

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

Form 10-K

Mark one

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended October 25, 1998

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to  
Commission file number 0-6920

APPLIED MATERIALS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	94-1655526
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3050 Bowers Avenue, Santa Clara, California	95054
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (408) 727-5555

Securities registered pursuant to Section 12(b) of the Act:

Title of class	Name of each exchange on which registered
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None	None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.01 par value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Aggregate market value of the voting stock held by nonaffiliates of the registrant as of December 18, 1998: \$16,799,361,740

Number of shares outstanding of the issuer's Common Stock, \$.01 par value, as of December 18, 1998: 371,763,263

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Applied Materials 1998 Annual Report for the year ended October 25, 1998 are incorporated by reference into Parts I, II and IV of this Form 10-K.

Portions of the definitive Proxy Statement for Applied Materials' Annual Meeting of Stockholders to be held on March 31, 1999 are incorporated by reference into Part III of this Form 10-K.

When used in this Form 10-K, the words "anticipate," "estimate," "expect," and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect management's opinion as of the date hereof and are subject to certain risks and uncertainties that could cause actual results to differ materially from those stated or implied. Applied Materials, Inc. (Applied Materials or the Company) assumes no obligation to update this information. Risks and uncertainties include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis-Trends, Risks and Uncertainties" in the Applied Materials 1998 Annual Report, which section is incorporated herein by reference.

## PART I

### ITEM 1: BUSINESS

Organized in 1967, Applied Materials develops, manufactures, markets and services semiconductor wafer fabrication equipment and related spare parts for the worldwide semiconductor industry. The Company's customers include semiconductor wafer manufacturers and semiconductor integrated circuit (IC) manufacturers, who either use the ICs they manufacture in their own products or sell them to other companies. In early fiscal 1999, the Company entered the semiconductor and electronics manufacturing execution systems software and services business through its acquisition of Consilium, Inc.

### PRODUCTS

Applied Materials' products are used to build ICs, or chips, on a substrate of material (typically silicon). These products, also referred to as equipment or systems, are designed using sophisticated physics, chemistry and engineering technology to provide chipmakers productive, reliable and cost-effective solutions for the manufacture of their products.

Building a chip requires the deposition of a series of film layers, which may be conductors, insulators (called "dielectrics") or semiconductors. The deposition of these film layers is interspersed with numerous other processes that create circuit patterns, remove portions of the film layers, and perform other functions, such as heat treatment, measurement and inspection. Most advanced chip designs require well over 300 individual steps, so many of these processes are performed multiple times. Most chips are built on a base of silicon, called a wafer, and consist of two main structures. The lower structure is made up of components, typically transistors or capacitors, that perform the "smart" functions of the chip. The upper structure consists of the "interconnect" circuitry that connects the components.

Applied Materials' product line includes equipment capable of performing the following major steps in the chip-building process: film deposition, etching, ion implantation, rapid thermal processing (RTP), chemical mechanical polishing (CMP), reticle inspection, wafer defect detection and review, and metrology. In calendar 1998, the Company estimates that it was the leading supplier of chemical and physical vapor deposition, plasma etch, epitaxial deposition, RTP and CMP systems to the semiconductor industry.

### SYSTEM ARCHITECTURES

The architecture of most semiconductor processing equipment is basically either a "batch" or "single-wafer" type. Batch systems process many wafers at once, whereas single-wafer systems process each wafer individually. Among single-wafer systems, there are single-chamber and multi-chamber designs. Multi-chamber systems can accept two or more individual processing chambers or stations on a "platform" and can process wafers in each of these chambers simultaneously.

In addition to the process precision and control afforded by single-wafer process chambers, the multi-chamber platform concept provides customers a significant benefit in processing productivity and integration. Several process chambers can be mounted on a platform, which acts as a central wafer-handling system. This architecture provides a closed, vacuum controlled environment for the wafer and enables the system to process several wafers simultaneously. Since Applied Materials' first multi-chamber platform (the Precision 5000(R)) was introduced in 1987, the use of multi-chamber platform technology has helped the Company achieve fast and efficient entry into new market segments by allowing new technology development to focus on the process chamber.

Applied Materials is the global leader in single-wafer, multi-chamber platforms, and has four major processing architectures--the Precision 5000, the Centura(R), the Endura(R) and the Producer(TM) platforms, which together have a global installed base exceeding 6,500 systems. These platforms currently support chemical vapor deposition, physical vapor deposition, RTP, epitaxy,

polysilicon and plasma etch technologies. The Company's Mirra(R) CMP, ion implantation, reticle inspection, wafer defect detection and review, and metrology systems each use their own proprietary platform due to the unique nature of their technologies.

#### PROCESS TECHNOLOGIES

Deposition. Deposition is a fundamental step in fabricating an integrated circuit. During deposition, a layer of either electrically insulating (dielectric) or electrically conductive material is deposited or grown on a wafer. The Company offers products in chemical vapor deposition, physical vapor deposition, epitaxial deposition and polysilicon deposition. Additionally, the Company offers certain types of dielectric deposition processes with its RTP systems (see page 5).

Chemical Vapor Deposition (CVD) Systems. CVD is used to deposit films that function as dielectrics (insulators), metals (conductors) or semiconductors (partial conductors). Applied Materials uses three platforms for depositing dielectric CVD films: Precision 5000, Centura and Producer. The Company entered the CVD market with the Precision 5000 platform in 1987, and continued product development on the Precision 5000 and Centura platforms during the 1990s. The Producer was introduced in June 1998 for high-volume blanket film applications, and features unique Twin-Chamber(TM) process modules with two single-wafer process chambers per module unit. Up to three Twin-Chamber modules can be mounted on each Producer platform, thus considerably increasing wafer throughput by allowing six wafers to be processed simultaneously. Producer offers many of the Company's standard dielectric CVD applications for blanket (non-gap-fill) films.

High-Density Plasma CVD (HDP-CVD) is one of the most advanced technology market segments in dielectric CVD because of its ability to fill very small, deep spaces (gaps) without voids. In November 1996, the Company launched a second-generation HDP-CVD technology, called the Ultima HDP-CVD(TM) Centura. A unique "Remote Plasma Clean" technology was first introduced on the Ultima HDP-CVD system, and has since been expanded to other CVD systems, offering "soft" chamber cleaning without damage to chamber parts and virtually zero perfluorocompound "global warming" emissions. This feature provides environmental benefits that are becoming increasingly important to chipmakers.

Other dielectric CVD process technologies include films deposited using plasma-enhanced CVD (PECVD) methods as well as sub-atmospheric CVD (SACVD) methods. A steady stream of chamber enhancements and new chamber designs -- like the zero-consumables xZ(TM)-series of chambers -- have contributed to the continuing acceptance of these products in the most advanced fabs. The Company's newest dielectric film is Black Diamond(TM), a low dielectric constant (low k) film used as insulating material between copper circuit lines.

Metal films are used in specific areas of an integrated circuit to form the interconnect circuitry, or wiring, of a semiconductor device. Applied Materials has offered metal CVD systems since 1989, beginning with blanket tungsten capability on the Precision 5000 CVD system and later extended to the Centura platform. Since that time, tungsten silicide, titanium, titanium nitride and aluminum have been added to the Company's metal CVD capabilities. Fiscal 1998 new process announcements included a proprietary low-resistivity tungsten process that cuts the electrical resistance of tungsten by up to 40 percent. A new type of titanium/titanium nitride (Ti/TiN) process using TiCl<sub>4</sub> chemistry was launched for very small, deep contacts in DRAM (Dynamic Random Access Memory) ICs.

Physical Vapor Deposition (PVD) Systems. PVD is mainly a physical, rather than chemical, process used to deposit metal films on a wafer. Applied Materials entered the PVD market in April 1990 with the Endura PVD system. This system is designed with a multi-chamber, dual-loadlock architecture that moves a wafer through a staged vacuum sequence to an ultra-high vacuum level, which ensures maximum purity of the deposited films. The Endura system, with its many subsequent enhancements, has been the basis for a broad range of advanced PVD applications. A variety of process advancements have also been continually introduced to keep pace with customers' changing technology requirements.

Ion Metal Plasma (IMP) PVD, introduced in 1997, uses a proprietary technology to allow metal atoms to fill very narrow, deep structures with a uniform layer of film. IMP has been generally accepted by the industry as a technology that extends low-cost PVD technology to future processing schemes. IMP technology is used in Applied Materials' Endura Electra(TM) Barrier/Seed Cu system and Endura Ti/TiN Liner/Barrier systems.

The flexible architecture of the Endura system has encouraged the development of integrated processes that combine multiple PVD processes or integrated combinations of metal CVD and PVD technologies. In 1996, two integrated processes combining metal CVD and PVD technologies were announced on the Endura platform. The Endura Advanced Liner system features PVD titanium technology coupled with either CVD TiN or IMP PVD TiN to form the critical liner/barrier films in interconnect structures. The Cool Al(TM)

process uses CVD aluminum and PVD aluminum for the bulk filling of very small, deep interconnect structures. The low temperature of the process is compatible with the low k dielectric films that are being developed to make high speed, multi-level devices at or below 0.25-micron design geometries.

**Epitaxial Deposition Systems.** Epitaxial deposition (epitaxy or epi) systems grow a layer of extremely pure silicon on a wafer in a perfectly uniform crystalline structure to form a high quality base for building certain types of chips. Applied Materials' experience in epi dates from the Company's inception. In 1993, the Company introduced the Epi Centura, a single-wafer, multi-chamber epi system for wafers up to 200mm (8 inches) in diameter. The Epi Centura is also being used to develop and manufacture leading-edge silicon-germanium (SiGe)-based devices for faster performing transistors with lower power consumption.

**Polysilicon Deposition Systems.** Polysilicon (often called poly) is a material used to form various portions of a transistor structure within a semiconductor device. In September 1992, the Company announced the Poly Centura, a single-wafer, multi-chamber system that deposits thin polysilicon films at high temperatures. The Polycide Centura, launched in December 1993, combines chambers for polysilicon and tungsten silicide deposition in an integrated process to create the "polycide" structures found in advanced semiconductors. By depositing both films in a single integrated sequence under vacuum, the Polycide Centura avoids oxide growth at the film interface for high device reliability. An enhancement was made to the system in 1998 called the Polycide xZ system, which features the extension of the integrated polysilicon-tungsten silicide process technology to the most recent "xZ" process chamber for tungsten silicide.

In 1997, using a variant of the technology for polysilicon deposition, Applied Materials launched a new process for depositing high-temperature, single-wafer silicon nitride, a film previously deposited almost exclusively in batch furnaces. The process control of the single-wafer approach results in films of greater uniformity and precision, which is increasingly important as transistor structures shrink to smaller dimensions.

**Dry Etching.** The etching process selectively removes patterned material from the surface of a wafer to create the device structures. With the advent of sub-micron feature sizes, "dry" (plasma) etching has become one of the most frequently-used processes in semiconductor manufacturing. Applied Materials entered the etch market in 1981, and has since introduced systems for etching three basic materials, including metal, silicon and dielectric films.

Since 1993, the Company has launched a series of MxP(TM) process chambers for metal, dielectric and silicon etching, available on both the Precision 5000 and Centura platforms. This reactive ion etch chamber has proven capable of continuous technology improvements, with the latest chamber enhancement in use for 0.25-micron designs. In addition to providing excellent etch technology, MxP chambers are known for reliability and low operating costs in high-volume production environments.

Beginning in 1996, the Company introduced a new series of high-density plasma etch systems for critical, advanced etch applications. The introductions of the Metal Etch DPS(TM) (Decoupled Plasma Source) Centura system and the Silicon Etch DPS Centura system target 0.35-micron and below device designs for etching metal and silicon, respectively. In July 1997, a second-generation chamber design was introduced for the Metal Etch DPS Centura system, employing several key engineering enhancements to the system. Both DPS etch systems offer leading-edge technology for multiple device generations: from 0.35-micron to 0.18-micron feature sizes and beyond.

In April 1997, the Company launched its most advanced, high-density plasma system for etching dielectric films, called the Dielectric Etch IPS(TM) Centura. It is designed for etching very small, deep interconnect structures, including damascene, as well as for other dielectric etch applications.

**Ion Implantation.** Ion implantation inserts carefully controlled amounts of selected impurities or "dopant" elements into parts of a transistor structure to create the electronic properties that govern the transistor's operation. Applied Materials entered the high-current portion of the implant market in 1985 with the Precision Implant 9000 and introduced the Precision Implant 9200 in 1988. In November 1992, the Company introduced a new high-current ion implantation system, the Precision Implant 9500, for the production of high-density semiconductors, such as 16Mb and 64Mb memory devices and advanced microprocessors.

In 1996, the Company introduced a new series of compact implant systems with the Implant xR80, and subsequently added two new systems to the xR family--the Implant xR120 and Implant xR LEAP(TM) (Low Energy Advanced Processing). The xR120 extended the energy range of the xR80 to 120 kilovolts while maintaining the same small size. The xR LEAP enhanced low energy performance by

doubling beam current in the sub-5 kilovolt energy range. These systems were enhanced in 1997 with an "S" series that offers significantly increased system throughput and lower cost of ownership.

In 1998, the low-energy capabilities of the xR LEAP system were being used by many chipmakers to create ultra-shallow junction transistors, enabling denser and higher speed devices. The xR LEAP system is being used in collaboration with the Company's RTP (see below) technology to offer the Ultra-Shallow Junction Equipment Set Solution, a module consisting of both implant and RTP technologies that has been optimized for the highest degree of technical performance. Also in 1998, the Company entered into a collaborative arrangement with Orion Technologies for the development of a completely new generation of ion implant systems.

Rapid Thermal Processing (RTP). RTP subjects the wafer to short, intense bursts of heat to modify the properties of various materials, such as those implanted with dopants. In June 1995, Applied Materials launched its first RTP system, the RTP Centura. Its proprietary temperature sensing and heating calibration technologies allow wafer temperature control that is completely insensitive to wafer backside emissivity. An enhanced version, called the XE model, was introduced in 1997, with a further enhancement, called the XEplus, in August 1998. Moving beyond core heat treatment applications, the Company's RTP system is now also used to deposit very thin dielectric films. A nitric oxide process deposits critical (50 angstroms) gate dielectric layers required for the most advanced logic, DRAM and flash memory devices. A wet oxide process, introduced in 1997, can grow gate oxides as thin as 25 angstroms.

Chemical Mechanical Polishing (CMP). CMP is a process in which uneven film material is removed from the wafer to create a flat (planarized) surface, thus making it easier to pattern subsequent layers before etching. The Company announced its entry into the CMP market with the Mirra CMP system in December 1995. This system uses a four-station, rotating "carousel" design, in which three separate "active" planarization stations process wafers while a fourth station loads and unloads wafers. In June 1997, the Company announced the new Titan Head(TM) polishing unit for the Mirra CMP system, which allows better uniformity and a higher degree of planarity than traditional polishing heads. The Mirra CMP system has steadily expanded its library of CMP processes, which now includes several dielectric films as well as tungsten.

#### RETICLE INSPECTION, WAFER DEFECT DETECTION AND REVIEW, AND METROLOGY

Reticle Inspection. Reticles are high precision quartz plates that contain microscopic images of electronic circuits. These reticles are used to transfer circuit patterns onto semiconductor wafers to fabricate ICs. The reticle must be defect-free, with perfect image fidelity, because any imperfection will be replicated on the wafer. Reticle inspection systems look for possible defects that could be transmitted to the design pattern on the wafer. Applied Materials' RT 8000 reticle inspection system was upgraded in August 1998 to the RT 8200ES with a variety of new features that improved its sensitivity, productivity and reliability to meet the demands of the sub-0.25 micron, 256Mb generation of semiconductor devices. The RT 8200ES doubles the scan speed and throughput of the earlier model and reduces reticle inspection cost. The system's enhanced sensitivity capabilities enable detection for the most advanced technologies such as optical proximity correction and phase-shifting masks.

Wafer Defect Detection and Review. Patterned wafer defect detection systems inspect wafers as they move between processing steps. Defect detection requires advanced image-capturing technology combined with high-speed computer data processing to maintain high yield in chip production. Defects may include particles, design abnormalities and other problems. Launched in February 1998, the WF-731 and WF-736 DUO are used to inspect highly advanced semiconductor devices and perform "on-the-fly" classification of defects as they are detected. Defect Review Scanning Electron Microscopes (DR-SEMs) analyze and then classify even smaller defects on the wafer, such as small particles, scratches or residues. Introduced in May 1998, Applied Materials' SEMVision(TM) system reviews and classifies a broad range of defect types found on blanket or patterned wafers. SEMVision is the industry's first high-throughput, fully automatic DR-SEM, marking a major advance over conventional, manually operated systems.

Metrology. SEMs use an electron beam to image and measure surface features on a semiconductor wafer at a much higher resolution than images captured by optical microscopes. Critical Dimension (CD) SEMs are used by semiconductor makers to measure the "dimension" of critical sub-micron-sized design features on a chip, thus assuring the accuracy of the manufacturing process. Applied Materials' 7830Si CD-SEM, introduced in 1997, generates images of critical device structures having depth to width ratios of up to 10:1 with high resolution of the bottom details of these structures. The production-proven OperatorFree(TM) platform allows advanced measurement of 0.18-micron processes with 3-nanometer precision for lines and spaces.

300mm

Throughout its history, the semiconductor industry has migrated to increasingly larger wafer sizes--from one and two-inch wafers in its early days, through several intermediate sizes, to today's 200mm (8 inch) standard. To gain the economic advantages of a larger surface area on which to fabricate semiconductor devices, the industry is generally anticipating that 300mm (12 inches) will be the next wafer size (300mm wafers have a 2.25x-greater surface area than 200mm wafers). The hardware required for processing 300mm wafers will be entirely new or scaled up from 200mm dimensions depending on the equipment's configuration. The Company is designing some systems with dual 200mm-300mm capabilities.

With many customers in the planning process for possible migration to 300mm wafer fabs, Applied Materials has been developing a complete line of 300mm systems in its mainstream process technologies, covering more than 60 applications. In March 1997, Applied Materials shipped the industry's first 300mm system, for RTP, to a customer. Several other 300mm systems, including epi and CVD systems, have been delivered to customers and to industry consortia at various locations, including a multi-system purchase by Semiconductor 300 in Dresden, Germany, the industry's only operating 300mm fab. The success of these new and enhanced products in the market has yet to be determined. Over the course of fiscal 1998, and particularly in the second half, the Company's 300mm product development efforts were reduced significantly to reflect the semiconductor industry's decision to slow migration to 300mm wafer processing.

#### EQUIPMENT SET SOLUTIONS

Applied Materials is proactive in developing advanced technology that enables chipmakers to meet the demand for more complex chips. In addition to manufacturing, selling and supporting individual systems, the Company has recently begun to offer customers fully supported, integrated "sets" of equipment designed to reduce customers' development and engineering time and enable faster time-to-market when those customers introduce new chip technologies. An Equipment Set Solution(TM) (ESS(TM)) combines multiple systems and/or technologies into a single package.

#### TRANSITION TO NEW MATERIALS

After decades of using the same materials to build ICs, advanced generation devices are now being designed with many new materials. Each new material involves a number of challenges in making it a reliable part of the semiconductor device. The most significant material change involves a switch from aluminum to copper as the conducting material used in the interconnect.

In the next several years, the Company believes that chipmakers will transition from aluminum to copper as the interconnect material in ICs to reduce costs and improve speed and performance. Applied Materials has been working with key customers to develop copper-related technologies and believes that such technologies will be available to meet the anticipated demand. In December 1997, Applied Materials announced the industry's first system for depositing the critical barrier and copper seed layers of the copper interconnect structure -- the Endura Electra Barrier/Seed Cu system. The barrier and seed layers are key to ensuring the integrity of the copper structure.

In November 1998, Applied Materials announced the industry's first integrated, multi-system product for building the copper interconnect structure (Copper Interconnect ESS). Since using copper will demand a new process methodology, the Copper Interconnect ESS eases the transition to these new materials for chipmakers by providing a completely demonstrated, tested and pre-qualified set of systems. This set of systems includes the following products, technologies and services: Black Diamond low k deposition system; Dielectric Etch IPS Centura system; 7830Si CD-SEM; Endura Electra Barrier/Seed Cu system; electroplating technology; Mirra CMP Cu system; low temperature annealing technology; WF-736 DUO system; SEMVision(TM); test chips; mask set for test chips; and Applied Materials' ESS start-up and implementation support package at the customer's location.

The Copper Interconnect ESS can be fully demonstrated in Applied Materials' new Equipment and Process Integration Center (EPIC) facility. Opened in November 1998, EPIC houses all of the equipment and processes needed for chipmakers to develop and test a multi-level metal, completely integrated copper interconnect process before installing it in their fabs.

In addition to the transition to copper wiring on the IC, many chipmakers are planning to incorporate new low k dielectric (insulating) materials between the metal lines to replace the conventional silicon dioxide dielectric for better performance. In November 1998, Applied Materials introduced Black Diamond, a product that provides chipmakers a cost efficient low k dielectric deposition solution for this application. This film can be integrated with other existing process technologies.

There are other new materials being evaluated for use in the transistor structure, particularly high k dielectrics that can store a larger charge in the capacitor of memory chips. The first of these new materials is tantalum pentoxide, which was introduced in July 1998 on the Company's Tanox xZ Centura system.

#### CUSTOMER SERVICE AND SUPPORT

The Installed Base Support Services organization (IBSS) plays a unique and critical role in the Company's ability to satisfy its customers' production requirements. IBSS installs equipment and provides warranty service worldwide through offices located in the United States, Europe (including Israel), Japan, Korea, Taiwan and Asia-Pacific (China and Southeast Asia). IBSS has more than 2,000 highly-trained customer engineers and process support engineers, usually located in or near the customers' fab site, servicing more than 10,000 Applied Materials' systems currently operating in customer facilities. IBSS also manages a complex global spare parts operation. Semiconductor fabrication systems are highly complex, often elaborately customized machines with thousands of specialized parts. Having the required consumable and spare parts available to customers anywhere in the world on very short notice enables a cost-effective, profitable production system. In addition, IBSS provides service and labor, technical training, product enhancements and systems refurbishment.

The Company maintains approximately 79 sales and service offices worldwide, with 29 offices located in North America (primarily the United States), 14 in Europe, 23 in Japan, 6 in Korea, 2 in Taiwan and 5 in Asia-Pacific.

#### BACKLOG

The Company's backlog decreased from \$1.7 billion at October 26, 1997 to \$917 million at October 25, 1998. The Company schedules production of its systems based upon order backlog and customer commitments. Backlog includes only orders for which written authorizations have been accepted and shipment dates within 12 months have been assigned. However, customers may delay delivery of products or cancel orders at their option. Due to possible customer changes in delivery schedules and cancellation of orders, the Company's backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period could have a material adverse effect on the Company's business, financial condition and results of operations.

#### MANUFACTURING, RAW MATERIALS AND SUPPLIES

The Company's manufacturing activities consist primarily of assembling various commercial and proprietary components into finished systems, principally in the United States, with additional operations in England, Israel, Japan, Korea and Taiwan. Production requires some raw materials and a wide variety of mechanical and electrical components that are manufactured to the Company's specifications. The Company uses numerous suppliers to supply parts, components and subassemblies (collectively, "parts") for the manufacture and support of its products. Although the Company makes reasonable efforts to ensure that parts are available from multiple suppliers, this is not always possible; accordingly, certain key parts may be obtained from a single supplier or a limited group of suppliers. These suppliers are, in some cases, thinly capitalized, independent companies that generate significant portions of their business from the Company and/or a small group of other companies in the semiconductor industry. The Company has sought, and will continue to seek, to minimize the risk of production and service interruptions and/or shortages of key parts by: (1) selecting and qualifying alternative suppliers for key parts; (2) monitoring the financial stability of key suppliers; and (3) maintaining appropriate inventories of key parts. There can be no assurance that the Company's results of operations will not be materially and adversely affected if, in the future, the Company is unable to receive a sufficient supply of parts to meet its requirements in a timely and cost-effective manner.

