligned our strategy and investments around this vision for the future. And, we are uniquely positioned to accelerate the industry's new PPACt playbook – to advance Power, Performance, Area-Cost and Time-to-market of next generation semi devices.

SUMMARY

Before I hand the call over to Dan, let me quickly summarize:

Despite the unprecedented challenges of 2020, Applied is delivering record performance. We are outperforming the market overall and have strong momentum in key growth areas like etch and inspection. The demand outlook for semiconductors remains very strong, driven by IT infrastructure, digital transformation of businesses, and an acceleration of longer-term technology trends, especially AI. Our future opportunities have never been better. We have been investing in next-generation technologies that are critical for the AI ecosystem and laying the groundwork for Applied's future growth. Our strategy to accelerate the PPACt playbook is already yielding results for our customers and Applied. And, as I look ahead, I am very excited about the innovative new products and integrated solutions we will bring to market in 2021 and beyond.

Now, I will turn the call over to Dan.

DAN DURN | Senior Vice President, Chief Financial Officer

Thanks Gary.

Today, I'll add my perspective on our Q4 performance and full-year results. I'll share some noteworthy developments in our installed base business and I'll provide you with our backlog entering our next fiscal year along with our business outlook for Q1.

Q4 OVERALL PERFORMANCE

Beginning with our Q4 performance, I'm pleased that our company delivered record revenue and earnings per share despite the ongoing challenges related to COVID.

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Our teams managed to significantly increase our system shipments and customer support and we did this in a very disciplined manner that resulted in higher operating profits and free cash flow. We've now shipped all the unmet backlog from earlier in the year and our Q1 guidance gives you a direct look at the healthy demand trends we continue to see in our business.

Q4 RESULTS

In Q4, we delivered revenue above the midpoint of our guidance across all of the segments including record revenue in Semi Systems and AGS. We grew revenue by 25% versus the same period last year, increased non-GAAP operating profit by 49% year-on-year, and delivered record non-GAAP EPS of \$1.25 cents – which was up 56% year-over-year. We also increased operating cash flow to over \$1.3 billion, up 59% year-over-year.

TRADE SITUATION

About two months into our quarter, the U.S. government imposed a licensing requirement related to one of our foundry customers in China. This requirement reduced our revenue in Q4 and our guidance for Q1. We've already applied for licenses where needed to comply with the new rules.

FY2020 GROWTH: SEMI AND INSTALLED BASE BUSINESS

Turning to our full-year results, I'm especially pleased with the growth of our semiconductor-related businesses. Semi Systems and AGS combined grew by over 20%, year-over-year. Our installed base business, which includes AGS plus 300mm upgrades, grew by over 9% year-on-year and continues to represent close to a third of Applied's revenue. This growing part of our company provides an annuity-like revenue stream that makes us more resilient across market cycles.

LONG-TERM SERVICE AGREEMENTS

Within AGS, we've seen positive developments in our long-term service agreements. Until recently, the vast majority of our agreements had one-year terms, but in 2020, about a third of the agreements we signed had terms of at least three years. We've increased these extended service agreements by a factor of 10 over the past three years.

This outstanding growth underscores the close working relationships we have with customers who are using our data-enabled services over the life of a node to generate world-class yields, output and costs. In fact, in 2020, we grew the installed base of our data-enabled tools by nearly 40%.

FY2020 GROWTH: COMPANY

For the company as a whole in 2020, we delivered record revenue in both Semi Systems and AGS. We increased non-GAAP gross margin by 110 basis points, invested 69% of non-GAAP OpEx in research and development, grew non-GAAP operating profit by 32%, and increased EPS by 37%.

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FY2020 CAPITAL RETURNS AND KOKUSAI ELECTRIC DEAL STATUS

We also generated \$3.8 billion in operating cash flow setting a new record and returned \$1.44 billion to shareholders. We raised the dividend for the third year in a row, paid dividends of \$787 million, and allocated nearly \$650 million to stock buybacks, repurchasing at an average price of \$56.32.

We increased cash on the balance sheet by nearly \$2 billion as we prepared for the Kokusai Electric transaction. In Q4, our stock buybacks were limited to \$50 million as our legal department imposed a trading blackout out of an abundance of caution in connection with our discussions with the Chinese regulatory agency that is reviewing the Kokusai Electric transaction. We continue to have constructive discussions and we're working to secure clearance for the transaction before the end of the calendar year.

BACKLOG

Next I'll share some color regarding the demand we see as we enter our new fiscal year.

Applied's backlog reached nearly \$6.7 billion in Q4, setting a new year-end record. The combined backlog of our semi-related businesses also set a year-end record, growing to nearly \$5.5 billion. Our Display backlog declined year-over-year and, as Gary discussed, we're tracking the leading indicators of the eventual recovery.

Q1 BUSINESS OUTLOOK

Now I'll share our Q1 business outlook.

We expect company revenue to be approximately \$4.95 billion, plus or minus \$200 million, with the midpoint up about 19%, year-over-year. We expect non-GAAP EPS to be about \$1.26 plus or minus 6 cents, or up nearly 30%, year-over-year.

Within this outlook, we project Semiconductor Systems revenue of around \$3.45 billion, up nearly 23% year-over-year, AGS revenue of about \$1.07 billion, up around 7% year-over-year, and Display revenue of around \$400 million, up about 20% year-on-year.

We expect non-GAAP gross margin to be about 45.3%, which is higher year-over-year and lower sequentially due to near-term changes in product and customer mix. We expect Non-GAAP OpEx to increase to \$860 million reflecting higher expenses from a 14-week quarter plus one month of annual merit increases partially offset by holiday shut-down savings.

Our Q1 guidance assumes a tax rate of around 12% and a weighted average share count of around 925 million.

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SUMMARY

In summary, I'm pleased that Applied delivered record performance in Q4 and has strong momentum entering our new fiscal year. Our backlog is at record levels as our products and technology generate strong customer pull. Our installed base business is becoming larger and more resilient with growth in our data-enabled services and multiyear service agreements. I'm incredibly proud of our teams for supporting our customers under challenging global circumstances while delivering record earnings and increased cash flow to our shareholders.

Now Mike, let's begin the Q&A.