#### MARKETING AND SALES

Because of the highly technical nature of its products, the Company markets its products worldwide through a direct sales force, with sales and service offices in the United States, Europe, Japan, Korea, Taiwan and Asia-Pacific. For the fiscal year ended October 25, 1998, net sales to customers in North America (primarily the United States), Europe, Japan, Korea, Taiwan and Asia-Pacific were 38 percent, 16 percent, 17 percent, 4 percent, 20 percent and 5 percent, respectively, of the Company's total net sales. The Company's business is not usually seasonal in nature, but it is cyclical based on the capital equipment investment patterns of major semiconductor manufacturers. These expenditure patterns are based on many factors, including anticipated market demand for integrated circuits, the development of new technologies and global and regional economic conditions.

The Company sells systems and provides services to customers located throughout the world. Managing global operations and sites located throughout the world presents challenges associated with, among other things, cultural diversities and organizational alignment. Moreover, each region in the global semiconductor equipment market exhibits unique characteristics that can cause capital investment patterns to vary significantly from period to period. Periodic economic downturns, trade balance issues, political instability and fluctuations in interest and foreign currency exchange rates are all risks that could materially and adversely affect, and in the past have affected, global product and service demand, and therefore, the Company's financial performance.

Information on sales to unaffiliated customers, transfers among geographic regions, net sales, income/(loss) from operations and identifiable assets attributable to the Company's geographic regions is included in Note 12 of Notes to Consolidated Financial Statements contained in the Applied Materials 1998 Annual Report, which note is incorporated herein by reference.

#### RESEARCH, DEVELOPMENT AND ENGINEERING

Applied Materials' long-term growth strategy requires continued development of new semiconductor manufacturing technology. The Company's significant investment in research, development and engineering (RD&E) has generally enabled it to deliver new products and technologies before the emergence of strong competition, thus allowing customers to incorporate these products into their manufacturing plans at an early stage in the technology selection cycle. The Company works closely with its global customers to design systems that meet their planned technical and production requirements. Engineering organizations are located in the United States, England, Israel and Japan, with process support and customer demonstration laboratories in the United States, England, Israel, Japan, Korea and Taiwan.

In fiscal 1998, the Company invested \$644 million, or 15.9 percent of net sales, in RD&E for product development and engineering programs to improve or sustain existing product lines. During fiscal 1996 and 1997, RD&E expenses were \$481 million and \$568 million, respectively. The Company has spent an average of 13 percent of net sales on RD&E over the last five years. In addition to RD&E in specific product technologies, the Company maintains ongoing programs in software, automation control systems, materials research, microcontamination and environmental control that have applications to its products.

Key activities during fiscal 1998 involved development of a number of process technologies used in fabricating the copper/low k interconnect structure for emerging copper-based devices. These technologies include copper CMP, electrochemical deposition, copper etch, low k dielectric CVD and inspection/metrology tools.

As part of its technology development program, Applied Materials has built the semiconductor equipment industry's first complete interconnect fabrication line, containing all necessary process tools to fabricate and test the interconnect structures in copper-based devices. This facility enables customers to develop and test a completely integrated copper interconnect process flow before installing it in their fab.

#### COMPETITION

The global semiconductor equipment industry is highly competitive and is characterized by increasingly rapid technological advancements and demanding worldwide service requirements. Applied Materials' ability to compete depends on its ability to continually improve its products, processes and services, as well as its ability to develop new products that meet constantly evolving customer requirements. Each of the Company's products competes in markets defined by the particular wafer fabrication process it performs. There are several companies that compete with Applied Materials in each of these markets. Competitors are primarily based in the United States, Japan and Europe, and range in size from small companies competing in specific market segments (single product) to large multinationals with products that span several market segments. At present, no single company competes with Applied Materials in all of the same market segments. Competitors in a given technology tend to have different degrees of market presence in the various regional geographic markets. Competition is based on many factors, primarily technological advancements, productivity and cost-effectiveness, customer support, contamination control and overall product quality. Management believes that the Company's competitive position in each of its served markets is based on the ability of its products and services to address customer requirements related to these competitive factors. Management believes that the Company is a strong competitor with respect to its products, services and resources. However, new products, pricing pressures, rapid changes in technology and other competitive actions from both new and existing competitors could materially affect the Company's market position.



## APPLIED KOMATSU TECHNOLOGY, INC. JOINT VENTURE

In September 1993, the Company entered into an agreement with Komatsu, Ltd. to form Applied Komatsu Technology, Inc. (AKT), a joint venture corporation that develops, manufactures and markets systems used to produce Flat Panel Displays for laptop, notebook and palmtop computers, desktop monitors, digital/video cameras, portable televisions and instrument displays. During the fourth fiscal quarter of 1998, the Company decided to discontinue the operations of AKT. The Company's interest in this joint venture will be wound down over a period not to exceed twelve months from the date of the decision to discontinue operations. As a result of this decision, AKT has stopped selling PVD and Etch systems and has ceased development efforts on new and next generation systems and technology. AKT will continue to offer its existing CVD product line for sale and will also provide existing customers with ongoing system support. See "Management's Discussion and Analysis - AKT Joint Venture" and Note 4 of Notes to Consolidated Financial Statements, which are incorporated herein by reference from the Applied Materials 1998 Annual Report.

## ACQUISITION

On October 12, 1998, the Company announced that it entered into an agreement to acquire Consilium, Inc. (Consilium), a leading independent supplier of integrated semiconductor and electronics manufacturing execution systems software and services, in a stock-for-stock merger. The acquisition was consummated on December 11, 1998 and will be accounted for as a pooling of interests. The Company issued approximately 2 million shares of its common stock in connection with this transaction. Consilium's financial condition and historical results of operations are not material in relation to the Company's financial condition and historical results of operations.

## PATENTS AND LICENSES

Management believes that the Company's competitive position is significantly dependent upon skills in engineering, production and marketing, rather than its patent position. However, protection of the Company's technology assets by obtaining and enforcing patents is important. Therefore, the Company has an active program to file patent applications in the United States and other countries for inventions that the Company considers significant. The Company has a number of patents in the United States and other countries and additional applications are pending for new developments in its equipment and processes. In addition to patents, the Company also possesses other proprietary intellectual property, including trademarks, know-how, trade secrets and copyrights.

The Company enters into patent and technology licensing agreements with other companies when management determines it is in the Company's best interest. The Company pays royalties under existing patent license agreements for the use, in several of its products, of certain patented technologies that are licensed to the Company for the life of the patents. The Company also receives royalties from licenses granted to third parties. Royalties received from third parties have not been, and are not expected to be, material.

In the normal course of business, the Company from time to time receives and makes inquiries regarding possible patent infringement. In dealing with such inquiries, it may become necessary or useful for the Company to obtain or grant licenses or other rights. However, there can be no assurance that such licenses or rights will be available to the Company on commercially reasonable terms. Although there can be no assurance about the outcome of patent infringement inquiries, the Company believes it is unlikely that their resolution will have a material adverse effect on its financial condition or results of operations.

## ENVIRONMENTAL MATTERS

Two of the Company's locations have been designated as Superfund sites by the United States Environmental Protection Agency since 1987; however, neither compliance with Federal, State and local provisions regulating discharge of materials into the environment, nor remedial agreements or other actions relating to the environment, has had, or is expected to have, a material effect on the Company's capital expenditures, financial condition, results of operations or competitive position. The Company has been designated a "Responsible Party" by the U.S. Environmental Protection Agency with respect to one site and a "Potentially Responsible Party" with respect to the other site.

## EMPLOYEES

At October 25, 1998, the Company employed 12,060 regular employees. In the high-technology industry, competition for highly-skilled employees is intense. The Company believes that its future success is highly dependent upon on its continued ability to attract and retain qualified employees. There can be no assurance that the Company will be able to attract and retain qualified employees. In response to the current semiconductor industry downturn, the Company completed two separate restructuring actions in 1998 that reduced its global workforce by approximately 2,800 employees. All activities of the Company were subject to this restructuring effort. None of the Company's employees are represented by a trade union, and management considers its relations with employees to be good.

## ITEM 2: PROPERTIES

Certain information concerning the Company's principal properties at October 25, 1998 is set forth below:

LOCATION -----	TYPE ----	PRINCIPAL USE -----	SQUARE FOOTAGE -----	OWNERSHIP -----
Santa Clara, CA	Office, plant & warehouse	Headquarters, Marketing, Manufacturing, Distribution, Research and Engineering	968,000 3,120,000 (1)	owned leased
Austin, TX	Office, plant & warehouse	Manufacturing	824,000 320,000	owned leased
Horsham, England	Office, plant & warehouse	Manufacturing, Research and Engineering	126,000	leased
Narita, Japan	Office, plant & warehouse	Manufacturing, Research and Engineering	222,000 (2)	owned
Chunan, Korea	Office, plant & warehouse	Manufacturing, Research and Engineering	107,000	owned
Hsinchu, Taiwan	Office, plant & warehouse	Manufacturing, Research and Engineering	89,000 130,000	owned leased
Tel Aviv, Israel	Office	Research and Engineering	21,000	leased
Nes Ziona, Israel	Office, plant & warehouse	Manufacturing, Research and Engineering	72,000	leased
Yavne, Israel	Office, plant & warehouse	Manufacturing, Research and Engineering	55,000	leased

(1) Includes approximately 765,000 square feet that is either currently being subleased or is being marketed for sublease.

(2) Subject to loans of \$43 million, secured by property and equipment having an approximate net book value of \$63 million at October 25, 1998.

The Company also leases office space for 79 sales and service offices throughout the world: 29 offices are located in North America (primarily the United States), 14 in Europe, 23 in Japan, 6 in Korea, 2 in Taiwan and 5 in Asia-Pacific.

The Company currently owns 167,000 square feet of manufacturing and other operating facilities in California that have not yet been completed and placed in service. In addition, the Company is currently constructing 330,000 square feet of manufacturing facilities in Texas.

The Company also owns 99 acres of buildable land in Austin, Texas, 43 acres of buildable land in Santa Clara, California and 9 acres of buildable land in Narita, Japan. The Austin, Santa Clara and Narita land can accommodate approximately 1,509,000, 1,046,000 and 766,000 square feet, respectively, of additional building space to help satisfy the Company's current and future needs.

Management considers the above facilities suitable and adequate to meet the Company's requirements.

### ITEM 3: LEGAL PROCEEDINGS

In April 1997, the Company initiated separate lawsuits against AST Electronik GmbH and AST Electronik USA, Inc. (collectively AST), and AG Associates, Inc. (AG) (case no. C-97-20375-RWM) in the United States District Court for the Northern District of California, alleging infringement of certain patents concerning rapid thermal processing technology. Discovery has commenced and trial in the AG matter has been set for July 1999. In October 1997, AST and AG each filed counterclaims against the Company alleging patent infringement concerning related technology. AG later filed additional counterclaims, alleging infringement of several patents. These additional counterclaims were dismissed by the court in July 1998. In response, in August 1998, AG filed two separate patent infringement lawsuits based on these same patents, one in the United States District Court for the Northern District of California (case no. C98-03044-WHO) and one in the United States District Court for the District of Delaware (civil action no. 98-479). No trial dates have been set in these actions. The Company and AST have resolved their dispute under terms and conditions set forth in a Memorandum of Understanding signed by the parties, and a final Settlement Agreement is being completed. The settlement is not expected to be material. The Company continues to believe it has meritorious claims and defenses against AG, and intends to pursue them vigorously.

As a result of the Company's acquisition of Orbot Instruments, Ltd. (Orbot), the Company is involved in a lawsuit captioned KLA Instruments Corporation (KLA) v. Orbot (case no. C93-20886-JW) in the United States District Court for the Northern District of California. KLA alleges that Orbot infringes one patent regarding equipment for the inspection of masks and reticles, and seeks an injunction, damages and such other relief as the Court may find appropriate. There has been limited discovery, but no trial date has been set. Management believes it has meritorious defenses and intends to pursue them vigorously.

On June 13, 1997, the Company filed a lawsuit against Varian Associates, Inc. (Varian) captioned Applied Materials, Inc. v. Varian Associates, Inc. (case no. C-97-20523-RMW), alleging infringement of several of the Company's patents concerning physical vapor deposition (PVD) technology. The complaint was later amended on July 7, 1997 to include Novellus Systems, Inc. (Novellus) as a defendant as a result of Novellus' acquisition of Varian's thin film systems PVD business. The Company seeks damages for past infringement, a permanent injunction, treble damages for willful infringement, pre-judgment interest and attorneys' fees. Varian answered the complaint by denying all allegations, counterclaiming for declaratory judgment of invalidity and unenforceability and alleging conduct by the Company in violation of antitrust laws. On June 23, 1997, Novellus filed a separate lawsuit against the Company captioned Novellus Systems, Inc. v. Applied Materials, Inc. (case no. C-97-20551-EAI), alleging infringement by the Company of three patents concerning PVD technology that were formerly owned by Varian. On July 8, 1997, Varian filed a separate lawsuit against the Company captioned Varian Associates, Inc. v. Applied Materials, Inc. (case no. C-97-20597-PVT), alleging a broad range of conduct in violation of federal antitrust laws and state unfair competition and business practice laws. Discovery has commenced in these actions, but no trial dates have been set. Management believes it has meritorious claims and defenses and intends to pursue them vigorously.

During fiscal 1998, the Company settled all outstanding litigation with ASM International N.V. As a result of this settlement, the Company received a convertible note for \$80 million, against which \$15 million was collected in November 1997. Because of the impact of the current industry downturn on ASM's financial condition and liquidity, ASM was not able to pay the \$65 million remaining balance at the maturity date. Therefore, ASM's obligations under the November 1997 litigation settlement agreement were restructured in December 1998. Pursuant to the new agreement, ASM paid \$20 million upon completion of the restructuring, and agreed to pay \$10 million on November 2, 1999 and \$35 million no later than November 2, 2000. Certain other obligations of ASM were also modified; however, these modifications are not expected to be material to the Company's financial condition or results of operations.

In November 1997, OKI Electric Industry, Co., Ltd. (OKI) filed suit against one of the Company's wholly-owned subsidiaries, Applied Materials Japan (AMJ), in Tokyo District Court in Japan, alleging that AMJ is obligated to indemnify OKI for a portion of patent license royalties paid by OKI to Texas Instruments, Inc. Several hearings have been held, but no trial date has been set. Management believes it has meritorious defenses and intends to pursue them vigorously.

The Company is subject to various other legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business. Although the outcome of these claims cannot be predicted with certainty, management does not believe that any of these legal matters will have a material adverse effect on the Company's financial condition or results of operations.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS IN FOURTH FISCAL QUARTER OF 1998

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table and notes thereto identify and set forth information about the Company's five executive officers:

NAME OF INDIVIDUAL -----	CAPACITIES IN WHICH SERVED -----
James C. Morgan(1).....	Chairman of the Board of Directors and Chief Executive Officer
Dan Maydan(2).....	President of the Company and Chairman of Applied Komatsu Technology, Inc.
Joseph R. Bronson(3).....	Senior Vice President, Office of the President, Chief Financial Officer and Chief Administrative Officer
Sasson Somekh(4).....	Senior Vice President, Office of the President
David N.K. Wang(5).....	Senior Vice President, Office of the President

- -----

- (1) Mr. Morgan, age 60, has been Chief Executive Officer since 1977 and Chairman of the Board of Directors since 1987. Mr. Morgan also served as President of the Company from 1976 to 1987.
- (2) Dr. Maydan, age 63, was appointed President of the Company in December 1993. Dr. Maydan served as Executive Vice President from 1990 to December 1993. Prior to that, Dr. Maydan had been Group Vice President since February 1989. Dr. Maydan joined the Company in 1980 as a Director of Technology.
- (3) Mr. Bronson, age 50, was appointed Senior Vice President, Office of the President, Chief Financial Officer and Chief Administrative Officer in January 1998. Mr. Bronson served as Group Vice President from April 1994 to January 1998. Prior to that, Mr. Bronson had been Vice President since November 1990. Mr. Bronson joined the Company in September 1984 as Corporate Controller.
- (4) Dr. Somekh, age 52, was appointed to the Office of the President in January 1998, and was appointed Senior Vice President of the Company in December 1993. Dr. Somekh served as Group Vice President from 1990 to 1993. Prior to that, Dr. Somekh had been a divisional Vice President. Dr. Somekh joined the Company in 1980 as a Project Manager.
- (5) Dr. Wang, age 52, was appointed to the Office of the President in January 1998, and was appointed Senior Vice President of the Company in December 1993. Dr. Wang served as Group Vice President from 1990 to 1993. Prior to that, Dr. Wang had been a divisional Vice President. Dr. Wang joined Applied Materials in 1980 as a Manager, Process Engineering and Applications.

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

"Stock Price History" on page 66 of the Applied Materials 1998 Annual Report is incorporated herein by reference.

The Company's common stock is traded on the Nasdaq over-the-counter market. As of December 18, 1998, there were approximately 5,791 holders of record of the common stock.

To date, the Company has paid no cash dividends to its stockholders. The Company has no plans to pay cash dividends in the near future.

## ITEM 6: SELECTED CONSOLIDATED FINANCIAL DATA

"Selected Consolidated Financial Data" on page 29 of the Applied Materials 1998 Annual Report is incorporated herein by reference.

## ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Management's Discussion and Analysis" on pages 30 through 43 of the Applied Materials 1998 Annual Report is incorporated herein by reference.

## ITEM 7a: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

"Market Risk Disclosure" on page 43 of the Applied Materials 1998 Annual Report is incorporated herein by reference.

## ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP, Independent Accountants, dated November 17, 1998, except as to Note 14 which is dated as of December 23, 1998, and appearing on pages 44 through 64 and page 66 of the Applied Materials 1998 Annual Report, are incorporated herein by reference.

## ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## PART III

Pursuant to Paragraph G(3) of the General Instructions to Form 10-K, portions of the information required by Part III of Form 10-K are incorporated by reference from the Company's Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting of Stockholders ("the Proxy Statement").

## ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

- (a) Information concerning directors of the Company appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.
- (b) For information with respect to Executive Officers, see Part I of this Annual Report on Form 10-K.

## ITEM 11: EXECUTIVE COMPENSATION

Information concerning executive compensation appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.

## ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information concerning the security ownership of certain beneficial owners and management appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.

## ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information concerning certain relationships and related transactions appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.

## PART IV

## ITEM 14: EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

## (a) 1. FINANCIAL STATEMENTS

The consolidated financial statements listed in the accompanying "Index to Financial Statements and Financial Statement Schedule" are incorporated herein by reference from the Applied Materials 1998 Annual Report.

## 2. FINANCIAL STATEMENT SCHEDULE

The financial statement schedule listed in the accompanying "Index to Financial Statements and Financial Statement Schedule" is filed as part of this Annual Report on Form 10-K.

## 3. EXHIBITS

The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Annual Report on Form 10-K.

- (b) The Company filed a Report on Form 8-K on October 23, 1998. The report contains the Company's press release, dated October 23, 1998, announcing the completion of a previously announced restructuring plan and one-time charges for the fourth fiscal quarter of 1998.

INDEX TO FINANCIAL STATEMENTS  
AND FINANCIAL STATEMENT SCHEDULE  
(Item 14(a))

	ANNUAL REPORT PAGE NUMBER -----
 (1) Financial Statements	
Consolidated Statements of Operations for the Fiscal Years Ended October 27, 1996, October 26, 1997 and October 25, 1998.....	44
Consolidated Balance Sheets at October 26, 1997 and October 25, 1998.....	45
Consolidated Statements of Stockholders' Equity for the Fiscal Years Ended October 27, 1996, October 26, 1997 and October 25, 1998.....	46
Consolidated Statements of Cash Flows for the Fiscal Years Ended October 27, 1996, October 26, 1997 and October 25, 1998.....	47
Notes to Consolidated Financial Statements.....	48 - 64
Report of Independent Accountants.....	66
FORM 10-K PAGE NUMBER -----	
 (2) Financial Statement Schedule	
Report of Independent Accountants on Financial Statement Schedule.....	19
Schedule II -- Valuation and Qualifying Accounts.....	20

Schedules not listed above have been omitted because they are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or Notes to Consolidated Financial Statements.

The consolidated financial statements listed in the above index that are included in the Applied Materials 1998 Annual Report are incorporated herein by reference. With the exception of the pages listed in the above index and the portion of such report referred to in items 1, 5, 6, 7, 7a and 8 of this Form 10-K, the Applied Materials 1998 Annual Report is not to be deemed filed as part of this report.

## INDEX TO EXHIBITS

These Exhibits are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K:

EXHIBIT NO. -----	DESCRIPTION -----
2.1	Agreement and Plan of Merger, by and among Applied Materials, Inc., Orion Corp. I, and Opal, Inc. dated as of November 24, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
2.2	Stock Purchase Agreement dated as of November 24, 1996 by and among Applied Materials, Inc., Orbot Instruments, Ltd. and the Stockholders of Orbot Instruments, Ltd., previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
2.3	Agreement and Plan of Merger And Reorganization between Applied Materials, Inc. and Consilium, Inc., previously filed with the Company's Form S-4A dated November 6, 1998, and incorporated herein by reference.
3(i)	Certificate of Incorporation of Applied Materials, Inc., a Delaware corporation, as amended to March 18, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
3(i)(a)	Amendment to Articles of Incorporation dated March 27, 1998, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
3(i)(b)	Articles of Incorporation (as amended to March 27, 1998), previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
3(ii)	Bylaws of Applied Materials, Inc., as amended to December 13, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
4.1	Rights Agreement, dated as of June 14, 1989, between Applied Materials, Inc. and Bank of America NT&SA, as Rights Agent, including Form of Rights Certificate and Form of Summary of Rights to Purchase Common Stock, previously filed with the Company's report on Form 8-K dated June 14, 1989, and incorporated herein by reference.
4.2	Form of Indenture (including form of debt security) dated as of August 24, 1994 between Applied Materials, Inc. and Harris Trust Company of California, as Trustee, previously filed with the Company's Form 8-K on August 17, 1994, and incorporated herein by reference.
10.1*	The 1976 Management Stock Option Plan, as amended to October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
10.2*	Applied Materials, Inc., Supplemental Income Plan, as amended, including Participation Agreements with James C. Morgan, Walter Benzing, and Robert Graham, previously filed with the Company's Form 10-K for fiscal year 1981, and incorporated herein by reference.
10.3*	Amendment to Supplemental Income Plan, dated July 20, 1984, previously filed with the Company's Form 10-K for fiscal year 1984, and incorporated herein by reference.
10.4*	The Applied Materials Employee Financial Assistance Plan, previously filed with the Company's definitive Proxy Statement in connection with the Annual Meeting of Shareholders held on March 5, 1981, and incorporated herein by reference.
10.5*	The 1985 Stock Option Plan for Non-Employee Directors, previously filed with the Company's Form 10-K for fiscal year 1985, and incorporated herein by reference.
10.6*	Amendment 1 to the 1985 Stock Option Plan for Non-Employee Directors dated June 14, 1989, previously filed with the Company's Form 10-K for fiscal year 1989, and incorporated herein by reference.
10.7*	Applied Materials, Inc. Supplemental Income Plan as amended to December 15, 1988, including the Participation Agreement with James C. Morgan, previously filed with the Company's Form 10-K for fiscal year 1988, and incorporated herein by reference.

- 10.8 License Agreement dated January 1, 1992 between the Company and Varian Associates, Inc., previously filed with the Company's Form 10-K for fiscal year 1992, and incorporated herein by reference.
- 10.9\* Amendment dated December 9, 1992 to Applied Materials, Inc. Supplemental Income Plan dated June 4, 1981 (as amended to December 15, 1988), previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.10\* The Applied Materials, Inc. Executive Deferred Compensation Plan dated July 1, 1993 and as amended on September 2, 1993, previously filed with the Company's Form 10-Q for the quarter ended August 1, 1993, and incorporated herein by reference.
- 10.11 Joint Venture Agreement between Applied Materials, Inc. and Komatsu, Ltd. dated September 14, 1993 and exhibits thereto, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference. (Confidential treatment has been requested for certain portions of the agreement).
- 10.12\* Amendment No. 2 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated September 10, 1992, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.13\* Amendment No. 3 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.14\* Amendment No. 2 to the Applied Materials, Inc. Executive Deferred Compensation Plan, dated May 9, 1994, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
- 10.15\* Amendment No. 4 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated December 8, 1993, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
- 10.16\* Applied Komatsu Technology, Inc. 1994 Executive Incentive Stock Purchase Plan, together with forms of Promissory Note, 1994 Executive Incentive Stock Purchase Agreement, and Loan and Security Agreement, previously filed with the Company's Form 10-Q for the quarter ended July 31, 1994, and incorporated herein by reference.
- 10.17\* The Applied Materials, Inc. 1995 Equity Incentive Plan, dated April 5, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.18\* The Applied Materials, Inc. Senior Executive Bonus Plan, dated September 23, 1994, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.19\* The Applied Materials, Inc. Executive Deferred Compensation Plan, as amended and restated on April 1, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.20 Applied Materials, Inc. Medium-Term Notes, Series A Distribution Agreement, dated August 24, 1995, previously filed with the Company's Form 10-K for fiscal year 1995, and incorporated herein by reference.
- 10.21\* Resolution pertaining to the Amendment of the Applied Materials, Inc. 1995 Equity Incentive Plan, adopted by the Stock Option and Compensation Committee of the Board of Directors of Applied Materials on December 12, 1996, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.22 Participation Agreement dated as of April 30, 1997 among Applied Materials, Inc. (as Lessee and Construction Agent), Credit Suisse Leasing 92A, L.P., (as Lessor and Borrower), Greenwich funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.23 Appendix 1 to Participation Agreement, Master Lease Agreement and Loan Agreement, dated as of April 30, 1997 (Definitions and Interpretation) for Applied Materials, Inc., previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.24 Loan Agreement dated as of April 30, 1997 among Credit Suisse Leasing 92A, L.P. (as



- 17 Borrower), Greenwich Funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent) for Revolving Commercial Paper, Eurodollar Credit and Base Rate Program, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.25 Real Estate and Equipment Facility Master Lease dated as of April 30, 1997 between Credit Suisse Leasing 92A, L.P. (as Lessor), and Applied Materials, Inc. (as Lessee), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.26 Underwriting Agreement between Applied Materials, Inc. and Morgan Stanley & Co. Incorporated dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 10.27 Prospectus Supplement for Applied Materials' \$400 million Senior Notes dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 10.28 \$250,000 Five Year Credit Agreement and \$250,000 364-Day Credit Agreement, each dated as of March 13, 1998 among Applied Materials, Inc., Morgan Guaranty Trust Company of New York, as Documentation Agent and Administrative Agent, and Citicorp Securities, Inc., as Syndication Agent, previously filed with the Company's Form 10-Q for the quarter ended April 26, 1998, and incorporated herein by reference.
- 10.29\* Amendment No. 1 to the Applied Materials, Inc. Executive Deferred Compensation Plan dated August 1, 1997, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
- 10.30\* Amendment No. 2 to the Applied Materials, Inc. Executive Deferred Compensation Plan dated December 1, 1997, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
- 10.31\* Applied Materials, Inc. 1995 Equity Incentive Plan, as amended on March 17, 1998, previously filed with the Company's Preliminary Proxy Statement dated January 27, 1998, and incorporated herein by reference.
- 10.32 Letters of Guarantee dated October 28, 1998 between Applied Materials, Inc. and Bank of Tokyo-Mitsubishi, Ltd., Sanwa Bank, Ltd., Sakura Bank, Ltd. and Sumitomo Bank, Ltd. on behalf of Applied Komatsu Technology, Inc.
- 10.33 Promissory Note dated December 15, 1998 between Applied Materials, Inc. and Applied Komatsu Technology America, Inc.
- 10.34 Receivables Purchase Agreement dated October 22, 1998 between Applied Materials, Inc. and Deutsche Financial Services Corporation.
- 10.35\* Amendment No. 1 to the Applied Materials, Inc. Senior Executive Bonus Plan dated September 2, 1998.
- 12.1 Ratio of Earnings to Fixed Charges.
- 13 Applied Materials 1998 Annual Report for the fiscal year ended October 25, 1998 (to the extent expressly incorporated by reference).
- 21 Subsidiaries of Applied Materials, Inc.
- 23 Consent of Independent Accountants.
- 24 Power of Attorney.
- 27 Financial Data Schedule: filed electronically.

- -----  
 \* Indicates, as required by Item 14(a)3, a management contract or compensatory plan or arrangement.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED MATERIALS, INC.

By /s/ JAMES C. MORGAN

-----  
James C. Morgan  
Chairman of the Board and  
Chief Executive Officer

Dated: January 20, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME ----	TITLE -----	DATE ----
/s/ JAMES C. MORGAN ----- James C. Morgan	Chairman of the Board and Chief Executive Officer	January 20, 1999
/s/ JOSEPH R. BRONSON ----- Joseph R. Bronson	Senior Vice President, Office of the President, Chief Financial Officer and Chief Administrative Officer (Principal Financial Officer)	January 20, 1999
/s/ MICHAEL K. O'FARRELL ----- Michael K. O'Farrell	Vice President, Global Controller and Chief Accounting Officer (Principal Accounting Officer)	January 20, 1999

Directors:	
James C. Morgan	Director
Dan Maydan*	Director
Michael H. Armacost*	Director
Deborah A. Coleman*	Director
Herbert M. Dwight, Jr.*	Director
Philip V. Gerdine*	Director
Tsuyoshi Kawanishi*	Director
Paul R. Low*	Director
Alfred J. Stein*	Director

\* By /s/ JAMES C. MORGAN

-----  
James C. Morgan, Attorney-in-Fact \*\*

\*\*By authority of the power of attorney filed herewith.

REPORT OF INDEPENDENT ACCOUNTANTS ON  
FINANCIAL STATEMENT SCHEDULE

To the Board of Directors of Applied Materials, Inc.

Our audits of the consolidated financial statements referred to in our report dated November 17, 1998, except as to Note 14, which is dated as of December 23, 1998, appearing on page 66 of the 1998 Annual Report to Stockholders of Applied Materials, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K), also included an audit of the Financial Statement Schedule listed in Item 14(a) of this Form 10-K. In our opinion, this Financial Statement Schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PRICEWATERHOUSECOOPERS LLP

-----  
PricewaterhouseCoopers LLP

San Jose, California  
November 17, 1998

SCHEDULE II  
 VALUATION AND QUALIFYING ACCOUNTS  
 ALLOWANCE FOR DOUBTFUL ACCOUNTS  
 (Dollars in thousands)

FISCAL YEAR -----	BALANCE AT BEGINNING OF YEAR -----	ADDITIONS- CHARGED TO INCOME -----	DEDUCTIONS -----	BALANCE AT END OF YEAR -----
1996	\$ 3,017	\$ 1,548	\$ (396)	\$ 4,169
1997	\$ 4,169	\$ 2,433	\$ (1,024)	\$ 5,578
1998	\$ 5,578	\$ --	\$ (4,948)	\$ 630

## EXHIBITS INDEX

These Exhibits are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K:

EXHIBIT NO. -----	DESCRIPTION -----
2.1	Agreement and Plan of Merger, by and among Applied Materials, Inc., Orion Corp. I, and Opal, Inc. dated as of November 24, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
2.2	Stock Purchase Agreement dated as of November 24, 1996 by and among Applied Materials, Inc., Orbot Instruments, Ltd. and the Stockholders of Orbot Instruments, Ltd., previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
2.3	Agreement and Plan of Merger And Reorganization between Applied Materials, Inc. and Consilium, Inc., previously filed with the Company's Form S-4A dated November 6, 1998, and incorporated herein by reference.
3(i)	Certificate of Incorporation of Applied Materials, Inc., a Delaware corporation, as amended to March 18, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
3(i)(a)	Amendment to Articles of Incorporation dated March 27, 1998, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
3(i)(b)	Articles of Incorporation (as amended to March 27, 1998), previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
3(ii)	Bylaws of Applied Materials, Inc., as amended to December 13, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
4.1	Rights Agreement, dated as of June 14, 1989, between Applied Materials, Inc. and Bank of America NT&SA, as Rights Agent, including Form of Rights Certificate and Form of Summary of Rights to Purchase Common Stock, previously filed with the Company's report on Form 8-K dated June 14, 1989, and incorporated herein by reference.
4.2	Form of Indenture (including form of debt security) dated as of August 24, 1994 between Applied Materials, Inc. and Harris Trust Company of California, as Trustee, previously filed with the Company's Form 8-K on August 17, 1994, and incorporated herein by reference.
10.1*	The 1976 Management Stock Option Plan, as amended to October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
10.2*	Applied Materials, Inc., Supplemental Income Plan, as amended, including Participation Agreements with James C. Morgan, Walter Benzing, and Robert Graham, previously filed with the Company's Form 10-K for fiscal year 1981, and incorporated herein by reference.
10.3*	Amendment to Supplemental Income Plan, dated July 20, 1984, previously filed with the Company's Form 10-K for fiscal year 1984, and incorporated herein by reference.
10.4*	The Applied Materials Employee Financial Assistance Plan, previously filed with the Company's definitive Proxy Statement in connection with the Annual Meeting of Shareholders held on March 5, 1981, and incorporated herein by reference.
10.5*	The 1985 Stock Option Plan for Non-Employee Directors, previously filed with the Company's Form 10-K for fiscal year 1985, and incorporated herein by reference.
10.6*	Amendment 1 to the 1985 Stock Option Plan for Non-Employee Directors dated June 14, 1989, previously filed with the Company's Form 10-K for fiscal year 1989, and incorporated herein by reference.
10.7*	Applied Materials, Inc. Supplemental Income Plan as amended to December 15, 1988, including the Participation Agreement with James C. Morgan, previously filed with the Company's Form 10-K for fiscal year 1988, and incorporated herein by reference.

- 10.8 License Agreement dated January 1, 1992 between the Company and Varian Associates, Inc., previously filed with the Company's Form 10-K for fiscal year 1992, and incorporated herein by reference.
- 10.9\* Amendment dated December 9, 1992 to Applied Materials, Inc. Supplemental Income Plan dated June 4, 1981 (as amended to December 15, 1988), previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.10\* The Applied Materials, Inc. Executive Deferred Compensation Plan dated July 1, 1993 and as amended on September 2, 1993, previously filed with the Company's Form 10-Q for the quarter ended August 1, 1993, and incorporated herein by reference.
- 10.11 Joint Venture Agreement between Applied Materials, Inc. and Komatsu, Ltd. dated September 14, 1993 and exhibits thereto, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference. (Confidential treatment has been requested for certain portions of the agreement).
- 10.12\* Amendment No. 2 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated September 10, 1992, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.13\* Amendment No. 3 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
- 10.14\* Amendment No. 2 to the Applied Materials, Inc. Executive Deferred Compensation Plan, dated May 9, 1994, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
- 10.15\* Amendment No. 4 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated December 8, 1993, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
- 10.16\* Applied Komatsu Technology, Inc. 1994 Executive Incentive Stock Purchase Plan, together with forms of Promissory Note, 1994 Executive Incentive Stock Purchase Agreement, and Loan and Security Agreement, previously filed with the Company's Form 10-Q for the quarter ended July 31, 1994, and incorporated herein by reference.
- 10.17\* The Applied Materials, Inc. 1995 Equity Incentive Plan, dated April 5, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.18\* The Applied Materials, Inc. Senior Executive Bonus Plan, dated September 23, 1994, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.19\* The Applied Materials, Inc. Executive Deferred Compensation Plan, as amended and restated on April 1, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
- 10.20 Applied Materials, Inc. Medium-Term Notes, Series A Distribution Agreement, dated August 24, 1995, and incorporated herein by reference.
- 10.21\* Resolution pertaining to the Amendment of the Applied Materials, Inc. 1995 Equity Incentive Plan, adopted by the Stock Option and Compensation Committee of the Board of Directors of Applied Materials on December 12, 1996, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.22 Participation Agreement dated as of April 30, 1997 among Applied Materials, Inc. (as Lessee and Construction Agent), Credit Suisse Leasing 92A, L.P., (as Lessor and Borrower), Greenwich funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.23 Appendix 1 to Participation Agreement, Master Lease Agreement and Loan Agreement, dated as of April 30, 1997 (Definitions and Interpretation) for Applied Materials, Inc., previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.24 Loan Agreement dated as of April 30, 1997 among Credit Suisse Leasing 92A, L.P. (as

Borrower), Greenwich Funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent) for Revolving Commercial Paper, Eurodollar Credit and Base Rate Program, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.

- 10.25 Real Estate and Equipment Facility Master Lease dated as of April 30, 1997 between Credit Suisse Leasing 92A, L.P. (as Lessor), and Applied Materials, Inc. (as Lessee), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.26 Underwriting Agreement between Applied Materials, Inc. and Morgan Stanley & Co. Incorporated dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 10.27 Prospectus Supplement for Applied Materials' \$400 million Senior Notes dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 10.28 \$250,000 Five Year Credit Agreement and \$250,000 364-Day Credit Agreement, each dated as of March 13, 1998 among Applied Materials, Inc., Morgan Guaranty Trust Company of New York, as Documentation Agent and Administrative Agent, and Citicorp Securities, Inc., as Syndication Agent, previously filed with the Company's Form 10-Q for the quarter ended April 26, 1998, and incorporated herein by reference..
- 10.29\* Amendment No. 1 to the Applied Materials, Inc. Executive Deferred Compensation Plan dated August 1, 1997, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
- 10.30\* Amendment No. 2 to the Applied Materials, Inc. Executive Deferred Compensation Plan dated December 1, 1997, previously filed with the Company's Form 10-Q for the quarter ended July 26, 1998, and incorporated herein by reference.
- 10.31\* Applied Materials, Inc. 1995 Equity Incentive Plan, as amended on March 17, 1998, previously filed with the Company's Preliminary Proxy Statement dated January 27, 1998, and incorporated herein by reference.
- 10.32 Letters of Guarantee dated October 28, 1998 between Applied Materials, Inc. and Bank of Tokyo-Mitsubishi, Ltd., Sanwa Bank, Ltd., Sakura Bank, Ltd. and Sumitomo Bank, Ltd. on behalf of Applied Komatsu Technology, Inc.
- 10.33 Promissory Note dated December 15, 1998 between Applied Materials, Inc. and Applied Komatsu Technology America, Inc.
- 10.34 Receivables Purchase Agreement dated October 22, 1998 between Applied Materials, Inc. and Deutsche Financial Services Corporation.
- 10.35\* Amendment No. 1 to the Applied Materials, Inc. Senior Executive Bonus Plan dated September 2, 1998.
- 12.1 Ratio of Earnings to Fixed Charges.
- 13 Applied Materials 1998 Annual Report for the fiscal year ended October 25, 1998 (to the extent expressly incorporated by reference).
- 21 Subsidiaries of Applied Materials, Inc.
- 23 Consent of Independent Accountants.
- 24 Power of Attorney.
- 27 Financial Data Schedule: filed electronically.

\* Indicates, as required by Item 14(a)3, a management contract or compensatory plan or arrangement.

October 28, 1998

To: The Bank of Tokyo -- Mitsubishi, Ltd.

LETTER OF GUARANTEE

Dear Sirs:

With reference to the credit facilities extended by you to Applied Komatsu Technology, Inc., ("AKT") a company duly organized and existing under the laws of Japan, having its principal office at KSK West Bldg. 3F, 3-25-9, Hacchobori, Tokyo 104-0032 for the sum of, up to Japanese Yen One Thousand, Three Hundred and Fifty Million (JYen1,350,000,000), including principal, interest and all other charges payable under the facilities, the undersigned Applied Materials, Inc., ("Applied") a company duly organized and existing under the laws of Delaware and having its principal office at 3050 Bowers Avenue, Santa Clara, California, 95054, hereby guarantees the due fulfillment of payment obligations of AKT to you under the facilities up to the sum of Japanese Yen Six Hundred and Seventy-Five Million (JYen675,000,000), or 50% of amount of the credit facilities used at any time, whichever is smaller, and agrees to pay you the same if AKT fails to pay any amount due.

This guarantee shall continue in full force and effect from October 28, 1998 until April 30, 1999.

Sincerely,

/s/ Nancy H. Handel

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Nancy H. Handel  
Applied Materials, Inc.  
Vice President, Global Finance and  
Treasurer



October 28, 1998

To: The Sakura Bank Ltd.

LETTER OF GUARANTEE

Dear Sirs:

With reference to the credit facilities extended by you to Applied Komatsu Technology, Inc., ("AKT") a company duly organized and existing under the laws of Japan, having its principal office at KSK West Bldg. 3F, 3-25-9, Hacchobori, Tokyo 104-0032 for the sum of up to Japanese Yen Eight Hundred Million (JYen800,000,000), including principal, interest and all other charges payable under the facilities, the undersigned Applied Materials, Inc., ("Applied") a company duly organized and existing under the laws of Delaware and having its principal office at 3050 Bowers Avenue, Santa Clara, California, 95054, hereby guarantees the due fulfillment of payment obligations of AKT to you under the facilities up to the sum of Japanese Yen Four Hundred Million (JYen400,000,000), or 50% of amount of the credit facilities used at any time, whichever is smaller, and agrees to pay you the same if AKT fails to pay any amount due.

This guarantee shall continue in full force and effect from October 28, 1998 until April 30,1999.

Sincerely,

/s/ Nancy H. Handel

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Nancy H. Handel  
Applied Materials, Inc.  
Vice President, Global Finance and  
Treasurer

October 28, 1998

To: The Sanwa Bank, Limited

LETTER OF GUARANTEE

Dear Sirs:

With reference to the credit facilities extended by you to Applied Komatsu Technology, Inc., ("AKT") a company duly organized and existing under the laws of Japan, having its principal office at KSK West Bldg. 3F, 3-25-9, Hacchobori, Tokyo 104-0032 for the sum of up to Japanese Yen Eight Hundred Million (JYen800,000,000), including principal, interest and all other charges payable under the facilities, the undersigned Applied Materials, Inc., ("Applied") a company duly organized and existing under the laws of Delaware and having its principal office at 3050 Bowers Avenue, Santa Clara, California, 95054, hereby guarantees the due fulfillment of payment obligations of AKT to you under the facilities up to the sum of Japanese Yen Four Hundred Million (JYen400,000,000), or 50% of amount of the credit facilities used at any time, whichever is smaller, and agrees to pay you the same if AKT fails to pay any amount due.

This guarantee shall continue in full force and effect from October 28, 1998 until April 30, 1999.

Sincerely,

/s/ Nancy H. Handel

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Nancy H. Handel  
Applied Materials, Inc.  
Vice President, Global Finance and  
Treasurer

October 28, 1998

To: The Sumitomo Bank, Limited

LETTER OF GUARANTEE

Dear Sirs:

With reference to the credit facilities extended by you to Applied Komatsu Technology, Inc., ("AKT") a company duly organized and existing under the laws of Japan, having its principal office at KSK West Bldg. 3F, 3-25-9, Hacchobori, Tokyo 104-0032 for the sum of up to Japanese Yen One Thousand Seven Hundred Seventy Million (JYen1,770,000,000), including principal, interest and all other charges payable under the facilities, the undersigned Applied Materials, Inc., ("Applied") a company duly organized and existing under the laws of Delaware and having its principal office at 3050 Bowers Avenue, Santa Clara, California, 95054, hereby guarantees the due fulfillment of payment obligations of AKT to you under the facilities up to the sum of Japanese Yen Eight Hundred Eighty Five Million (JYen885,000,000), or 50% of amount of the credit facilities used at any time, whichever is smaller, and agrees to pay you the same if AKT fails to pay any amount due.

This guarantee shall continue in full force and effect from October 28, 1998 until April 30, 1999.

Sincerely,

/s/ Nancy H. Handel

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Nancy H. Handel  
Applied Materials, Inc.  
Vice President, Global Finance and  
Treasurer

## PROMISSORY NOTE

\$4,946,000.00

Santa Clara, California  
December 15, 1998

FOR VALUE RECEIVED, Applied Komatsu Technology America, Inc. ("Borrower") agrees to pay on demand to Applied Materials, Inc. ("Lender"), or its assignee, at Santa Clara, California, or such other place as the holder of this Note may from time to time designate, the principal sum of four million, nine hundred and forty-six thousand dollars (\$4,946,000.00), with simple interest on the unpaid principal balance from time to time outstanding at an interest rate of three month US dollar LIBOR plus 0.3% per annum until paid, commencing on the date hereof and reset on the last business day of each fiscal quarter during which the loan is outstanding. Interest will be calculated on the actual number of days elapsed on the basis of actual days in the year. Interest will be due and payable in arrears annually, on or before January 31st of each year. Any interest unpaid as of January 31st of each year will be added to the principal balance then outstanding and begin accruing interest.

All payments by Borrower shall be made in freely transferable same day funds in such manner as the holder may designate. Borrower may prepay all amounts due under this Note at any time without penalty.

Borrower shall pay reasonable attorney's fees and all other costs and expenses of any collection or litigation regarding this Note. Borrower waives formal presentment or demand.

This Note shall be governed by the laws of the State of California as applied to contracts entered into and wholly performed within said state.

APPLIED KOMATSU TECHNOLOGY  
AMERICA, INC.

APPLIED MATERIALS, INC

By /s/ Howard L. Neff  
-----Name: Howard L. Neff  
Title: PresidentBy /s/ Nancy H. Handel  
-----Name: Nancy H. Handel  
Title: Vice President Global  
Finance and TreasurerBy /s/ Tadashi Saito  
-----Name: Tadashi Saito  
Title: Chief Financial Officer

## RECEIVABLES PURCHASE AGREEMENT

THIS RECEIVABLES PURCHASE AGREEMENT ("Agreement") is dated as of the 22nd day of October, 1998, by and between APPLIED MATERIALS, INC., a Delaware corporation ("Seller") and DEUTSCHE FINANCIAL SERVICES CORPORATION, a Nevada corporation ("Purchaser").

## R E C I T A L S

A. Among other things, Seller sells certain manufacturing products and provides services related thereto in the ordinary course of its business (the "Products" and the "Services", respectively, or collectively, the "Goods").

B. Seller may sell and Purchaser may purchase from time to time, on the terms and conditions set forth herein, all of Seller's right, title and interest in and to payment for the Products sold and Services rendered by Seller to the Obligors (as defined herein) (such accounts collectively referred to herein as the "Receivables" or, individually, a "Receivable").

C. Purchaser wishes that Seller act as Purchaser's initial Collection Agent with respect to Receivables sold by Seller in connection with the collection of the amounts owing on the Receivables, and wishes to pay the Seller a Collection Agent Fee, as herein defined, in return for the Seller's services as Collection Agent.

D. Seller and Purchaser desire to enter into this Agreement to govern the purchase and sale of the Receivables, the administration and collection thereof, and related matters.

NOW, THEREFORE, in consideration of the agreements contained herein and for other good and valuable consideration, the parties hereto mutually agree as follows:

ARTICLE 1  
Definitions

Section 1.1. Definitions.

Except as otherwise specified in this Agreement, all references (i) to any Person, other than Seller, shall be deemed to include such Person's successors and assigns, and (ii) to any law, agreement, statute or contract specifically defined or referred to in this Agreement shall be deemed references to such agreement, or contract as the same may be supplemented, amended, waived, consolidated, replaced or modified from time to time, but only to the extent permitted by, and effected in accordance with, the terms hereof. The words "herein," "hereof" and "hereunder" and words of similar import, when used in this Agreement shall refer to this Agreement as a whole and not to any provision of this Agreement, and "Article," "Section," "paragraph," "Schedule" and respective references are to this Agreement unless otherwise specified. Whenever the context so requires, words importing any gender include the other genders. Any of the terms defined in this Article 1 may, unless

the context otherwise requires, be used in the singular or the plural depending on the reference; the singular includes the plural and the plural includes the singular.

All terms defined in this Article 1 shall have the defined meanings when used in this Agreement or, except as otherwise expressly stated therein, any certificate, opinion or other document delivered pursuant to this Agreement.

All accounting terms not otherwise defined in this Article 1 or elsewhere in this Agreement shall have the meanings assigned them in conformity with GAAP.

All terms used in Article 9 of the UCC and not specifically defined in this Article 1 or elsewhere in this Agreement shall be defined herein as such terms are defined in the UCC as in effect in the State of California on the date hereof.

References to "writing" include printing, typing, lithography and other means of reproducing words in a tangible visible form. References to "written" include "printed," "typed," "lithographed" and other adjectives relating to words reproduced in a tangible visible form consistent with the preceding sentence including electronic mail. The words "including," "includes" and "include" shall be deemed to be followed by the words "without limitation."

A/R Limit. As defined in Section 2.1.B.

Balance. As defined in Section 2.1.B.

Billing Date. The date on which an invoice is issued with respect to the sale of Goods resulting in the creation of a Receivable.

Business Day. Any day on which dealings in currencies and exchange may be carried on in the interbank eurodollar market, excluding Saturday, Sunday and any day which is a day on which national banking institutions are authorized or required by law or other governmental action to close.

Collateral. As defined in Section 5.1.

Collection Agent. A Person that is selected and appointed by Purchaser, in accordance with Section 3.1, to act on Purchaser's behalf in the administration, servicing and collection of the Sold Receivables. Such Person may be Seller. The term "Collection Agent" includes a Successor Collection Agent.

Collection Agent Fee. A fee calculated and payable by Purchaser to Seller in accordance with the terms of Article 4 hereof.

Collection Settlement Date. With respect to each Funding Date in connection with the sale of Sold Receivables to Purchaser, the related First Collection Settlement Date (the 60th day after such Funding Date or if such date is not a Business Day, the Business Day thereafter), and to the extent the Outstanding Balances of such Sold Receivables have not been reduced to zero, each succeeding Business Day.

Collections. All amounts received by the Collection Agent or Purchaser from any Obligor as a payment with respect to a Sold Receivable.

Contract. An agreement pursuant to which an Obligor agrees to pay money to Seller for Products sold or Services rendered by Seller in the ordinary course of its business.

Credit Adjustment. Any refund, rebate, credit, early pay discount or other adjustment granted to an Obligor with respect to a Sold Receivable after such Receivable is sold to Purchaser.

Defaulted Receivable. (i) A Sold Receivable that the Collection Agent determines in good faith to be uncollectible, or (ii) a Sold Receivable which remains unpaid, for any reason, including without limitation, set off by the Obligor (whether in connection with the same or a related transaction or unrelated transaction) or a bankruptcy proceeding of the Obligor where the Obligor is the debtor, more than 45 days from the Billing Date.

Discount. With respect to any Sold Receivable, an amount equal to the product of: (a) the LIBOR Rate (Reserve Adjusted)-Two Month plus ninety-eight one-hundredths of one percent (0.98%) per annum of the Outstanding Balance of such Sold Receivable, and (b) 60/365.

Dollars. Lawful money of the United States of America.

Eligible Receivable. Any Receivable which does not otherwise constitute an Ineligible Receivable.

Eurocurrency Liabilities. Has the meaning specified in Regulation D of the Board of Governors of the Federal Reserve System, as in effect from time to time.

Eurocurrency Reserve Percentage. For any Purchase, means the reserve percentage, if any, applicable two (2) Business Days before the date the applicable LIBOR Rate is determined under regulations issued from time to time by the Board of Governors of the Federal Reserve System (or any successor) for determining the maximum reserve requirement (including without limitation any emergency, supplemental or other marginal reserve requirement for a member bank of the Federal Reserve System in New York City) with respect to liabilities or assets consisting of or including Eurocurrency Liabilities (or with respect to any other category of liabilities that includes deposits by reference to which the interest rate on Purchases is determined) having a one-month term for LIBOR Rate-One Month, and a two-month term, for LIBOR Rate-Two Month.

Event of Default. As defined in Section 12.1.

Facility Termination Date. The earlier of the Termination Date or when Purchaser terminates this Agreement under Section 12.2.

Federal Bankruptcy Code. The bankruptcy code of the United States of America codified in Title 11 of the United States Code, as amended.

Financing Statement. The financing statements that are properly filed with the various Secretaries of State or other jurisdictions to perfect security interests in any property described by such financing statements.

First Collection Settlement Date. With respect to each Funding Date that date which is sixty (60) days after such Funding Date, provided that if such date is not a Business Day, then the First Collection Settlement Date shall be the next succeeding Business Day.

Funding Date. The Initial Funding Date, and such other and further dates as the parties hereto may agree to in writing as of the date on which Purchaser acquires additional Receivables hereunder.

GAAP. Generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as may be approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

Goods. As defined in the Recitals to this Agreement.

Indemnitees. As defined in Section 10.1.

Ineligible Receivables. Shall mean any of the following, as determined by Purchaser in its reasonable discretion, at the time of each Purchase hereunder:

- (a) Receivables created from the sale of Goods and services not in accordance with Seller's Payment Terms as described in Exhibit III attached hereto;
- (b) Receivables created from the sale of Goods that allow for payment to be made more than forty-five (45) days after the Billing Date and/or Receivables which are unpaid more than forty-five (45) days from the Billing Date;
- (c) all Receivables of an Obligor if fifty percent (50%) or more of the Outstanding Balance of all such Obligor's Receivables are more than forty-five (45) days past the applicable due date;
- (d) all Receivables of an Obligor if the Outstanding Balance of all Sold Receivables of such Obligor exceeds either (i) Fifty Million Dollars (\$50,000,000.00) (or any other Dollar limitations as may be set forth on Schedule B hereto, as amended from time to time) or as otherwise agreed to by Purchaser, or (ii) fifty percent (50%) of the Outstanding Balance of all Eligible Receivables;
- (e) Receivables with respect to which the Obligor is an officer, employee, agent, parent, Subsidiary or affiliate of Seller or has common officers or directors with Seller;
- (f) Receivables arising out of any consignment sale;
- (g) Receivables with respect to which the payment by the Obligor is conditional, other than as may be required by applicable statute;
- (h) Receivables with respect to which the Obligor is not a commercial or institutional entity;



- (i) Receivables with respect to which Seller is or may become liable to the Obligor thereof for goods sold or services rendered by such Obligor to Seller, other than as may be required by applicable statute;
- (j) Receivables with respect to which any warranty or representation provided in Sections 7.3, 8.4 or 8.8 is not true and correct;
- (k) Receivables which represent goods purchased for a personal, family or household purpose;
- (l) Receivables which are progress payment, retention or contra accounts;
- (m) Receivables with respect to which the Obligor is in default of any material provision of any agreement between Seller and Obligor governing such Receivable, including, without limitation, Receivables paid with checks returned and marked "Insufficient Funds" and Receivables which are otherwise in dispute and, in each case, not resolved within thirty (30) days;
- (n) Receivables arising pursuant to documentation not satisfactory to Purchaser in its sole discretion;
- (o) Receivables on which the Obligor is not located in the United States if such Receivable is not fully secured by foreign credit insurance or letter of credit, in each case acceptable to Purchaser in its sole discretion;
- (p) Receivables which were not incurred in the ordinary course of Seller's business;
- (q) Receivables which, prior to sale, were not owned by Seller; or
- (r) any and all other Receivables which Purchaser deems to be unacceptable; provided, however, that Receivables of the Obligors listed on Schedule B hereto which also satisfy paragraphs (c) through (q) above, shall be deemed acceptable to Purchaser, subject to any limitations in such Schedule B.

Initial Funding Date. The date that Purchaser makes its initial Purchase of Receivables, in accordance with Section 2.1, which, unless otherwise agreed to by the parties in writing, shall be October 23, 1998.

LIBOR Rate-One-Month. Shall mean, for purposes solely of calculation of the Collection Agent Fee, the London Interbank Offered Rate (LIBOR) for one-month deposits in U.S. Dollars that appears on Page 3745 of the Bloomberg News Service (or any other page that may replace any such page on such service in the reasonable judgment of Purchaser) on the Business Day of any such Collection Agent Fee payment.

LIBOR Rate-Two Month. Shall mean for any Purchase, the London Interbank Offered Rate (LIBOR) for two-month deposits in U.S. Dollars that appears on Page 3745 of the Bloomberg News Service (or any other page that may replace any such page on such service in the reasonable

judgment of Purchaser) on the third Business Day immediately preceding a Funding Date.

LIBOR Rate (Reserve Adjusted)-One Month. Shall mean, the rate per annum obtained by dividing the LIBOR Rate-One Month by a percentage equal to 100% minus the Eurocurrency Reserve Percentage.

LIBOR Rate (Reserve Adjusted)-Two Month. Shall mean, the rate per annum obtained by dividing the LIBOR Rate-Two Month by a percentage equal to 100% minus the Eurocurrency Reserve Percentage.

Lien. A mortgage, pledge, lien, security interest or other charge or encumbrance of any kind (including without limitation any conditional sale or other title retention agreement, any lease in the nature thereof, and any agreement to give any security interest).

Net Purchase Price. With respect to any Eligible Receivable, the total Outstanding Balance of such Eligible Receivable, minus: (i) the Discount attributable to such Eligible Receivable, as determined as of the Settlement Date and (ii) Twenty-Three One Hundredths of One Percent (0.23%) of the total Outstanding Balance of such Eligible Receivable, as of such Settlement Date.

Notices. All notices, requests, demands and other communications provided for under this Agreement.

Obligor. Each customer to whom Seller has sold Products or provided Services and who has agreed to pay money to Seller therefor whether or not pursuant to a Contract.

Officer's Certificate. A certificate executed on behalf of Seller by its chief financial officer, treasurer or other authorized officer.

Outstanding Balance. With respect to any Sold Receivable as of any date, the total outstanding principal balance thereof as of such date.

Outstanding Eligible Receivables. As at any moment, all Eligible Receivables which are then outstanding (i.e., not yet paid by their respective Obligors).

Party. Seller or Purchaser, as defined.

Person. Natural persons, corporations, limited partnerships, general partnerships, joint stock companies, joint ventures, incorporated or unincorporated associations, companies, limited liability companies, trusts or other organizations, whether or not legal entities, and governments and agencies and political subdivisions thereof, or any other entity of any kind.

Prime Rate. The prime rate as published in The Wall Street Journal. The Prime Rate will change and take effect for purposes of this Agreement on the day of any change in the prime rate published in The Wall Street Journal.

Products. As defined in the Recitals to this Agreement.

Purchase. A purchase of Receivables made by Purchaser pursuant to Section 2.1.

Receivables. As defined in the Recitals to this Agreement.

Receivables Purchase Settlement Statement. A statement substantially in the form of Exhibit II to be executed by Seller and Purchaser, prepared in accordance with Section 2.1.C and other provisions of this Agreement.

Releases. The termination statements or other documents that are filed with the various Secretaries of State or other jurisdictions for the purpose of releasing any security interests that have been filed or perfected through the filing of one or more Financing Statements.

Request for Information or Copies. The documents that are submitted to the various Secretaries of State or other jurisdictions for the purpose of ascertaining whether or not any financing statements, tax liens, judgment liens or other filings have been filed with respect to some item of property.

Secretary of State. Any Secretary of State, or any person acting in an official capacity for such person or for other jurisdictions, elected or appointed, to receive filings of Financing Statements, articles of incorporation or other documents pertaining to the business structure or operation of any of the entities referred to in this Agreement.

Services. As defined in the Recitals to this Agreement.

Settlement Date. The first Business Day immediately preceding each Funding Date, and such other dates as may be agreed to in writing by Seller and Purchaser.

Sold Receivable. A Receivable purchased by Purchaser until paid in full by the Obligor.

Status Report. As defined in Section 3.2.B.

Subsidiary. With respect to any Person, any corporation, association or other business entity of which more than 50% of the total voting power of shares of common stock or units of ownership or beneficial interest entitled to vote in the election of directors, managers or trustees thereof is at the time owned or controlled, directly or indirectly, by such Person.

Successor Collection Agent. As defined in Section 3.1.C.

Termination Date. As defined in Section 11.1.

UCC. The California Uniform Commercial Code.

## ARTICLE 2

### Amount and Terms of Purchase Commitments

#### Section 2.1. Purchase of Receivables.

##### A. Sale; Effective Date of Sale.

(i) Generally. On each Funding Date, Purchaser shall Purchase the Eligible Receivables from Seller, in accordance with the terms hereof, that Purchaser has elected, in its sole discretion, to Purchase.

Purchaser's decision to make a Purchase hereunder will not be binding until the funds are actually advanced. A condition of each Purchase on any Funding Date shall be delivery by Seller of the Receivables Purchase Settlement Statement required pursuant to Section 2.1.C on the Settlement Date. No Purchase shall occur after the Facility Termination Date or if Purchaser exercises its rights under Section 12.2.

(ii) Limitations. Notwithstanding anything herein, Seller shall have no obligation to sell, and Purchaser shall have no obligation to Purchase, any Receivables: (1) on any dates other than the Funding Dates, and (2) which fail to comply with the terms hereof.

B. Purchase; Transfer of Receivables. Each Purchase hereunder shall take place on the applicable Funding Date, at the office of Purchaser at 2401 East Katella Avenue, Suite 400, Anaheim, CA 92803-4850, or such other place as may be mutually agreed upon by Seller and Purchaser. Purchaser shall purchase the applicable Receivables on any Funding Date for an aggregate purchase price equal to the Net Purchase Price of the Eligible Receivables reflected on the Receivables Purchase Settlement Statement prepared in connection with such Purchase. Seller agrees further that, at all times during the term of this Agreement, the aggregate cumulative amount of all Net Purchase Prices received by Seller in respect of the then Outstanding Eligible Receivables, minus all Collections received thereon (the "Balance"), shall not exceed One Hundred Million Dollars (\$100,000,000.00) (the "A/R Limit"). Title to all Receivables which are acquired by Purchaser shall pass to Purchaser on the applicable Funding Date. Each Purchase shall be made without recourse, except as specifically provided herein.

C. Receivables Purchase Settlement Statements. On each Settlement Date, Seller shall execute a Receivables Purchase Settlement Statement, dated as of such date, which, among other things: (i) assigns and transfers to Purchaser, effective as of the Funding Date, all right, title and interest of Seller in and to the Sold Receivables described in the schedule attached to such Receivables Purchase Settlement Statement, free and clear of all security interests, liens, charges, encumbrances and rights of others, other than the respective Obligor's interest in the Products and/or Services, as appropriate, relating thereto, (ii) includes copies of all invoices and a summary of all sales resulting in Sold Receivables, and a calculation of the Eligible Receivables to be sold, a schedule of the Sold Receivables, and the Net Purchase Price, and (iii) provides such other information as Purchaser may reasonably request at least five (5) days in advance of such Settlement Date for the purpose of effecting the transactions contemplated hereby.

D. Collateral Assignment. Certain of the Obligors have granted Seller a Lien on certain of such Obligor's assets as security for the obligations of such Obligor to Seller. On or prior to each Settlement Date, Seller shall deliver to Purchaser, assignments of all security agreements, instruments or other documents pursuant to which such Obligors have granted Seller such a Lien in its assets.

E. Power of Attorney. Seller hereby grants to Purchaser an irrevocable power of attorney, with full power of substitution, coupled with an interest, to take in the name of Seller or in Purchaser's own name all steps necessary or advisable to (i) whether or not an Event of Default has occurred and is continuing, endorse and negotiate any writing or other right of any kind held or owned by Seller or transmitted to or received by Purchaser as payment on account or otherwise in respect of any Sold Receivables, and (ii) effective upon the occurrence and during the continuance of any Event of Default, enforce, foreclose, demand or accelerate on any writing or other right of any kind held or owned by Seller or transmitted to or received by Purchaser as payment on account or

otherwise in respect of any Sold Receivable, and (ii) effective upon the occurrence and during the continuance of any Event of Default, enforce, foreclose, demand or accelerate on any writing or other right of any kind held or owned by Seller or transmitted to or received by Purchaser as payment on account or otherwise in respect of any Sold Receivable.

ARTICLE 3  
Collections; Maintenance of Records;  
Disbursements of Collections

Section 3.1. Collection Procedure.

A. Appointment of Seller as Collection Agent. Purchaser hereby appoints Seller to act as Collection Agent with respect to Sold Receivables and Seller hereby accepts such appointment until a Successor Collection Agent is appointed in accordance with the terms hereof.

B. Duties and Standard of Care as Collection Agent.

(1) The Collection Agent will endeavor to collect the amount owing to Purchaser on each Sold Receivable in accordance with terms hereof, as and when the same becomes due, at Seller's cost and expense and as agent for Purchaser, but subject to the right of Purchaser to direct and control such activities in accordance with the terms hereof.

(2) In performing its functions and duties on behalf of Purchaser as the Collection Agent, Seller shall exercise the same care that it would exercise in the collection of Receivables for its own account, in accordance with, among other things, Seller's current Collection Procedures attached hereto as Exhibit IV, which standard of care shall not be less than the standard of care prevalent in the industry in which Seller engages. Collection Agent may amend, from time to time, its Collection Procedures with the consent of Purchaser, such consent not to be unreasonably withheld.

(3) The Collection Agent may allow such Credit Adjustments for Purchaser's account as the Collection Agent may determine in good faith to be either (i) appropriate to facilitate maximum Collections or (ii) required by applicable law or any applicable Contract and may receive any Products relating thereto, subject to Purchaser's aforesaid interests, as may be returned or rejected by, or repossessed from, the Obligors; provided, however, that any Credit Adjustment shall be reflected in a Status Report or other writing delivered by Collection Agent to Purchaser prepared for the period in which the Credit Adjustment was made, and the amount of any such Credit Adjustment shall be paid to Purchaser in full, in good funds, on each Collection Settlement Date. With respect to each Defaulted Receivable, the Collection Agent shall have the power and authority, on behalf of Purchaser, to take action in accordance with Seller's standard collection policies (including, in the case of any such Receivable in respect of which a security interest in Products shall have been obtained, the repossession and resale of such Products). Purchaser may request, to the extent reasonable, from time to time information relating to any Defaulted Receivable. A Collection Agent other than Seller may also make Credit Adjustments for Purchaser's account with the consent of Purchaser. Any such Credit Adjustment made pursuant to clause (ii) above by a Collection Agent other than Seller, shall be treated the same as a Credit Adjustment made by Seller as Collection Agent, including for purposes of requiring payment or credit by Seller.

(4) In the enforcement or collection of any Sold Receivable, the Collection Agent must obtain Purchaser's prior written consent to name Purchaser as a party in any legal proceeding; provided, however, that nothing contained herein shall limit Purchaser's right, exercisable in its sole discretion, following demand made by Purchaser on Seller and Seller's refusal or inability to proceed against an Obligor, to sue or proceed against any Obligor in its own name at any time upon two (2) days prior written notice to Seller after the 60th day after the applicable Funding Date. Moreover, notwithstanding the foregoing, (i) following the occurrence and during the continuance of any Event of Default after notice to Seller, (ii) if Seller has determined in good faith that a Sold Receivable is uncollectible, or (iii) if (1) an Obligor becomes insolvent or becomes subject to the Federal Bankruptcy Code, any state insolvency law or any similar law, as a debtor, (2) an Obligor makes a general assignment for the benefit of creditors, or (3) a receiver is appointed for any assets of an Obligor; no demand by Purchaser on Seller shall be required before Purchaser may sue or proceed against any Obligor in its own name.

(5) Purchaser may at any time with contemporaneous notice to Seller, contact any Obligor utilizing the form of verification letter attached hereto as Schedule C, for any purpose related to the performance of audits and verification analyses, and the determination of account balances and other data maintained by Seller. Except for sending the verification letter to the Obligors and except as otherwise provided herein, Purchaser shall not contact any Obligor with respect to the transactions contemplated herein. Purchaser may at any time following (i) the occurrence and during the continuance of an Event of Default; or (ii) the termination of Seller as Collection Agent: (a) notify any Obligor of the purchase by Purchaser of any Sold Receivable hereunder; (b) direct any Obligor to make all payments in respect of Sold Receivables directly to Purchaser at an address designated by Purchaser, or to a third party or a bank or depository designated by Purchaser; and/or (c) proceed directly against any Obligor, either with respect to the collection of any Sold Receivable or any related matter.

(6) All Collections received by the Collections Agent on and prior to the related First Collection Settlement Date shall be paid on each Tuesday (for Collections received by the Collection Agent during the immediately preceding calendar week), directly to the Purchaser as provided in Section 3.3. All Collections received by the Collections Agent after the related First Collection Settlement Date, shall be paid within one Business Day directly to the Purchaser as provided in Section 3.3. On any Collection Settlement Date, Seller shall remit to Purchaser, for Purchaser's own account, all amounts representing Credit Adjustments which relate to the Sold Receivables which are applicable to each such Collection Settlement Date. All payments and all amounts received in settlement, adjustment or liquidation of any Sold Receivable will be credited by Purchaser on the Business Day good funds are received by Purchaser. All payments in respect of Sold Receivables of a particular Obligor shall be applied against specific items of Sold Receivables as specifically identified in writing by the Obligor thereon. If an Obligor fails to so specify, then the Collection Agent shall use its best efforts, including contacting such Obligor, to determine the appropriate application of the payment.

C. Termination of Appointment. Upon the occurrence and continuance of an Event of Default or upon termination of this Agreement, Purchaser may at any time immediately terminate Seller's

appointment as the Collection Agent by delivery of a notice of such termination in writing to Seller, provided, however, that if there exists no Event of Default, Purchaser's termination of Seller as Collection Agent shall be effective fifteen (15) days after Purchaser's giving of notification thereof to Seller. Upon the termination of Seller as the Collection Agent, without limitation, (i) Purchaser, or a financial institution designated by Purchaser (Purchaser in such capacity or such third party, a "Successor Collection Agent"), shall administer the administrative, servicing and collection functions with respect to Purchases from Seller in any commercially reasonable manner and in accordance with this Agreement; (ii) Purchaser shall, at any time thereafter, be entitled to notify the Obligors on any Sold Receivables to make payment of amounts due thereunder directly to Purchaser at an address designated by Purchaser or to such third party or to a bank or other depository designated by Purchaser; and (iii) Seller shall, at its own expense, (a) if so requested by Purchaser, endorse each instrument, if any, evidencing any Sold Receivable to Purchaser in such manner as Purchaser shall reasonably direct and (b) perform any and all acts and execute any and all documents as may be reasonably requested by Purchaser in order to effect the purposes of this Agreement and the Purchase of Receivables and to perfect and protect the ownership interest of Purchaser in the Sold Receivables.

### Section 3.2. Records and Reports.

A. Maintenance of Records. Until the earlier of the termination of this Agreement or until each Sold Receivable has been paid in full, Purchaser shall have the right (but not the obligation), for the purposes hereunder described, to enter upon Seller's premises from time to time during normal business hours following three (3) Business Days notice to Seller (unless an Event of Default has occurred and is continuing, in which event no advance notice will be required hereunder, but such entry shall be during normal business hours) during the term of this Agreement. The purposes for which Purchaser may enter pursuant to the terms of this Section 3.2 are as follows: (i) to examine Seller's books, accounts, records or other papers pertaining to Sold Receivables and otherwise pertaining to the transactions which are the subject of this Agreement, and for no other purposes; (ii) to examine the Collateral; (iii) to appraise the Collateral as security; (iv) to verify the condition of the Collateral; (v) to verify that all Collateral has been properly accounted for; and (vi) to verify that Seller is in compliance with all terms and provisions of this Agreement; provided, in all cases, that Purchaser shall have no right to examine any documents covered by attorney-client privileges or attorney work-product. Any fees, costs or expenses incurred by Purchaser in connection with such inspections, audits and examinations as aforesaid, shall be the sole responsibility of Purchaser (unless an Event of Default has occurred and is continuing, in which event Seller shall be solely responsible for such fees, costs and expenses). From time to time upon the reasonable written request of Purchaser, Seller, at its own expense, will deliver to Purchaser, or any agent selected by Purchaser (which agent Seller shall have consented to, such consent not to be unreasonably withheld), as the case may be: (i) a schedule of the Sold Receivables (or Sold Receivables relating to such Obligors as Purchaser may specify) sold by Seller to Purchaser indicating as to each such Sold Receivable information as to the Obligor thereon, the Outstanding Balance thereof, the location of any Contract evidencing such Sold Receivable and such other information as Purchaser may reasonably deem appropriate; and (ii) copies of any such Contract and such records and invoices pertaining thereto and evidence thereof as Purchaser may reasonably deem necessary to enable Purchaser to enforce its rights thereunder. At Purchaser's

request, Seller shall: (a) identify and hold as agent for Purchaser at the offices of Seller listed in Schedule A hereto (including without limitation for the purpose of protecting Purchaser's ownership interest therein) all books, records and documents evidencing or relating to the Sold Receivables, including any underlying Contracts, and maintain a current record of all Sold Receivables owned by Purchaser at any time in such reasonable detail and in form and substance satisfactory to Purchaser; (b) mark the legend "Receivables assigned to Deutsche Financial Services Corporation, under a Receivables Purchase Agreement, dated as of October 22, 1998" on Seller's aging schedule applicable to the Sold Receivables, and upon the occurrence of an Event of Default, on such instruments as Purchaser may from time to time reasonably designate; and/or (c) maintain and implement administrative and operating procedures (including without limitation an ability to recreate records evidencing the Sold Receivables in the event of the destruction of the original records), and keep and maintain all documents, books, records and other information reasonably necessary for the collection of the Sold Receivables for Purchaser.

B. Status Reports. Seller shall submit to Purchaser a Status Report on the dates specified in the immediately following sentence, substantially in the form of Exhibit V ("Status Report") consisting of information concerning Collections, Credit Adjustments, and Defaulted Receivables. Seller shall submit a Status Report to Seller (i) no later than the thirty-fifth (35th) day after a Funding Date, with respect to the 30-day period which commenced on such Funding Date, and (ii) no later than two (2) days after a First Collection Settlement Date, with respect to the 30-day period immediately preceding such First Collection Settlement Date. The Status Report shall include such other reports as Purchaser shall reasonably request. If any date for the delivery of a Status Report is not a Business Day, then such report shall be due on the next succeeding Business Day.

### Section 3.3. Manner and Time of Payments.

A. Payments to Seller. (i) On the Funding Date. With respect to any Funding Date, so long as Purchaser receives the Receivables Purchase Settlement Statement by 10:00 a.m., Pacific time, on the related Settlement Date, Purchaser shall pay the amounts that are payable to Seller hereunder on such Funding Date, as applicable, in immediately available funds deposited to the account of Seller listed in Section 13.2 hereof, no later than 2:00 p.m., Pacific time, and subject to the provisions of any other information reasonably requested by Purchaser from Seller in connection therewith in effect on or prior to such date. (ii) Collection Agent Fee. Purchaser's payment of the Collection Agent Fee to Seller shall be made in immediately available funds deposited to the account of Seller listed in Section 13.2 hereof, no later than 2:00 p.m., Pacific time, on the dates and as otherwise provided under the terms of Article 4 hereof. (iii) Generally. The foregoing notwithstanding, any amounts due Purchaser from Seller hereunder or in connection herewith, may be deducted by Purchaser from any amounts owed to Seller, with notice to Seller.

B. Payments to Purchaser. Seller shall pay the amounts that are payable to Purchaser hereunder, in immediately available funds, deposited to the account of Purchaser listed in Section 13.2 hereof, no later than 2:00 p.m., Pacific time, on any Collection Settlement Date, or as otherwise provided, subject to the provisions of any Status Report, or other information reasonably requested by Purchaser from Seller in connection therewith in effect on or prior to such date. In no



way limiting the foregoing, Seller agrees to pay Purchaser the following:

(i) Delinquent Receivables. If the Outstanding Balance of a Sold Receivable has not been paid in full on or before the 60th day after the Funding Date on which the Purchaser purchased such Sold Receivable, then, the Seller shall pay to the Purchaser an amount equal to the Payment Percentage of the unpaid Outstanding Balance of such Sold Receivable for each day after such 60th day that the Outstanding Balance is greater than zero until the earlier of (A) the date on which the Seller notifies Purchaser that it has determined in good faith that such Sold Receivable is uncollectible, (B) the date that is the 90th day after the Funding Date on which the Purchaser purchased such Sold Receivable, and (C) the date on which the Outstanding Balance is reduced to zero. Any amount required to be paid under this paragraph shall be paid to the Purchaser on the immediately following Collection Settlement Date. As used herein, the "Payment Percentage" is equal to the sum of: (a) the LIBOR Rate (Reserve Adjusted)-Two Month relating to the Purchase of such Sold Receivables plus ninety-eight one-hundredths of one percent (0.98%) per annum, divided by 365, plus (b) Twenty-Three One Hundredths of One Percent (0.23%), divided by 60.

Section 3.4. Eurodollar Deposits Unavailable or Rate Unascertainable. (a) In the event that on or prior to the date the LIBOR Rate-Two Month is determined, Purchaser shall have determined (which determination shall be conclusive and binding on the parties hereto) that by reason of circumstances affecting the interbank eurodollar market, adequate and reasonable means do not exist for ascertaining the LIBOR Rate-Two Month applicable to a Purchase, Purchaser shall promptly give notice of such determination to Seller, and any such Purchase shall be made using a Discount based upon the Prime Rate less the difference in the per annum interest rate between the Prime Rate (at the date the LIBOR Rate-Two Month ceased to exist) and the average of the LIBOR Rate-Two Month over the 30-day period immediately preceding the date the LIBOR Rate-Two Month ceased to exist. (b) In the event that on or prior to the date the LIBOR Rate-One Month is determined, Purchaser shall have determined (which determination shall be conclusive and binding on the parties hereto) that by reason of circumstances affecting the interbank eurodollar market, adequate and reasonable means do not exist for ascertaining the LIBOR Rate-One Month applicable to calculation and payment of the Collection Agent Fee, Purchaser shall promptly give notice of such determination to Seller, and any such Collection Agent Fee shall be made based upon the Prime Rate less the difference in the per annum interest rate between the Prime Rate (at the date the LIBOR Rate-One Month ceased to exist) and the average of the LIBOR Rate-One Month over the 30-day period immediately preceding the date the LIBOR Rate-One Month ceased to exist.

#### ARTICLE 4 Collection Agent Fee

Section 4.1. Collection Agent Fee. A fee shall be payable by Purchaser to Seller in its capacity as Collection Agent (the "Collection Agent Fee"), in an amount equal to the LIBOR Rate (Reserve Adjusted)-One Month on the average daily balance of the Collections received by Purchaser during the 30-day period preceding each Collection Agent Fee payment date specified in the immediately following sentence. The Collection Agent Fee shall be payable, in arrears, on that date which is thirty (30) days after a Funding Date (provided that if such date is not a Business Day, then on the next succeeding Business Day), and on the

First Collection Settlement Date. In no event, however, shall any Collection Agent Fee be payable to Seller for Collections relating to the applicable Sold Receivables received after the related First Collection Settlement Date. The Collection Agent Fee is to be paid by the Purchaser to the Seller as Collection Agent in consideration of Seller's agreement to serve as a Collection Agent and as compensation for such Collection Agent's services. Any amounts due to Purchaser from Seller hereunder, may be deducted from any Collection Agent Fee and credited to Purchaser, upon notice to Seller. Following the termination of Seller as a Collection Agent, Seller shall not continue to earn any Collection Fees.

ARTICLE 5  
Security Interest

Section 5.1. Sale; Grant of Security Interest. The parties hereto intend that the Purchase by Purchaser of Sold Receivables pursuant to this Agreement shall constitute a sale under all applicable laws. Notwithstanding such intent, if for any reason the Sold Receivables are not under applicable law deemed to have been Purchased by Purchaser, Purchaser shall be deemed to have made a loan to Seller in the amount of the purchase price paid to Seller, secured by the following grant of security in Seller's assets. In the event of any such designation as a loan, all provisions of this Agreement referring to the sale of the Sold Receivables shall be construed as the context may require as references to the grant of a security interest in such Receivables. In such regard and in any event to secure all of Seller's current and future debts to Purchaser under this Agreement or any side letters entered into between Purchaser and Seller in connection with this Agreement, whether now or hereafter existing, due or to become due, direct or indirect, or absolute or contingent, indemnification obligations pursuant to Section 10.1 and payments on account of Collections received, Seller hereby assigns and grants to Purchaser a security interest in all of Seller's right, title and interest now or hereafter existing in, to and under (i) all Sold Receivables, now owned or hereafter acquired, (ii) all contract rights, chattel paper, security agreements, instruments, documents of title, deposit accounts, reserves and general intangibles, now owned or hereafter acquired, all returned, reclaimed or repossessed inventory and Products, in each case securing or otherwise supporting such Sold Receivables, and (iii) all proceeds of any of the foregoing (the "Collateral"). To the extent so defined, the above assets shall have the same meanings as in Article 9 of the UCC. Seller will hold all of the Collateral in trust for Purchaser and will account for and remit directly to Purchaser all such proceeds when payment is required under terms of this Agreement. Purchaser's lien or security interest will not be impaired by any payments Seller may make to any other person or entity. This Agreement shall constitute a security agreement under applicable law with regard to the security interest granted pursuant to this Section 5.1.

ARTICLE 6  
Seller's Affirmative Covenants

Seller covenants and agrees that, unless Purchaser shall otherwise give its express prior written consent, until the earlier of the termination of this Agreement or each Sold Receivable has been paid in full, Seller shall comply with and perform in accordance with all covenants contained in this Article 6.

Section 6.1. Financial Statements and Other Reports. Seller will maintain a system of accounting established and administered in accordance with sound business practices to permit preparation of financial statements of Seller in conformity with GAAP. Seller will deliver to Purchaser:

A. as soon as available and in any event within 50 days after the end of each of the first three quarters of each fiscal year of Seller, consolidated balance sheets of Seller as of the end of such quarter and consolidated statements of income and of cash flows of Seller for the period commencing at the end of the previous fiscal year and ending with the end of such quarter, certified by the Treasurer of Seller; provided that Seller may satisfy this obligation by filing its Form 10-Q for such fiscal quarter with the Securities and Exchange Commission;

B. as soon as available and in any event within 105 days after the end of each fiscal year of Seller a copy of the annual report of such year for Seller containing consolidated financial statements for such year certified by Seller's independent public accountants; provided that Seller may satisfy this obligation by filing its Form 10-K for such fiscal year with the Securities and Exchange Commission;

C. promptly after the sending or filing thereof, copies of all reports which Seller sends to its security holders generally, and copies of all registration statements which Seller files with the Securities and Exchange Commission or any national securities exchange (other than those on Form S-8);

D. promptly upon any vice president or president of Seller obtaining knowledge or becoming aware of an occurrence of a breach of Seller's obligations under this Agreement which would give rise to an Event of Default, an Officer's Certificate specifying the nature and period of existence of any such breach, condition or event, or specifying the notice given or action taken by such holder or Person and the nature of such claimed breach, event or condition, and what action, if any, Seller has taken, is taking and proposes to take with respect thereto;

E. thirty (30) days' notice prior to Seller's changing its name or any name under which it does business or relocating its chief executive offices or relocating the books, records and documents evidencing the Receivables owned or to be purchased by Purchaser hereunder;

F. prior to the implementation of any material change in Seller's policies, procedures or practices with respect to extending credit to its customers, making Credit Adjustments or collecting amounts owed by customers, in each case that would affect Sold Receivables, a written description of such proposed change at least ten (10) days in advance of such change;

G. with reasonable promptness, such other information, reports or documents concerning the Receivables which are owned or to be purchased by Purchaser hereunder, the underlying Contracts, or the credit or collection policies, practices and procedures of Seller, as Purchaser may from time to time reasonably request; and

H. such other information respecting the financial condition or operations of Seller as Purchaser may from time to time reasonably request.

Section 6.2. Corporate Existence, etc. Subject to Section 7.5 hereof, Seller will at all times preserve and keep in full force and effect its corporate existence and all material licenses, rights and privileges relating to Sold Receivables, and qualify and remain qualified as a foreign corporation in each jurisdiction in which such qualification is necessary to avoid a material adverse effect on the validity, enforceability and collectibility of Sold Receivables.

Section 6.3. Compliance with Laws, etc. Seller will comply in all material respects with the requirements of all applicable laws, rules, regulations and orders of any governmental authority, noncompliance with which would adversely affect the validity, enforceability or collectibility of Sold Receivables.

Section 6.4. Transfer of Receivables. Seller shall take all steps necessary or, in the reasonable opinion of Purchaser, advisable to validate or protect the ownership interest of Purchaser in, or to defeat the assertion by any third party of any adverse claims with respect to, the Sold Receivables or any underlying Contracts. If an Event of Default by Seller hereunder has occurred and is continuing, Seller hereby irrevocably authorizes Purchaser to execute and deliver, in Seller's name and on Seller's behalf, such instruments and documents (including bills of sale and assignments) necessary or desirable to evidence or protect Purchaser's ownership interest in the Sold Receivables. Regardless of whether an Event of Default by Seller has occurred and is continuing, Seller hereby irrevocably authorizes Purchaser to execute and file, in Seller's name and on Seller's behalf, financing statements (including amendments and continuation statements) under the UCC (or similar law where the UCC is not enacted) in such jurisdictions where it may be necessary to validate or protect Purchaser's position as owner of, or, as provided in Section 5.1, secured party with respect to, such Sold Receivables. Seller shall execute and deliver such additional documents and shall take such further action as Purchaser may reasonably request to effect or evidence the transfer of the Sold Receivables and shall execute and deliver to Purchaser such powers-of-attorney as may be necessary or appropriate to enable Purchaser to endorse for payment any check, draft or other instrument delivered in payment of any amount under or in respect of a Sold Receivable. If, at any time, Seller receives any cash or checks, drafts or other instruments for the payment of money on account or otherwise in respect of Sold Receivables, Seller shall segregate such cash and other items, hold such cash and other items (properly endorsed, where required, so that such items may be collected by Purchaser) in trust for Purchaser, and promptly paid directly to Purchaser in accordance with Section 3.1.B(6).

Section 6.5. Assignment of Contracts; Instruments. Seller hereby assigns to Purchaser all rights of Seller under each Contract underlying a Sold Receivable relating to the collectibility of payments thereunder, security interests and other liens created in connection therewith and the enforcement thereof, but Purchaser does not and shall not thereby assume any obligations of Seller under any such Contract. Such assignment shall include without limitation security interests in favor of Seller in any property (including without limitation any Goods) securing any Sold Receivable, whether pursuant to the contract underlying such Sold Receivables or otherwise, and all terms and

conditions of this Agreement shall be deemed applicable to such assigned security interests generally in the same manner and to the same extent as applied to the related Sold Receivable. In the event any Sold Receivable becomes, either at the time of creation of such Sold Receivable or any time thereafter, evidenced by a promissory note or other document or instrument (other than a Contract), Seller will promptly endorse and physically deliver such promissory note, document or instrument to Purchaser.

ARTICLE 7  
Seller's Negative Covenants

Until the earlier of the termination of this Agreement or each Sold Receivable has been paid in full, unless Purchaser shall otherwise give prior written consent, Seller will perform all covenants contained in this Article 7.

Section 7.1. Character of Business. Seller will make no material change in its Collection Procedures that would adversely affect the validity, enforceability or collectibility of the Sold Receivables or materially adversely affect the ability of Seller to perform its obligations hereunder without the consent of Purchaser.

Section 7.2. Modification of Contracts. Except as set forth in Section 3.1.B(3), without the prior written consent of Purchaser, Seller will not amend, modify or waive any term or condition of any Contract underlying any Sold Receivable, which amendment, modification or waiver would adversely affect the validity, enforceability or collectibility of such Receivable or adversely affect Purchaser's right to collect any Sold Receivables.

Section 7.3. Quality of Receivables. Seller will not sell to Purchaser any Receivable that is not an Eligible Receivable on the date of sale. Seller will not sell to Purchaser any Receivable, that, on the date of sale : (i) is an Ineligible Receivable; (ii) is evidenced by a promissory note or other document or instrument (other than a Contract); (iii) does not conform with applicable laws, rules or regulations or is based on a Contract that does not conform in all material respects with applicable laws, rules or regulations; (iv) is a Defaulted Receivable; (v) is a Receivable with respect to which Seller is engaged in any dispute or warranty claim or which is subject to any lien, claim, security interest, offset, counterclaims or defense; (vi) permits the Obligor to pay less than the Outstanding Balance for any reason other than a Credit Adjustment; (vii) does not satisfy the requirements of Sections 8.4 and 8.8 hereof in all material respects; or (viii) the Purchase of which by Purchaser, or the sale of which by Seller, is subject to any order, judgment or decree of any court, arbitrator or similar tribunal or governmental authority, or is the subject of any proceedings before any such court, arbitrator or similar tribunal or government authority purporting to enjoin or restrain Purchaser from making any Purchase, Seller from selling such Receivable or the Collection Agent or Purchaser from making any Collection of such Receivables. Purchaser may from time to time, in its discretion, upon advance written notification to Seller, withdraw its approval of any or all of the Obligors, including but not limited to those listed on Schedule B hereto.

Section 7.4. Financial Statements. Seller will not prepare, or permit the preparation of, any financial statements which shall account for the transactions contemplated hereby in a manner that is

inconsistent with Purchaser's ownership interest in the Sold Receivables.

Section 7.5. Restriction on Fundamental Changes. Seller can merge with another Person if immediately thereafter, giving effect to such merger, no Event of Default exists and either (i) the Seller survives the merger or (ii) the successor agrees to be bound by this Agreement.

Section 7.6. Seller's Interest. Seller will not retain any interest in any Sold Receivable hereunder and each sale of a Sold Receivable hereunder shall be of all of Seller's right, title and interest in such Sold Receivable.

Section 7.7. Negative Pledge. Seller will not mortgage, pledge, grant or permit to exist a security interest or Lien caused by it, in or upon any of the Sold Receivables or the Collateral.

ARTICLE 8  
Seller's Representations and Warranties

In order to induce Purchaser to enter into this Agreement and to make the Purchases, Seller represents and warrants to Purchaser that the following statements are true, correct and complete in all material respects (except to the extent such representations and warranties are already qualified as to materiality in which case they are true, correct and complete) as of the date hereof and as of the date of each sale of Receivables hereunder (all representations and warranties concerning Receivables shall be made solely as of the date of the sale of such Receivables hereunder):

Section 8.1. Organization, Powers and Good Standing.

A. Organization and Powers. Seller is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation. Seller has all requisite corporate power and authority to own and operate its properties, to carry on its business as such business is now conducted and as it is proposed to be conducted hereunder, to enter into this Agreement and to carry out the transactions contemplated hereby, except where failure to have such licenses and permits would not have a material adverse effect on the financial condition or assets of Seller.

B. Good Standing. Seller is in good standing wherever necessary to carry on its present business and operations, except in jurisdictions in which the failure to be in good standing has and will have no material adverse effect on the conduct of the business of Seller or any adverse effect on the validity, enforceability or collectibility of any Sold Receivable.

Section 8.2. Authorization of Sales, etc.

A. Authorization of Sales. The execution, delivery and performance of this Agreement and the sales of Receivables sold and to be sold to Purchaser hereunder and the grant of the security interest in the Collateral have been duly authorized by all necessary corporate action by Seller.

B. No Conflict. The execution, delivery and performance by Seller of this Agreement and the sales of Receivables do not and will not: (i) violate any provision of law applicable to Seller, the Certificate of Incorporation or Bylaws of Seller, or any order, judgment or decree of any court or other agency of government binding on Seller; (ii) conflict with, result in a breach of or constitute (with due notice or lapse of time or both) a default under or permit an acceleration or increased amortization of any material obligation of Seller; (iii) result in or require the creation or imposition of any Lien, charge or encumbrance of any nature whatsoever upon any of the properties or assets of Seller except as provided herein or pursuant to the terms hereof; or (iv) require any approval of stockholders or any approval or consent of any Person under any obligation of Seller or Contract to which Seller is a party other than approvals or consents that have been obtained and disclosed in writing to Purchaser.

C. Governmental Consents. The execution, delivery and performance by Seller of this Agreement and the Purchases of Receivables do not and will not require any registration with, consent or approval of, or notice to, or other action to, with or by, any federal, state or other governmental authority or regulatory body or other Person, other than a filing with certain Secretaries of State and other jurisdictions evidencing the Purchase of Receivables hereunder, and no transaction contemplated hereby requires compliance with any bulk sales act or similar law.

D. Binding Obligation. This Agreement creates and constitutes legal, valid and binding obligations of Seller, enforceable in accordance with its terms, except as enforcement may be limited by applicable bankruptcy, insolvency or similar laws and principles of equity.

Section 8.3. No Material Adverse Change. Since September 9, 1998, there has been no material adverse change in the business, operations, properties, or financial position of the Seller and its subsidiaries taken as a whole.

Section 8.4. Protection of Ownership Interest. All filings or other actions under the UCC have been made or taken in each jurisdiction that are necessary or appropriate to validate and perfect Purchaser's ownership interest in and rights to collect any and all Sold Receivables and the proceeds thereof; Purchaser has a valid and perfected ownership or security interest in the Sold Receivables and the proceeds thereof, free and clear of all security interests, liens, charges, encumbrances or rights of others except as otherwise expressly provided herein; and no effective financing statement or other instrument similar in effect covering all or any part of the Sold Receivables is currently on file or of record at any location except as has been filed or recorded from time to time in favor of Purchaser in accordance with this Agreement.

Section 8.5. Office Locations. As of the date hereof, the chief executive office of Seller is located at the address of Seller's business office appearing in Schedule A hereof, and the books, records and documents evidencing the Receivables to be sold hereunder are located at Seller's business offices located at the address appearing in Schedule A hereof.

Section 8.6. Taxes, etc. Seller's federal tax identification number is 94-1655526. There is no federal, state or local law or ordinance (other than income or franchise tax laws applicable to

Purchaser generally) under which any Receivable which is sold to Purchaser under this Agreement shall be subjected to any property, excise, sales or other tax, assessment or governmental charge other than income or franchise taxes of Purchaser. To the extent any such Receivable is subject to any such tax, assessment or governmental charge, Seller hereby agrees to pay all such taxes, assessments and governmental charges.

Section 8.7. Disclosure. No representation or warranty of Seller contained in this Agreement or any other document, certificate or written statement furnished to Purchaser by Seller in connection with the transactions contemplated by this Agreement contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the statements contained herein or therein, in the light of the circumstances under which they were made, not misleading; provided that any projections, proforma or preliminary financial information furnished are based on good faith estimates and assumptions believed to be reasonable at the time made and Purchaser acknowledges that such projections as to future events are not to be viewed as facts and that actual results for such period may differ from such projected results. There is no fact known to Seller (other than matters of a general economic nature) that materially adversely affects the business, operations, property, assets or condition (financial or otherwise) of Seller and its Subsidiaries, taken as a whole, that has not been disclosed herein or in such other documents, certificates and statements furnished to Purchaser for use in connection with the transactions contemplated hereby.

Section 8.8. Receivables Valid and Binding; No Litigation. Each Receivable sold to Purchaser hereunder constitutes at the time of sale the legal, valid and binding obligation of the Obligor to Seller, subject to laws affecting the rights of creditors generally. Each such Receivable complies at the time of sale with the provisions of all applicable laws and regulations, whether federal, state or local, applicable thereto, other than provisions as to which the failure to comply would not adversely affect the validity, enforceability or collectibility of the Receivables, and satisfies at the time of sale the requirements of Section 7.3 hereof in all respects. Each such Receivable is denominated and payable in Dollars. There are no known counterclaims or rights of set-off limiting the right of Purchaser to collect the Outstanding Balance, as adjusted for Credit Adjustments, of each such Receivable. To the best of Seller's knowledge, there is no order, judgment or decree of any court, arbitrator or similar tribunal or governmental authority purporting to enjoin or restrain Purchaser from making any Purchase, Seller from selling any Receivable or the Collection Agent or Purchaser from making any Collection, or which might otherwise adversely affect Seller's ability to perform its obligations hereunder. To the best of Seller's knowledge, there are no proceedings before any court, arbitrator or similar tribunal or governmental authority seeking to enjoin or restrain Purchaser from making any Purchase, Seller from selling any Receivable or the Collection Agent or Purchaser from making any Collection, or which might otherwise adversely affect Seller's ability to perform its obligations hereunder.

Section 8.9. Satisfaction of Conditions Precedent. At the time of each Purchase hereunder, each of the conditions precedent to such Purchase set forth in Article 9 will have been (i) waived in writing by Purchaser, or (ii) satisfied.



ARTICLE 9  
Conditions To Purchases

Section 9.1. Conditions to Initial Purchases. The obligation of Purchaser to make its initial Purchase is, in addition to the conditions precedent specified in Sections 9.2 and 9.3 hereof, subject to prior or concurrent satisfaction of the following conditions. On or before the Initial Closing Date, Seller shall deliver to Purchaser:

A. Good Standing, Etc. Evidence reasonably satisfactory to Purchaser that Seller is duly organized and existing under the laws of Seller's state of incorporation and in California;

B. Corporate Resolutions. Resolutions of the Board of Directors of Seller approving and authorizing the execution, deliver and performance of this Agreement and the sales of Receivables to be made hereunder, certified as of the Initial Funding Date by its corporate secretary or an assistant secretary;

C. Signature and Incumbency Certificate. Signature and incumbency certificates of the officers of Seller executing this Agreement;

D. UCC Searches. A certificate copy of each Request for Information or Copies (Form UCC-11) (or a similar search report acceptable to Purchaser) listing the Financing Statements filed with respect to the Collateral (or similar search reports for jurisdictions where the UCC is not enacted), and showing that no Financing Statements have been filed with respect to, and presently cover, such Receivables (except those filed pursuant to this Agreement); the foregoing notwithstanding, Purchaser hereby confirms that with respect to the Initial Funding Date, Purchaser shall obtain such searches required hereunder;

E. Agreement. Executed original of this Agreement;

F. Opinion of Counsel. Executed original of one or more favorable written opinions of counsel, substantially in the form of Exhibit I hereto, reasonably satisfactory to Purchaser, dated as of the Initial Funding Date;

G. UCC-1s. Purchaser shall have received from Seller acknowledgment copies of all Financing Statements (Form UCC-1) filed with respect to the Collateral in each jurisdiction where necessary or appropriate to perfect Purchaser's ownership interest in such Collateral (or evidence of the satisfaction of such similar filing or other requirements as may be so necessary in each jurisdiction where the UCC is not enacted), Purchaser hereby agreeing that with respect to the Initial Funding Date, if Purchaser has received duly executed originals of the Financing Statements required hereunder at least two (2) days prior to the Initial Funding Date, then the acknowledgment copies of such filings required hereunder will be acceptable if received by Purchaser no later than ten (10) Business Days after such Initial Funding Date;

H. Receivables Purchase Settlement Statement. As of the Settlement Date in respect of the Initial Funding Date, Seller shall deliver the Receivables Purchase Settlement Statement required by Section 2.1.C;

I. Subordination Agreements. Subordination agreements in form and substance acceptable to Purchaser from any and all prior filers with conflicting security interests in the Collateral; and

J. Other Documents. Such other documents, certificates, submissions, instruments, and agreements as reasonably requested by Purchaser relating to the transaction herein contemplated.

Section 9.2. Conditions to All Purchases. The obligation of Purchaser to make each Purchase, including the initial Purchase, is subject to the following further conditions precedent:

A. Purchaser shall have received, in accordance with the provisions of Section 2.1 as of any Settlement Date, an originally executed Receivables Purchase Settlement Statement relating to such Purchase, signed by the chief executive officer, the chief financial officer, the treasurer or any other authorized officer or designee of Seller on behalf of Seller.

B. As of the date of any Purchase:

1. The representations and warranties of Seller contained herein shall be true, correct and complete in all material respects on and as of the date of Purchase to the same extent as though made on and as of that date;

2. All Receivables sold by Seller on such date hereunder shall comply in all material respects with Section 7.3 hereof;

3. No event shall have occurred and be continuing or would result from the consummation of the Purchase contemplated by such Receivables Purchase Settlement Statement that would constitute an Event of Default or permit the acceleration or the increased amortization of the obligations created, or but for the passage of time or the giving of notice or both would constitute an Event of Default or permit the acceleration or the increased amortization of the obligations created, under this Agreement or any other agreement to which Seller is a party;

4. Seller shall have performed in all material respects all agreements and satisfied all conditions which this Agreement provides shall be performed by it on or before such date of Purchase;

5. Seller shall have delivered such other and further Receivables Purchase Settlement Statements as may be required hereunder;

6. There shall not have occurred and be continuing an Event of Default by Seller under this Agreement;

7. Seller shall have delivered such other and further UCC-1s, amendments thereto and Subordination Agreements as Purchaser shall deem reasonably necessary; and

8. Seller shall have delivered such other documents, certificates, submissions, instruments, and agreements as reasonably requested by Purchaser relating to the transaction herein contemplated.

ARTICLE 10  
Indemnities By Seller

Section 10.1. Right to Indemnification. Without prejudice to any other rights that Purchaser may have hereunder or under applicable law, Seller agrees to indemnify, pay and hold Purchaser and the employees and agents of Purchaser (collectively called the "Indemnitees") harmless from and against, any and all liabilities, obligations, losses, damages (including consequential damages, except as expressly set forth below), penalties, actions, judgments, suits, claims, costs and expenses (including without limitation the reasonable fees and disbursements of counsel for such Indemnitees and reasonable costs of investigation and accountants) (collectively, "Indemnified Amounts"), which arise or result from: (i) any breach by Seller of its duties hereunder individually or as the Collection Agent, in connection with the collection of Sold Receivables; (ii) any dispute, claim, offset or defense of any Obligor (other than as a result of the Obligor's bankruptcy or insolvency) to the payment of any Receivable owned by Purchaser (including without limitation a defense based on such Receivable or the underlying Contract not being the legal, valid and binding obligation of such Obligor enforceable against such Obligor in accordance with its terms), in either case other than as a result of an act or omission of Purchaser not required or permitted under this Agreement; (iii) any other claim resulting from the sale of the Products and Services underlying the Receivable (including without limitation any warranty or product liability claims); or (iv) any breach by Seller of any of the terms, covenants, conditions or representations of this Agreement; excluding, in all cases however, (A) Indemnified Amounts to the extent resulting from gross negligence or willful misconduct on the part of such Indemnitee, (B) consequential, indirect, punitive or exemplary damages, except such damages which are imposed on the Indemnitee in favor of any third party in connection with the actions described in (i) through (iv) above, and (C) recourse for uncollectible Receivables and all income and franchise taxes on Purchaser; provided, further, that if an arbitrator or court of competent jurisdiction in a final non-appealable order determines that such Indemnified Amounts arose in part from such Indemnitee's gross negligence or willful misconduct, Seller shall reimburse such Indemnitee for the portion of such claim not resulting from such Indemnitee's gross negligence or willful misconduct. The obligations of Seller pursuant to this Section 10.1 shall survive any termination of this Agreement.

Section 10.2. Notification of Potential Liability. Each party will make good faith efforts to identify potential situations involving possible liability under this Article 10, and to determine the amount, if any, of such liability or obligations, and will, upon learning of such potential situations, promptly advise the other party.

Section 10.3. Litigation. The Seller agrees at its expense, at the Purchaser's request, to cooperate with the Purchaser in any action, suit or proceeding brought by or against the Purchaser relating to any of the transactions contemplated by this Agreement or to any of the Sold Receivables owned by the Purchaser (other than an action, suit or proceeding by the Seller against the Purchaser). In addition, the Seller agrees to notify the Purchaser and the Purchaser agrees to notify the Seller, at the Seller's expense, promptly upon learning of any pending or threatened action, suit or proceeding if the judgment or expenses of defending such action, suit or proceeding would be covered by Section 10.1 and (except for an action, suit or proceeding by the Seller against the Purchaser) to consult with the Purchaser, concerning

the defense and prior to settlement; provided, however, that if (i) the Seller shall have acknowledged that Section 10.1 would cover any judgment or expenses in any action, suit or proceeding and (ii) in the Purchaser's sole determination, the Seller has the financial ability to satisfy such judgment or expenses, then the Seller shall have the right, on the Purchaser's behalf but at the Seller's expense, to defend such action, suit or proceeding with counsel selected by the Seller and shall have sole discretion as to whether to litigate, appeal or enter into an exclusively monetary settlement; and provided further that (i) the Purchaser's failure to provide any notice pursuant to this Section 10.3 shall not affect the indemnification of any party by the Seller hereunder, and (ii) the Seller's sole and exclusive remedy in the event of any such failure to give notice by the Purchaser shall be a separate action against the Purchaser for damages actually incurred by the Seller as a direct result of the Purchaser's failure to provide such notice.

Section 10.4. Seller to Remain Obligated. Anything herein to the contrary notwithstanding: (i) Seller shall remain responsible and liable under the Contracts to the extent set forth in such Contracts or otherwise to perform all of its duties and obligations thereunder to the same extent as if the Sold Receivables applicable to such Contracts had not been sold to Purchaser hereunder; (ii) the exercise by Purchaser of any of its rights hereunder shall not release Seller from any of its duties or obligations under such Contracts; and (iii) Purchaser shall not have any obligation or liability under such Contracts by reason of the purchase of the applicable Sold Receivables hereunder, nor shall Purchaser be obligated to perform any of the obligations or duties of Seller thereunder.

#### ARTICLE 11 Termination

Section 11.1. Termination. Absent termination of this Agreement pursuant to Article 12, this Agreement shall continue in full force and effect until the earlier of the date (i) which is ninety (90) days after written notice from any Party to the other Party of its election to terminate this Agreement, or (ii) on which all obligations of Seller to Purchaser and Purchaser to Seller, have been satisfied in full (the "Termination Date"). Subject to the provisions of Article 12, (i) no termination of this Agreement shall affect any monetary obligations hereunder of any Party arising prior to the effective date of such termination, (ii) no termination of this Agreement shall affect the obligation of Seller to make any payments to Purchaser required hereunder, including but not limited to payments of Credit Adjustments, (iii) no termination of this Agreement shall affect any obligations which, specifically by their terms, survive termination hereof, including but not limited to, Seller's indemnification obligations hereunder, and (iv) payments of any and all amounts from Obligors with respect to Sold Receivables (regardless of the existence of any other obligation or indebtedness of such Obligors then owed to the Seller or any other person or entity) to the Seller shall continue to be treated as Collections and shall be applied to repayment of Sold Receivables as set forth herein. Notwithstanding any such termination, Seller agrees that from time to time thereafter it will promptly execute and deliver all further instruments and documents, and take all further actions, that may be necessary or that Purchaser may reasonably request, in order to perfect, protect or more fully evidence Purchaser's right, title and interest in and to the Sold Receivables owned by Purchaser hereunder; to enable Purchaser to exercise or enforce any such rights; to facilitate

maximum Collections; and/or otherwise to effectuate the intent of the Parties hereto with respect to the Sold Receivables and Collections.

ARTICLE 12  
Events of Default

Section 12.1. Events of Default. Any of the following events will constitute an Event of Default by Seller under this Agreement:

(a) Except for the breach described in Section 12.1(c) below, Seller fails to perform any of its obligations contained herein or in any other related agreements between Seller and Purchaser, and such breach is not cured within thirty (30) days of Seller's receipt of written notice of such breach from Purchaser;

(b) any representation, statement, report, or certificate made or delivered by Seller to Purchaser is not accurate in all material respects when made (or when deemed made);

(c) Seller fails to pay any of its monetary obligations payable to Purchaser hereunder or under any other agreements related to this Agreement within five (5) days of when due and payable;

(d) any event or condition shall occur which results in the acceleration of the maturity of any debt of Seller or any subsidiary of Seller to a third party in excess of \$50,000,000 or enables (or, with the giving of notice or lapse of time or both, would enable) the holder of such debt or any Person acting on such holder's behalf to accelerate the maturity thereof;

(e) final judgments or orders for the payment of money in excess of \$50,000,000 in the aggregate (excluding amounts with respect to which a financially sound and reputable insurer has admitted liability) shall be rendered against the Seller or any subsidiary of Seller and such judgments or orders shall continue unsatisfied or unstayed for a period of thirty (30) consecutive days;

(f) an attachment, sale or seizure issues or is executed against any assets of Seller or any subsidiary of Seller; provided, however, that no event that would otherwise constitute an Event of Default under this Section 12.1(f) shall be an Event of Default if the total assets of all entities with respect to which such event has occurred which would otherwise have constituted an Event of Default under Sections 12.1 (f), (h), or (i) do not exceed \$50,000,000 in the aggregate;

(g) Seller shall cease existence as a corporation, other than as permitted under Section 7.5 hereof;

(h) Seller or any subsidiary of Seller shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall fail generally to pay its debts as they become due, or shall take any corporate action to authorize any of

the foregoing; provided, however, that no event that would otherwise constitute an Event of Default under this Section 12.1(h) shall be an Event of Default if the total assets of all entities with respect to which such event has occurred which would otherwise have constituted an Event of Default under Sections 12.1 (f), (h), or (i) do not exceed \$50,000,000 in the aggregate; or

(i) an involuntary case or other proceeding shall be commenced against Seller or any subsidiary of Seller seeking liquidation, reorganization or other relief with respect to it or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, and such involuntary case or other proceeding shall remain undismissed and unstayed for a period of 60 days; or an order for relief shall be entered against Seller or any subsidiary of Seller under the federal bankruptcy laws as now or hereafter in effect; provided, however, that no event that would otherwise constitute an Event of Default under this Section 12.1(i) shall be an Event of Default if the total assets of all entities with respect to which such event has occurred which would otherwise have constituted an Event of Default under Sections 12.1 (f), (h) or (i) do not exceed \$50,000,000 in the aggregate.

Section 12.2. Remedies. If any Event of Default is not cured within the period specified above, if any (with respect to Sections 12.1 (h) or (i) Purchaser may act immediately upon the occurrence of any such Event of Default), Purchaser may, at any time of its election, without prior notice or demand to Seller, do any one or more of the following: (i) cease making Purchases hereunder; (ii) declare the Facility Termination Date to have occurred; (iii) apply a default charge to Seller's outstanding monetary obligations then due and payable to Purchaser hereunder equal to the lesser of four percent (4%) per annum in excess of the Prime Rate, or the highest lawful contract rate of interest permitted by applicable law; provided, however, that such default charge shall accrue only during the continuance of an Event of Default or until payment of such monetary obligation and only be applicable to (A) Collections which Seller has failed to pay to Purchaser in accordance with the terms hereof after the applicable First Collection Settlement Date, and (B) Credit Adjustments, any delinquent Receivables payments described in Section 3.3.B(i) hereof, and any other obligations payable by Seller to Purchaser hereunder or under any other related agreements, which Seller has failed to pay to Purchaser when due (other than any indemnification obligations), or (iv) exercise any or all rights under applicable law. All Purchaser's rights and remedies are cumulative. The Purchaser's failure to exercise any of its rights or remedies hereunder will not waive any of its rights or remedies as to any past, current or future Event of Default.

#### ARTICLE 13 Miscellaneous

Section 13.1. Costs, Expenses and Taxes. Seller shall pay on demand all costs and expenses incurred by Purchaser in connection with enforcement of this Agreement and the other documents to be delivered hereunder, including accountants' and attorneys' fees and expenses. The obligations of Seller under this Section 13.1 shall survive the termination of this Agreement.

Section 13.2. Addresses. All Notices provided for hereunder shall be in writing (including facsimile transmissions or telegraphic or

telex communications) and mailed (return receipt requested), telecopied, telegraphed, telexed or delivered, as appropriate, to each party at the address set forth as follows or at such other address as the party affected may designate in a written notice to the other parties hereto complying as to delivery with the terms of this Article 13. All such Notices and fund transfers shall be effective when received.

If Notice to Purchaser:

Deutsche Financial Services Corporation  
2401 East Katella Avenue, Suite 400  
Anaheim, CA 92803-4850  
Attention: Regional Vice President  
Facsimile No.: (714) 937-0199

With a copy to:

Deutsche Financial Services Corporation  
655 Maryville Centre Drive  
St. Louis, MO 63141-5832  
Attention: General Counsel  
Facsimile No.: (314) 523-3190

If Notice to Seller:

Applied Materials, Inc.  
3050 Bowers Avenue, M/S 2036  
Santa Clara, CA 95054  
Attention: Diane Gale, Assistant Treasurer  
Facsimile No.: (408) 986-7825

With a copy to:

Applied Materials, Inc.  
3050 Bowers Avenue, M/S 2062  
Santa Clara, CA 95054  
Attention: Barry Quan, Managing Director, Legal Affairs  
Facsimile No.: (408) 986-2836

All funds transfers shall be made as follows:

If funds transfer to Purchaser:

Bank:	Chase Manhattan Bank, New York
ABA Routing No.:	021000021
Account No.:	9102734903
Reference:	Deutsche Financial Services

If funds transfer to Seller:

Bank:	Mellon Bank, Pittsburgh, PA
ABA Routing No.:	043000261
Account No.:	020-8830
Reference:	Applied Materials Inc.

Section 13.3. Further Cooperation. Seller agrees that from time to time, at its expense, it will promptly execute and deliver all further instruments and documents, and take all further action, that may be necessary or that Purchaser may reasonably request, in order to

perfect, protect or more fully evidence Purchaser's right, title and interest in and to the Sold Receivables owned by Purchaser hereunder or to enable Purchaser to exercise or enforce any such rights. Purchaser will promptly execute and deliver any release or termination statement required under the UCC when this Agreement shall have terminated and all Sold Receivables shall have either been collected in full or otherwise discharged in a manner reasonably satisfactory to Purchaser.

Section 13.4. Severability. In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall, to the extent permitted by law, not in any way be affected or impaired thereby.

Section 13.5. Amendments and Waivers. No amendment or waiver of any provision of this Agreement, nor consent to any departure by Seller or Purchaser therefrom, shall in any event be effective unless the same shall be in writing and signed by Seller and Purchaser, and then such waiver or consent shall be effective only in the specified instance and for the specific purpose for which given.

Section 13.6. Cumulative Rights. All rights and remedies of the parties hereto under this Agreement shall, except as otherwise specifically provided herein, be cumulative and nonexclusive of any rights and remedies which they may have under any other agreement or instrument, by operation of law, or otherwise.

Section 13.7. Effectiveness. This Agreement shall become effective when it shall have been executed and delivered by all parties hereto and thereafter shall be binding upon and inure to the benefit of Seller and Purchaser and their respective successors and assigns, except that neither party shall have the right to assign its rights hereunder or any interest herein without the prior written consent of the other party, which consent may in the discretion of such other party be withheld; provided, however, that Purchaser may participate any of its interest in this Agreement and the Sold Receivables to a third party, with the consent of Seller if no Event of Default exists and no consent of Seller but with notice to Seller if an Event of Default exists.

Section 13.8. Execution in Counterparts. This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same Agreement.

Section 13.9. Confidentiality. The Purchaser and the Seller each shall hold all non-public information obtained pursuant to this Agreement and the transactions contemplated hereby or effected in connection herewith confidential. Purchaser may make disclosure reasonably required by any bona fide transferee or prospective transferee in connection with the contemplated transfer of any Sold Receivable or participation in this Agreement by the Purchaser so long as such Person signs a confidentiality agreement. Either Party may disclose confidential information as required by law or as requested by any governmental agency or representative thereof or pursuant to legal process; provided that, unless specifically prohibited by applicable law or court order, each party hereto shall notify the other parties hereto of any request by any governmental agency or representative thereof (other than any such request in connection with an examination of the



financial condition of the Purchaser by such governmental agency) for disclosure of any such non-public information prior to disclosure of such information to permit the party affected to contest such disclosure, if possible; provided further that in no event shall the Purchaser be obligated or required to return any materials furnished by the Seller.

Section 13.10. No Affiliation. Purchaser and Seller each hereby represents and warrants that neither Purchaser nor Seller is under common control or ownership with the other. Neither Seller nor Purchaser shall have any right or authority to bind the other or create any obligation or responsibility, express or implied, on behalf of the other, or in the other's name, except as may be herein expressly permitted. Nothing stated in this Agreement shall be construed as constituting Seller and Purchaser as partners or joint venturers, or as creating the relationship of employer and employee, master and servant, franchisor and franchisee, or principal and, except for Seller being Collection Agent, agent between Seller and Purchaser.

Section 13.11. List of Schedules and Exhibits. The following Schedules and Exhibits are attached to this Agreement and are incorporated herein by this reference:

- Schedule A - Seller's Chief Executive Offices
- Schedule B - Acceptable Obligors
- Schedule C - Form of Receivable Verification Letter
- Exhibit I - Forms of Opinions of Counsel
- Exhibit II - Form of Receivables Purchase Settlement Statement
- Exhibit III - Seller's Payment Terms
- Exhibit IV - Seller's Collection Procedures
- Exhibit V - Form of Monthly Status Report

Section 13.12. Limitation on Damages. Except as may be expressly provided for in this Agreement or any other agreement between them, neither Purchaser nor Seller shall be liable to the other for exemplary, consequential or punitive damages.

Section 13.13. Jurisdiction; Jury Trial Waiver, Etc. ANY LEGAL PROCEEDING WITH RESPECT TO ANY DISPUTE OR OTHER MATTER ARISING OUT OF OR IN ANY WAY RELATED TO THIS AGREEMENT OR THE DOCUMENTS INSTRUMENTS OR AGREEMENTS RELATED HERETO WILL BE TRIED IN A COURT OF COMPETENT JURISDICTION LOCATED IN SANTA CLARA COUNTY, CALIFORNIA, BY A JUDGE WITHOUT A JURY. SELLER AND PURCHASER WAIVE ANY RIGHT TO A JURY TRIAL IN ANY SUCH PROCEEDING. SELLER AND PURCHASER FURTHER WAIVE ANY RIGHT TO CLAIM ANY EXEMPLARY OR PUNITIVE DAMAGES IN ANY SUCH PROCEEDING.

Section 14. GOVERNING LAW. Purchaser and Seller acknowledge and agree that this and all other agreements between Purchaser and Seller have been substantially negotiated, and will be substantially performed, in the state of California. Accordingly, Purchaser and Seller agree that this Agreement and all matters relating hereto shall be governed by and construed in accordance with the laws of the State of California.

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IN WITNESS WHEREOF, the parties hereto have executed and delivered this Agreement by their officers thereunto duly authorized as of the date first above written.

THIS AGREEMENT CONTAINS JURY WAIVER AND PUNITIVE DAMAGES WAIVER PROVISIONS.

APPLIED MATERIALS, INC.

By: /s/ Nancy H. Handel

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Nancy H. Handel  
Title: Vice President, Global  
Finance and Treasurer

By: /s/ Joseph R. Bronson

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Joseph R. Bronson  
Title: Senior Vice President and  
Chief Financial Officer

DEUTSCHE FINANCIAL SERVICES CORPORATION

By:/s/ Dennis L. VanLeeuwen

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Dennis L. VanLeeuwen  
Title: Director of Operations

SCHEDULE A  
CHIEF EXECUTIVE OFFICES

Applied Materials, Inc.  
3050 Bowers Avenue  
Santa Clara, CA 95054

SCHEDULE B  
ACCEPTABLE OBLIGORS

The following Obligors shall be deemed acceptable, subject in all events to the terms of the Agreement and subject further to the maximum Outstanding Balance limitation set forth opposite such Obligor's name, which additionally are subject, in all events to the A/R Limit:

OBLIGOR	MAXIMUM OUTSTANDING BALANCE LIMITATION
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1. Advanced Micro Devices, Inc.	\$ 2,198,944.17
2. International Business Machines Corporation	\$ 4,277,575.10
3. Intel Corporation	\$ 2,410,000.00
4. Lucent Technologies, Inc.	\$13,947,867.70
5. Motorola Corp.	\$ 8,532,489.68
6. National Semiconductor	\$ 4,772,451.80
7. Rockwell International	\$ 1,164,709.31

SCHEDULE C  
FORM OF RECEIVABLE VERIFICATION LETTER

EXHIBIT I  
FORMS OF OPINIONS OF COUNSEL

EXHIBIT II

FORM OF RECEIVABLES PURCHASE SETTLEMENT STATEMENT

EXHIBIT III  
SELLER'S PAYMENT TERMS



EXHIBIT IV  
SELLER'S COLLECTION PROCEDURES

EXHIBIT V  
FORM OF MONTHLY STATUS REPORT  
(SELLER TO SUPPLY)

AMENDMENT NO. 1 TO THE  
APPLIED MATERIALS, INC.  
SENIOR EXECUTIVE BONUS PLAN

APPLIED MATERIALS, INC., having adopted the Applied Materials, Inc. Senior Executive Bonus Plan (the "Plan"), hereby amends the Plan, effective as of September 2, 1998, as follows:

1. Section 2.2 is amended in its entirety as follows:

2.2 "Annual Revenue" means the Company's or business unit's net sales for the Plan Year, determined in accordance with generally accepted accounting principles; provided, however, that prior to the Determination Date, the Committee shall determine whether any significant items(s) shall be excluded or included from the calculation of Annual Revenue with respect to one or more Participants.

2. Section 2.15 is amended in its entirety as follows:

2.15 "Net Income" means as to any Plan Year, the income after taxes of the Company and its consolidated subsidiaries for the Plan Year, determined in accordance with generally accepted accounting principles, provided that prior to the Determination Date, the Committee shall determine whether any significant item(s) shall be included or excluded from the calculation of Net Income with respect to one or more Participants.

IN WITNESS WHEREOF, Applied Materials, Inc., by its duly authorized officer, has executed this Amendment No. 1 on the date indicated below.

APPLIED MATERIALS, INC.

Dated: September 2, 1998

By: /s/ DONALD A. SLICHTER

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Donald A. Slichter  
Secretary

RATIO OF EARNINGS TO FIXED CHARGES  
(Dollars in thousands)

	Fiscal Year				
	1994	1995	1996	1997	1998
Income before taxes and fixed charges (net of capitalized interest):					
Income from continuing operations before taxes and cumulative effect of accounting change	\$334,497	\$698,543	\$922,436	\$798,921	\$437,833
Add fixed charges net of capitalized interest (1)	27,032	34,504	42,819	44,161	69,543
Total income before taxes and fixed charges	\$361,529	\$733,047	\$965,255	\$843,082	\$507,376
Fixed charges:					
Interest expense	\$ 15,962	\$ 21,401	\$ 20,733	\$ 20,705	\$ 45,309
Capitalized interest	--	--	5,108	750	4,268
Interest component of rent expense (2)	11,070	13,103	22,086	23,013	23,720
Total fixed charges	\$ 27,032	\$ 34,504	\$ 47,927	\$ 44,468	\$ 73,297
Ratio of earnings to fixed charges	13.37x	21.25x	20.14x	18.96x	6.92x

(1) Capitalized interest includes interest capitalized during the period, less the amount of previously capitalized interest that was amortized during the period.

(2) The interest factor is estimated at one-third of total rent expense for the applicable period, which management believes represents a reasonable approximation of the interest factor.

APPLIED MATERIALS

1998 ANNUAL REPORT

FISCAL YEAR ENDED OCTOBER 25, 1998

Fiscal year ended*	1994	1995	1996	1997	1998
(Dollars in thousands, except per share amounts)					
Net sales	\$1,659,807	\$3,061,881	\$ 4,144,817	\$ 4,074,275	\$4,041,687
Gross margin	\$768,295	\$1,409,848	\$1,949,739	\$1,900,925	\$1,863,156
(% of net sales)	46.3	46.0	47.0	46.7	46.1
Research, development and engineering	\$189,126	\$329,676	\$481,394	\$567,612	\$643,852
(% of net sales)	11.4	10.8	11.6	13.9	15.9
Marketing, selling and administrative	\$239,932	\$386,240	\$539,694	\$566,595	\$593,715
(% of net sales)	14.4	12.6	13.0	13.9	14.7
Income from continuing operations before taxes and cumulative effect of accounting change	\$334,497	\$698,543	\$922,436	\$798,921	\$437,833
(% of net sales)	20.2	22.8	22.3	19.6	10.8
Effective tax rate (%)**	35.0	35.0	35.0	37.6	34.0
Income from continuing operations***	\$217,423	\$454,053	\$599,585	\$498,474	\$288,970
Income from continuing operations per diluted share	\$0.64	\$1.28	\$1.63	\$1.32	\$0.76
Average common shares and equivalents (in thousands)	340,084	354,696	367,214	377,838	378,508
Order backlog	\$715,200	\$1,508,800	\$1,422,800	\$1,721,711	\$916,767
Working capital	\$734,104	\$1,449,882	\$1,757,842	\$2,368,269	\$2,400,629
Current ratio	2.5	2.7	2.9	2.7	3.1
Long-term debt	\$209,114	\$279,807	\$275,485	\$623,090	\$616,572
Stockholders' equity	\$966,264	\$1,783,503	\$2,370,425	\$2,942,171	\$3,120,621
Book value per share	\$2.87	\$4.97	\$6.58	\$8.01	\$8.48
Total assets	\$1,702,665	\$2,965,379	\$3,637,987	\$5,070,766	\$4,929,692
Capital expenditures, net	\$180,440	\$265,557	\$452,535	\$339,364	\$448,607
Regular full-time employees	6,497	10,537	11,403	13,924	12,060

\* The fiscal year ends on the last Sunday in October of each year. The fiscal year ends for the periods presented are: October 30, 1994, October 29, 1995, October 27, 1996, October 26, 1997 and October 25, 1998.

\*\* The fiscal 1997 tax rate is higher than the expected rate of 35 percent due to the non-deductible nature of acquired in-process research and development expense of \$59,500. During fiscal 1998, the Company changed its effective tax rate to 34 percent (see Note 11 of Notes to Consolidated Financial Statements).

\*\*\* Income from continuing operations includes one-time expenses, net, on an after-tax basis, of: \$16,315 for fiscal 1996, \$25,257 for fiscal 1997 and \$146,670 for fiscal 1998. Fiscal 1994 excludes equity in net loss of joint venture of \$3,727 and cumulative effect of accounting change of \$7,000. Including these items, fiscal 1994 data would be: net income of \$220,696 and earnings per diluted share of \$0.65. Fiscal 1998 excludes one-time costs of \$58,068 associated with the discontinued operations of Applied Komatsu Technology, Inc. (AKT), the Company's joint venture. Including AKT, fiscal 1998 data would be: net income of \$230,902 and earnings per diluted share of \$0.61.

When used in this Annual Report, including this Management's Discussion and Analysis, the words "anticipate," "estimate," "expect" and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect management's current opinions and are subject to certain risks and uncertainties that could cause actual results to differ materially from those stated or implied. Applied Materials, Inc. (the Company) assumes no obligation to update this information. Risks and uncertainties include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis--Trends, Risks and Uncertainties."

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RESULTS OF OPERATIONS

NET SALES

Although the Company's net sales are comparable for fiscal 1996, 1997 and 1998, each fiscal year was subject to cyclical industry conditions that caused significant fluctuations in quarterly new orders and net sales, both within and across fiscal years. Demand for semiconductor equipment has historically been volatile as a result of sudden changes in semiconductor supply and demand, as well as rapid shifts in technology. Information with respect to quarterly new orders and net sales is as follows:

	Quarter				Fiscal Year
	First	Second	Third	Fourth	
(In millions)					
1996:					
New orders	\$1,329	\$1,323	\$932	\$683	\$4,267
Net sales	\$1,041	\$1,128	\$1,115	\$861	\$4,145
1997:					
New orders	\$905	\$1,014	\$1,240	\$1,374	\$4,533
Net sales	\$836	\$901	\$1,057	\$1,280	\$4,074
1998:					
New orders	\$1,290	\$1,027	\$608	\$684	\$3,609
Net sales	\$1,308	\$1,176	\$885	\$673	\$4,042

In addition, each region in the global semiconductor equipment market exhibits unique characteristics that can cause, and have caused, capital equipment investment patterns to vary significantly from period to period. Information with respect to net sales by geographic region is as follows:

	1996		1997		1998	
	\$	%	\$	%	\$	%
North America*	1,270	30.6	1,501	36.8	1,549	38.3
Europe	686	16.6	600	14.7	645	16.0
Japan	1,009	24.3	750	18.4	678	16.8
Korea	567	13.7	333	8.2	167	4.1
Taiwan	406	9.8	696	17.1	817	20.2
Asia-Pacific	207	5.0	194	4.8	186	4.6
	4,145	100.0	4,074	100.0	4,042	100.0

\*Primarily the United States.

During 1996, the semiconductor industry experienced a slowdown as a result of excess production capacity and sharply decreasing device prices within the DRAM market segment. This slowdown caused semiconductor manufacturers to reduce and delay their equipment investments, thus negatively impacting the Company's results of operations for the second half of fiscal 1996 and first half of fiscal 1997.

During the Company's third fiscal quarter of 1997, the semiconductor industry began to recover from this slowdown, and the Company was able to achieve record levels of quarterly new orders and net sales for its fourth fiscal quarter of 1997. These record levels of new orders and net sales were driven by strengthening demand for leading-edge capability from logic and microprocessor device manufacturers, foundry capacity investments by customers primarily located in Taiwan, and selected strategic investments in 0.25 micron technology by DRAM manufacturers.

The current industry downturn, which began during the first half of the Company's fiscal 1998, has been much more severe than the slowdown that impacted the Company's results of operations during the first half of fiscal 1997. This downturn is the result of the convergence of several factors: an economic crisis in Asia; semiconductor industry overcapacity (particularly DRAM devices); and reduced profitability for semiconductor manufacturers resulting from a movement among end users to sub-\$1,000 personal computers (PCs). With respect to the Company's net sales for fiscal 1998, DRAM overcapacity and the Asian economic crisis particularly affected customers in Japan and Korea. These factors caused semiconductor manufacturers to significantly reduce and delay investment in manufacturing equipment during fiscal 1998. For example, new orders and net sales for the Company's fourth fiscal quarter of 1998 decreased almost 50 percent from the levels achieved for the first fiscal quarter of 1998. Therefore, despite comparable annual net sales for fiscal 1997 and fiscal 1998, the Company is entering fiscal 1999 in a dramatically different industry environment from the one that existed at the beginning of fiscal 1998. There is a high degree of uncertainty regarding the length and severity of the current industry downturn. For this and other reasons, the Company's results of operations for fiscal 1998 are not necessarily indicative of future operating results.

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#### GROSS MARGIN

Gross margin as a percentage of net sales was 47.0 percent for fiscal 1996, 46.7 percent for fiscal 1997 and 46.1 percent for fiscal 1998. The decrease in gross margin as a percentage of net sales from fiscal 1996 to fiscal 1997 can be attributed primarily to the fact that fiscal 1997 quarterly net sales were lower than those for the comparable fiscal 1996 quarters, with the exception of the fourth fiscal quarter, thus resulting in lower overall business volume. The decrease in gross margin as a percentage of net sales from fiscal 1997 to fiscal 1998 is the result of lower overall business volume, combined with underutilization of manufacturing resources during the second half of fiscal 1998 as business volume dropped significantly.

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#### RESEARCH, DEVELOPMENT AND ENGINEERING

The Company's future operating results depend, to a considerable extent, on its ability to maintain a competitive advantage in the products and services it provides. The Company believes it is critical to continue to make substantial investments in research and development to ensure the availability of innovative technology that meets the requirements of its customers' most advanced chip designs. Research, development and engineering expenses increased from 11.6 percent of net sales for fiscal 1996, to 13.9 percent for fiscal 1997 and 15.9 percent for fiscal 1998.



The increase in absolute spending from fiscal 1996 to fiscal 1997 was primarily for early stage development of 300mm products and continued investment in the development of systems for 0.25 micron and below production. In fiscal 1997, the Company introduced several advanced new products, including: the Ultima HDP-CVD(TM) (high density plasma chemical vapor deposition) Centura(R) for advanced, high-speed 0.25 micron devices; the Endura(R) HP Liner/Barrier systems for depositing critical titanium and titanium nitride films in 0.25 micron devices; the High Temperature Silicon Nitride Centura, which uses single-wafer technology for depositing high temperature films; and the Dielectric Etch IPS(TM) Centura, which is the industry's most advanced oxide etcher for 0.25 micron and below devices. The Company also introduced numerous process and technology advancements to existing products during 1997.

The increase in absolute spending from fiscal 1997 to fiscal 1998 resulted from several trends in semiconductor production technology, particularly the beginning of a shift to copper-based interconnects and the shrinking of device sizes. The Company opened a new facility, the Equipment and Process Integration Center (EPIC), and announced its Copper Interconnect Equipment Set Solution (ESS) product on November 3, 1998. These two industry "firsts" offer customers a complete set of integrated systems to fabricate the copper interconnect portion of their devices and a facility in which to demonstrate and test a set of systems before installation in their fabs. The facility houses all technologies needed to make the copper interconnect, including systems not offered by the Company but needed for demonstration purposes. Some of the Company's new technologies being demonstrated in the center are: the Endura Electra Barrier/Seed Cu(TM) system, the industry's first and current market-leading product to deposit the critical barrier/seed layers of the copper interconnect; an innovative "low k" dielectric material called Black Diamond; chemical mechanical polishing (CMP) of copper and barrier metals using the Company's Mirra(R) CMP system; and electroplating technology to fill the interconnect with bulk metal. The latter two technologies are in advanced stages of development and are expected to be introduced as products in fiscal 1999.

In addition to the Endura Electra Barrier/Seed Cu(TM) system, the Company introduced several new products in fiscal 1998 for the production of sub-0.25 micron devices, including: the Producer(TM), a new high-throughput platform for CVD applications; the SEMVision(TM) Defect Review Scanning Electron Microscope (SEM) system, the first fully-automated defect review and classification SEM specifically designed for in-line operation within advanced semiconductor production lines; the WF-73X series defect detection and classification systems for rapid yield ramping and high-throughput in-line monitoring; and the RTP (rapid thermal processing) XEplus(TM) Centura, an enhanced version of the Company's RTP system with an accelerating, highly controlled temperature ramp rate for forming ultra-shallow junctions. The Company also introduced numerous process and technology advancements to existing products during fiscal 1998, and development continued on a wide range of products using 300mm wafers in anticipation of future customer processing requirements. However, over the course of fiscal 1998, and particularly in the second half, the Company's 300mm product development efforts were reduced significantly to reflect the semiconductor industry's decision to slow migration to 300mm wafer processing. The success of these new and enhanced products in the market has yet to be determined (see "Trends, Risks and Uncertainties").

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#### MARKETING, SELLING, GENERAL AND ADMINISTRATIVE

Marketing, selling, general and administrative expenses as a percentage of net sales increased from 13.0 percent for fiscal 1996, to 13.9 percent for fiscal 1997 and 14.7 percent for fiscal 1998. During each of these fiscal years, the Company increased spending in marketing and selling programs to support the development of international markets and to increase customer awareness of new products and services. Administrative expenses have increased during each of the last three fiscal years to support the Company's revenue and headcount levels, to improve information technology capability and to protect the Company's intellectual property rights.

## NON-RECURRING ITEMS

Non-recurring operating expense items do not include litigation settlements and costs associated with Applied Komatsu Technology, Inc. (AKT) (see "Litigation Settlements" and "AKT Joint Venture" below). Non-recurring operating expense items for fiscal 1996, 1997 and 1998 included the following:

	1996	1997	1998
(In thousands)			
Acquired in-process research and development	\$--	\$59,500	\$32,227
Write-down of impaired assets	--	--	70,000
Restructuring	25,100	--	135,000
Bad debt expense	--	16,318	--
	\$25,100	\$75,818	\$237,227

**ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT** During the first fiscal quarter of 1997, the Company acquired two companies, Opal, Inc. (Opal) and Orbot Instruments, Ltd. (Orbot), in separate transactions for \$293 million, consisting primarily of cash, and recognized \$59.5 million of acquired in-process research and development expense. With the exception of this charge, the transactions did not have a material effect on the Company's results of operations for fiscal 1997. During fiscal 1998, the Company determined that certain intangible assets recorded in connection with these acquisitions were impaired (see "Write-down of Impaired Assets" below). There can be no assurance that the Company will not incur additional charges in connection with these or other acquisitions (see "Trends, Risks and Uncertainties").

During the first fiscal quarter of 1998, the Company entered into an agreement with Trikon Technologies, Inc. for a non-exclusive, worldwide, perpetual license of MORI(TM) plasma source and Forcefill(TM) deposition technology. Because the development of this technology had not yet reached technological feasibility at the time of its acquisition and had no alternative future use, the Company recognized \$32 million, including transaction costs, of acquired in-process research and development expense at the time of its acquisition.

**WRITE-DOWN OF IMPAIRED ASSETS** During the fourth fiscal quarter of 1998, the Company determined that the carrying value of certain purchased technology exceeded its net realizable value as a result of rapid changes in technology and a reduced demand outlook caused by significant changes in business conditions. This determination was supported by the results of an independent analysis prepared by a nationally-recognized valuation firm. In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," the Company recorded a pre-tax charge of \$70 million for this impairment in asset value.

**RESTRUCTURING** During the fourth fiscal quarter of 1996, the Company recorded a pre-tax restructuring charge of \$25 million in connection with a reduction of its workforce and related consolidation of facilities. These actions were taken in response to a downturn in the semiconductor industry.

During fiscal 1998, the Company recorded a pre-tax restructuring charge of \$135 million, consisting of \$75 million for headcount reductions and \$60 million for consolidation of facilities and related fixed assets. These restructuring actions occurred in the Company's third and fourth fiscal quarters, and were taken to align the Company's cost structure with prevailing market conditions and to create a more flexible and efficient organization that is well-positioned for an industry recovery. During the third fiscal quarter of 1998, the Company completed a voluntary separation plan that resulted in a headcount reduction of approximately 800 employees, or six percent of its global workforce, for a cost of \$25 million. The majority of employees who terminated employment were located in California and Texas. During the fourth fiscal quarter of 1998, the Company eliminated approximately 2,000 additional positions, or 15 percent of its global workforce, for a cost of \$50 million. Approximately 1,350 of these positions were eliminated in California and Texas, with the remainder being eliminated from other locations worldwide.

Total cash outlays for fiscal 1998 restructuring activities will be \$105 million. The remaining \$30 million of restructuring costs consists of non-cash charges primarily for asset write-offs. During fiscal 1998, \$42 million of cash was used for restructuring costs. The majority of the remaining cash outlays of \$63 million is expected to occur in fiscal 1999 (see Note 7 of Notes to Consolidated Financial Statements).

**BAD DEBT EXPENSE** During fiscal 1997, the Company determined that its outstanding accounts receivable balance from Thailand-based Submicron Technology PCL (SMT) was not collectible. Therefore, the Company repossessed systems previously sold to SMT and recorded \$16 million of bad debt expense.

#### LITIGATION SETTLEMENTS

During fiscal 1997, the Company settled certain outstanding litigation with Novellus Systems, Inc. (Novellus) and General Signal Corporation (GSC). In connection with the Novellus settlement, the Company received \$80 million in damages for past patent infringement, and was awarded the right to receive ongoing royalties for certain system shipments subsequent to the date of the settlement. In connection with the GSC settlement, the Company paid \$11 million and acquired ownership from GSC of five patents regarding "cluster tool" architecture.

During the first fiscal quarter of 1998, the Company settled all outstanding patent litigation with ASM International N.V. (ASM). As a result of this settlement, the Company received a convertible note for \$80 million, against which \$15 million was collected in November 1997. Because of the impact of the current industry downturn on ASM's financial condition and liquidity, ASM was not able to pay the \$65 million remaining balance at the maturity date. Therefore, the Company determined based on known facts and circumstances that collection of the note was doubtful, and recorded, for the fourth fiscal quarter of 1998, a \$65 million pre-tax charge to fully reserve the outstanding note. The net effect of the ASM settlement is \$15 million of non-operating income for fiscal 1998. Subsequent to the end of fiscal 1998, ASM secured financing and made a partial payment to the Company (see "Subsequent Events"). ASM is also required, as part of the litigation settlement, to pay ongoing royalties for certain system shipments subsequent to the date of the settlement. Ongoing royalties have not been, and are not expected to be, material.

#### INTEREST EXPENSE

Interest expense was \$21 million for fiscal 1996 and fiscal 1997, and \$45 million for fiscal 1998. There was not a significant change in interest expense from fiscal 1996 to fiscal 1997 since the Company's outstanding weighted average interest-bearing obligations and interest rates did not change significantly during these periods. The increase from fiscal 1997 to fiscal 1998 is primarily the result of interest expense associated with \$400 million of debt issued by the Company during the fourth fiscal quarter of 1997.

#### INTEREST INCOME

Interest income was \$40 million for fiscal 1996, \$60 million for fiscal 1997 and \$80 million for fiscal 1998. The increases from year to year can be attributed primarily to higher average cash and investment balances.

#### TAX RATE

The Company's effective income tax rate was 35 percent for fiscal 1996, 37.6 percent for fiscal 1997 and 34 percent for fiscal 1998. The 37.6 percent effective income tax rate for fiscal 1997 was higher than the expected rate of 35 percent due to the non-deductible nature of a \$59.5 million charge for acquired in-process research and development. The reduction to a 34 percent effective income tax rate for fiscal 1998 is attributable to several factors, including a reduction in state income taxes, U.S.-based income tax credits and a shift in the geographic composition of pre-tax income to entities operating in countries with lower tax rates.

## AKT JOINT VENTURE

The Company has a 50 percent ownership interest in AKT, a joint venture corporation that develops thin film transistor manufacturing systems for Flat Panel Displays. The Company accounts for the joint venture using the equity method. During the fourth fiscal quarter of 1998, the Company decided to discontinue the operations of AKT. The operations of AKT will be wound down over a period not to exceed twelve months from the date of the decision to discontinue operations. As a result of this decision, AKT has stopped selling PVD and Etch systems and has ceased development efforts on new and next generation systems and technology. AKT will continue to offer its existing CVD product line for sale and will also provide existing customers with ongoing system support. The Company expects to provide a maximum of \$27.5 million of funding to AKT, \$20 million of which had already been provided as of the end of fiscal 1998, and has also guaranteed approximately \$20 million of AKT's bank debt. The Company believes it has sufficient reserves for the potential financial effects of its funding expectations and debt guarantee.

The Company recorded, for its fourth fiscal quarter of 1998, after-tax costs of \$58 million, consisting of \$18 million for the Company's share of AKT's net losses prior to the decision to discontinue AKT's operations and \$40 million for net expenses and other obligations expected to be incurred during the wind-down period. There can be no assurance that the Company will not incur additional costs associated with the discontinuance of AKT's operations.

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## FOREIGN CURRENCY

Significant operations of the Company are conducted in foreign currencies, primarily Japanese yen. Forward exchange and currency option contracts are purchased to hedge certain existing firm commitments and foreign currency denominated transactions expected to occur within twelve months. Gains and losses on these contracts are recognized in income when the related transactions being hedged are recognized. Because the effect of movements in currency exchange rates on forward exchange and currency option contracts generally offsets the related effect on the underlying items being hedged, these financial instruments are not expected to subject the Company to risks that would otherwise result from changes in currency exchange rates. The Company does not use derivative financial instruments for trading or speculative purposes. Net foreign currency gains and losses did not have a significant effect on the Company's results of operations for fiscal 1996, 1997 or 1998.

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## SUBSEQUENT EVENTS

## ACQUISITION

On October 12, 1998, the Company announced that it entered into an agreement to acquire Consilium, Inc. (Consilium), a leading independent supplier of integrated semiconductor and electronics manufacturing execution systems software and services, in a stock-for-stock merger. The acquisition was consummated on December 11, 1998, and will be accounted for as a pooling of interests. Each share of Consilium's stock was exchanged for 0.165 of a share of the Company's common stock. The Company expects to issue approximately 2 million shares of its common stock to complete this transaction. Consilium's historical financial condition and results of operations are not material in relation to the Company's historical financial condition and results of operations.

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## SUBSEQUENT PAYMENT FROM ASM

During the first fiscal quarter of 1999, and subsequent to the original maturity date of the note, the Company received a \$20 million payment against its \$65 million outstanding note receivable from ASM. The \$65 million note receivable was fully reserved as of the end of fiscal 1998; accordingly, the \$20 million cash receipt will be reported as pre-tax non-operating income for the first fiscal quarter of 1999. ASM's payment was made in accordance with a restructuring of ASM's obligations under a November 1997

litigation settlement agreement. Pursuant to the new agreement, ASM agreed to pay \$20 million upon completion of the restructuring, \$10 million on November 2, 1999 and \$35 million no later than November 2, 2000. The Company will recognize income related to the remaining balance of the note receivable on a cash receipts basis going forward. Certain other obligations of ASM were also modified; however, these modifications are not expected to be material to the Company's financial condition or results of operations.

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#### RECENT ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 130 (SFAS 130), "Reporting Comprehensive Income," which establishes standards for the reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The Company will adopt SFAS 130 in the first fiscal quarter of 1999.

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosures About Segments of an Enterprise and Related Information," which changes the way public companies report information about operating segments. SFAS 131, which is based on a management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets and reports revenue. The Company is currently assessing the disclosure effects of adopting SFAS 131, which will be effective for the Company's fiscal 1999.

In February 1998, the FASB issued Statement of Financial Accounting Standards No. 132 (SFAS 132), "Employers' Disclosures about Pensions and Other Postretirement Benefits." SFAS 132 does not change the measurement or recognition of such plans, but does standardize the disclosure requirements for pensions and other postretirement benefits to the extent practicable. SFAS 132 also requires disclosure of additional information about changes in benefit obligations and fair values of plan assets, and eliminates certain other disclosures that were previously required. The Company will be required to adopt SFAS 132 in fiscal 1999.

In April 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 98-1 (SOP 98-1), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance regarding whether computer software is internal-use software, the capitalization of costs incurred for computer software developed or obtained for internal use and accounting for the proceeds of computer software originally developed or obtained for internal use and then subsequently sold to the public. The Company does not expect the impact of adopting SOP 98-1, which will be effective for the Company's fiscal 2000, to be material to its financial condition or results of operations.

In April 1998, the AICPA issued Statement of Position 98-5 (SOP 98-5), "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires companies to expense start-up and organization costs as incurred. SOP 98-5 broadly defines start-up activities and provides examples to help entities determine costs that are and are not within the scope of SOP 98-5. SOP 98-5 will be effective for the Company's fiscal 2000, and its initial application will be reported as a cumulative effect of a change in accounting principle. The Company does not expect the impact of adopting SOP 98-5 to be material to its financial condition or results of operations.

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. The Company is in the process of assessing the effect of adopting SFAS 133, which will be effective for the Company's fiscal 2000.

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

The Company's financial condition remained strong, as the ratio of current assets to current liabilities improved from 2.7:1 at October 26, 1997 to 3.1:1 at October 25, 1998. The Company increased its cash, cash equivalents and short-term investments from \$1.5 billion at October 26, 1997 to \$1.8 billion at October 25, 1998.

The Company generated \$692 million of cash from continuing operations in fiscal 1996, \$702 million in fiscal 1997 and \$816 million in fiscal 1998. The primary sources of cash from continuing operations in fiscal 1998 were net income (plus non-cash charges for one-time items, depreciation and amortization) of \$676 million and decreases of \$332 million in accounts receivable and \$134 million in inventories. These sources were partially offset by an increase of \$49 million in net deferred tax assets and decreases of \$159 million in accounts payable and accrued expenses and \$106 million in income taxes payable.

The Company used \$603 million of cash for investing activities in fiscal 1996, \$1.0 billion in fiscal 1997 and \$574 million in fiscal 1998. Cash used for investing activities in fiscal 1996 was for capital expenditures and net purchases of short-term investments. Cash used for investing activities in fiscal 1997 was for the acquisitions of Opal and Orbot, capital expenditures and net purchases of short-term investments. Cash used for investing activities in fiscal 1998 was primarily for net purchases of short-term investments (\$93 million) and property, plant and equipment (\$449 million), as well as the acquisition of licensed technology (\$32 million).

The Company generated \$30 million of cash from financing activities in fiscal 1996, \$391 million in fiscal 1997, and used \$123 million in fiscal 1998. The primary sources of cash from financing activities in fiscal 1996 were net borrowings of \$27 million and proceeds from stock issuances of \$40 million, which were partially offset by stock repurchases of \$37 million. The primary source of cash from financing activities in fiscal 1997 was the issuance of \$400 million of senior notes payable, which was partially offset by stock repurchases and the early retirement of certain long-term debt. Cash used for financing activities in fiscal 1998 was primarily for stock repurchases of \$153 million and net debt repayments of \$64 million, which were partially offset by net proceeds from stock issuances of \$94 million.

In March 1996, the Board of Directors authorized the Company to systematically repurchase up to 5,000,000 shares of its common stock in the open market through February 1999 to reduce the dilution from the Company's stock-based employee benefit and incentive plans. In December 1997, the Board of Directors rescinded the limitation on the number of shares and extended the authorization to March 2001. In fiscal 1996, the Company repurchased 2,370,000 shares of its common stock at an average price of \$15.63 per share, for a total cash outlay of \$37 million. In fiscal 1997, the Company repurchased 2,654,000 shares of its common stock at an average price of \$29.46 per share, for a total cash outlay of \$78 million. In fiscal 1998, the Company repurchased 4,863,000 shares of its common stock at an average price of \$31.53 per share, for a total cash outlay of \$153 million.

At October 25, 1998, the Company's principal sources of liquidity consisted of \$1.8 billion of cash, cash equivalents and short-term investments, and approximately \$600 million of available credit facilities. The Company has a \$250 million revolving line of credit agreement that expires in March 1999 and a \$250 million credit agreement that expires in March 2003; no amounts were outstanding under these agreements at the end of any fiscal year presented. The remaining credit facilities of \$100 million are primarily with Japanese and European banks at rates indexed to their prime reference rate. In addition to cash and available credit facilities, the Company may from time to time raise additional capital in the debt and equity markets. The Company's liquidity is affected by many factors, some based on the normal ongoing operations of the business and others related to the uncertainties of the industry and global economies. Although the Company's cash requirements will fluctuate based on the timing and extent of these factors, management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy commitments for capital expenditures and other cash requirements for the next fiscal year.

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#### TRENDS, RISKS AND UNCERTAINTIES

##### INDUSTRY VOLATILITY

The semiconductor equipment industry has historically been cyclical and subject to sudden changes in supply and demand. The timing, length and severity of these cycles are difficult to predict. During periods of reduced and declining demand, the Company must be able to quickly and effectively align its cost structure with prevailing market conditions, and motivate and retain key employees. During periods of rapid growth, the Company must be able to acquire and/or develop sufficient manufacturing capacity to meet customer demand, and hire and assimilate a sufficient number of qualified people. There can be no assurance that the Company will be able to align its cost structure quickly, motivate or retain key employees, acquire or develop sufficient manufacturing capacity or assimilate a sufficient number of qualified people during these industry cycles.

The semiconductor industry was in a severe downturn as of the end of the Company's fiscal 1998. In response to this industry downturn, the Company has taken a number of actions intended to align its cost structure with prevailing market conditions. Most recently, on October 23, 1998, the Company announced the completion of a restructuring plan whereby approximately 2,000 positions, or 15 percent of the Company's global workforce, were eliminated, and plans to consolidate facilities and related fixed assets were developed. During the third fiscal quarter of 1998, the Company completed a voluntary separation plan and developed plans to consolidate certain facilities. In connection with these two restructuring events, the Company incurred a pre-tax restructuring charge of \$135 million, consisting of \$75 million for headcount reductions and \$60 million for consolidation of facilities and related fixed assets. The Company has also significantly restricted new hiring and utilized mandatory shutdown days in an effort to reduce costs. There can be no assurance that these actions have sufficiently aligned the Company's cost structure with prevailing market conditions.

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##### DRAM OVERCAPACITY AND DEMAND SHIFTS IN THE PC INDUSTRY

The semiconductor industry is currently characterized by excess production capacity for DRAM devices, which has caused semiconductor manufacturers to decrease capital spending. In the PC market, a shift in demand from more expensive, high-performance products to lower-priced products (sub-\$1,000 PCs) has resulted in reduced profitability for semiconductor manufacturers. Therefore, during fiscal 1998, many of the Company's customers delayed or decreased their purchases of the Company's products. Continued DRAM overcapacity and strengthening demand for sub-\$1,000 PCs could cause further delays or decreased demand for the Company's products.

#### JAPANESE AND KOREAN ECONOMIES

Japan and Korea continue to experience banking, currency and other difficulties that are contributing to economic slowdowns or recessions in those countries. They also do not appear to be responding quickly to significant efforts to stimulate their economies. If these economies remain stagnant or continue to deteriorate, capital investment by Japanese and Korean customers could decrease from current levels. As a result of these negative economic conditions, combined with the industry uncertainties discussed above, customers in Japan and Korea canceled or delayed a significant amount of orders for the Company's products in fiscal 1998 and may cancel or delay additional orders in the future. For fiscal 1998, new orders from, and net sales to, customers located in Japan and Korea were 20 percent and 21 percent, respectively, of the Company's totals. If the economies of Japan and Korea remain stagnant or deteriorate further, the economies of other countries, particularly those in Asia, could also be negatively affected, possibly resulting in a material adverse effect on the Company's business, financial condition and results of operations.

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#### GLOBAL BUSINESS

The Company sells systems and provides services to customers located throughout the world. Managing global operations and sites located throughout the world presents challenges associated with, among other things, cultural diversities and organizational alignment. Moreover, each region in the global semiconductor equipment market exhibits unique characteristics that can cause capital equipment investment patterns to vary significantly from period to period. Periodic economic downturns, trade balance issues, political instability and fluctuations in interest and foreign currency exchange rates are all risks that could materially and adversely affect global product and service demand, and therefore, the Company's financial performance.

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#### HIGHLY COMPETITIVE INDUSTRY AND RAPID TECHNOLOGICAL CHANGE

The Company operates in a highly competitive industry characterized by increasingly rapid technological changes. For example, the Company was required to record, for its fourth fiscal quarter of 1998, a \$70 million pre-tax write-down of purchased technology that was acquired in connection with a January 1997 acquisition. The value of this asset was impaired primarily as the result of rapid changes in technology between January 1997 and September 1998 that, together with significant changes in business conditions, contributed to a reduced demand outlook for products incorporating this technology.

The Company's competitive advantage and future success depend on its ability to develop new products and technologies and to: develop new markets in the semiconductor industry for its products and services; introduce new products to the marketplace on a timely basis; qualify new products with its customers; and commence production to meet customer demands.

New products and technologies include those for copper interconnect, production of 300mm wafers and 0.25 micron and below devices. The introduction of new products and technologies grows increasingly complex over time. If the Company does not develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, its financial condition and results of operations could be materially and adversely affected.

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#### ACQUISITIONS

As part of its business strategy, the Company has made and expects to make acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. Acquisitions involve numerous risks, including, but not limited to: difficulties and increased costs in connection with integration of the operations, technologies, and products of the acquired companies; possible write-downs of impaired assets; diverting management attention from normal daily operations; and the potential loss of key employees of the acquired companies. The inability to effectively manage these risks could materially and adversely affect the Company's business, financial condition and results of operations.



## AKT JOINT VENTURE

The Company has a 50 percent ownership interest in AKT, a joint venture corporation that develops thin film transistor manufacturing systems for Flat Panel Displays. The Company accounts for the joint venture using the equity method. During the fourth fiscal quarter of 1998, the Company decided to discontinue the operations of AKT. The operations of AKT will be wound down over a period not to exceed twelve months from the date of the decision to discontinue operations. As a result of this decision, AKT has stopped selling PVD and Etch systems and has ceased development efforts on new and next generation systems and technology. AKT will continue to offer its existing CVD product line for sale and will also provide existing customers with ongoing system support. The Company expects to provide a maximum of \$27.5 million of funding to AKT, \$20 million of which had already been provided as of the end of fiscal 1998, and has also guaranteed approximately \$20 million of AKT's bank debt. The Company believes it has sufficient reserves for the potential financial effects of its funding expectations and debt guarantee.

The Company recorded, for its fourth fiscal quarter of 1998, after-tax costs of \$58 million, consisting of \$18 million for the Company's share of AKT's net losses prior to the decision to discontinue AKT's operations and \$40 million for net expenses and other obligations expected to be incurred during the wind-down period. There can be no assurance that the Company will not incur additional costs associated with the discontinuance of AKT's operations.

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## DEPENDENCE UPON KEY SUPPLIERS

The Company uses numerous suppliers to supply parts, components and subassemblies (collectively, "parts") for the manufacture and support of its products. Although the Company makes reasonable efforts to ensure that parts are available from multiple suppliers, this is not always possible; accordingly, certain key parts are obtained from a single supplier or a limited group of suppliers. These suppliers are, in some cases, thinly capitalized, independent companies that generate significant portions of their business from the Company and/or a small group of other companies in the semiconductor industry. The Company has sought and will continue to seek to minimize the risk of production and service interruptions and/or shortages of key parts by: 1) selecting and qualifying alternative suppliers for key parts; 2) monitoring the financial stability of key suppliers; and 3) maintaining appropriate inventories of key parts. There can be no assurance that the Company's results of operations will not be materially and adversely affected if, in the future, the Company does not receive sufficient parts to meet its requirements in a timely and cost-effective manner.

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## BACKLOG

The Company's backlog decreased from \$1.7 billion at October 26, 1997 to \$917 million at October 25, 1998. The Company schedules production of its systems based upon order backlog and customer commitments. Backlog includes only orders for which written authorizations have been accepted and shipment dates within 12 months have been assigned. However, customers generally may delay delivery of products or cancel orders. Due to possible customer changes in delivery schedules and cancellation of orders, the Company's backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period could have a material adverse effect on the Company's business, financial condition and results of operations.

## RISKS RELATED TO "YEAR 2000" COMPLIANCE

The Company has an initiative in place to address certain Year 2000 issues. The Company's Year 2000 Program Office focuses on four key readiness programs: 1) Internal Infrastructure Readiness, addressing internal hardware and software, including both information technology and non-information technology systems; 2) Supplier Readiness, addressing the preparedness of those suppliers providing material incorporated into the Company's products; 3) Product Readiness, addressing product functionality; and 4) Customer Readiness, addressing customer support and transactional activity. For each readiness area, the Company is systematically performing a global risk assessment, conducting testing and remediation (renovation and implementation), developing contingency plans to mitigate unknown risk, and communicating with employees, suppliers, customers and other third parties related to the Year 2000 problem.

**INTERNAL INFRASTRUCTURE READINESS PROGRAM** The Company, assisted by a third party, has completed an inventory of internal applications and information technology hardware and has commenced work on remediation strategies and testing. Some software applications have been made Year 2000 compliant, and resources have been assigned to address other applications based on their criticality and the time required to make them Year 2000 compliant. Readiness activities are intended to encompass all major categories of applications in use by the Company, including manufacturing, engineering, sales, finance and human resources. All software remediation is scheduled to be completed no later than July 1999. The Year 2000 compliance evaluation of hardware, including hubs, routers, telecommunication equipment, workstations and other items, is nearing completion. Upon completion of the evaluation, the Company plans to implement Year 2000 compliant versions of hardware, as required. In addition to applications and information technology hardware, the Company is in the process of assessing, testing and remediating its non-information technology systems, including embedded systems, facilities and other operations, such as financial, banking, security and utility systems. A contingency plan addressing issues related to the Company's internal infrastructure will be developed when ongoing testing and remediation activities are complete. Although the Company believes it is feasible to complete its evaluation and remediation efforts according to its current schedule, there can be no assurance that all such activities will be completed on time, or that such efforts will be successful.

**SUPPLIER READINESS PROGRAM** This program focuses on minimizing two areas of risk associated with suppliers: 1) a supplier's business capability to continue providing products and services; and 2) a supplier's product integrity. The Company has identified and contacted key suppliers based on their relative risks in these two areas. To date, the Company has received responses from over 90 percent of its key suppliers, most of which indicate that they believe the products provided to the Company are either Year 2000 compliant or will be made Year 2000 compliant on a timely basis. The responses received also indicate that most suppliers are in the process of developing or executing remediation plans to address Year 2000 issues that may affect the supplier's capability to continue providing products and services to the Company. Based on the Company's assessment of each supplier's progress to adequately address the Year 2000 issue, the Company expects to develop a supplier action list and contingency plans by April 1999. However, no assurance can be provided as to the effect or timely implementation of such action list or contingency plans, or that suppliers will effectively address their Year 2000 issues to enable them to continue providing the Company with products and services.

**PRODUCT READINESS PROGRAM** This program focuses on identifying and resolving Year 2000 issues existing in the Company's products. The program encompasses a number of activities, including testing, evaluation, engineering and manufacturing implementation. The Company has completed a Year 2000 readiness evaluation for over 95 percent of its current generation of released products based upon a series of testing scenarios. All testing and engineering activity for the Company's current generation of products is scheduled to be completed by the end of January 1999. The Company plans to ship all products Year 2000 ready by January 1999, to make Year 2000 retrofits available to customers during the first calendar quarter of 1999 and to have retrofits installed in the field by June 1999. The Company plans to make a contingency team available to address issues related to product readiness as a component of its Customer Readiness Program discussed below. However, the Company can make no assurance that product testing will identify all Year 2000 related issues or that the Company will effectively address all failures of the Company's products due to the Year 2000 problem.

**CUSTOMER READINESS PROGRAM** This program focuses on customer support issues, including the coordination of retrofit activity, testing existing customer electronic transaction capability, and providing other services to the Company's customers. Currently, in cooperation with its customers, the Company is assessing its products in use at customer sites, developing potential retrofit or upgrade programs, and offering assistance in making its products Year 2000 ready. The Company is also offering different upgrade packages for its products, including various parts, software and services in the form of "Year 2000 ready kits." Finally, the Customer Readiness Program plans to make a contingency team available, through the year 2000, to customers experiencing difficulty with the Company's products. There can be no assurance, however, that these activities will prevent or effectively address the occurrence of Year 2000 related problems in the Company's products in use at customer sites.

The Company estimates that total Year 2000 costs will range from \$30 million to \$50 million, the majority of which will be incurred by January 2000. This includes costs to support customer satisfaction programs and services. It does not include the cost of internal hardware and software that was to be replaced in the normal course of business but has been accelerated because of Year 2000 capability concerns. To date, Year 2000 costs incurred have either not been material or have been incurred in the normal course of business. The Company is continuing its assessments and developing alternatives that will require changes to this estimate over time. There can be no assurance, however, that there will not be a delay in, or increased costs associated with, the programs described in this section.

As discussed (see "Subsequent Events"), the Company completed an acquisition of Consilium in December 1998. Although the Company examined certain issues related to Consilium's Year 2000 readiness in connection with its due diligence examination of Consilium, the Company has not conducted a systematic assessment of Consilium's Year 2000 readiness in the same way that it has assessed its own readiness. Until the Company has completed an assessment of the Year 2000 readiness of Consilium's products, information technology and other systems, there can be no assurances concerning the Year 2000 readiness of Consilium's products and systems, the probability that remediation efforts directed to Consilium's products and systems will be successful, or the materiality of the costs of such assessment and remediation.

The programs described in this section are ongoing. Further, the Company has not yet identified all potential Year 2000 complications. Therefore, at this time, the Company cannot determine the potential impact of these complications and contingencies on the Company's financial condition and results of operations. If computer systems used by the Company or its suppliers, or the software applications used in systems manufactured and sold by the Company, fail or experience significant difficulties related to the Year 2000, the Company's financial condition and results of operations could be materially and adversely affected.

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**FOREIGN CURRENCY**

Significant operations of the Company are conducted in foreign currencies, primarily Japanese yen. The Company actively manages its exposure to changes in foreign currency exchange rates, but there can be no assurance that future changes in foreign currency exchange rates will not have a material and adverse effect on the Company's financial condition or results of operations.

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**EURO CONVERSION**

On January 1, 1999, 11 of the 15 member countries of the European Union are scheduled to establish fixed conversion rates between each of their existing sovereign currencies and the Single European Currency (the "euro"). The participating countries have agreed to adopt the euro as their common legal currency on

that date. The Company is currently evaluating issues raised by the introduction and initial implementation of the euro on January 1, 1999, and during the transition period through January 1, 2002. The Company anticipates that its internal systems that are likely to be affected by the initial implementation of the euro will be euro capable by January 1, 1999. The Company does not expect costs of system modifications to be material, nor does it expect the introduction and use of the euro to materially and adversely affect its financial condition or results of operations. The Company will continue to evaluate the impact of the euro introduction. There can be no assurance that affected systems will be euro capable by January 1, 1999, or that there will be no material effect to the Company.

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#### RISKS ASSOCIATED WITH LITIGATION

The Company and certain of its subsidiaries are currently involved in litigation regarding patent infringement, intellectual property rights, antitrust and other matters and could become involved in additional litigation in the future. The Company from time to time receives and makes inquiries with regard to possible patent infringement, and is subject to various other legal proceedings and claims, either asserted or unasserted. Any such claims, whether with or without merit, could be time-consuming and expensive to defend and could divert management's attention and resources. There can be no assurance regarding the outcome of current or future litigation or patent infringement inquiries. See Note 13 of Notes to Consolidated Financial Statements.

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#### MARKET RISK DISCLOSURE

##### INTEREST RATE RISK

As of October 25, 1998, the Company's investment portfolio includes fixed-income securities of \$1.4 billion. These securities are subject to interest rate risk, and will decline in value if interest rates increase. Due to the short duration of the Company's investment portfolio, an immediate 10 percent increase in interest rates would not have a material effect on the Company's financial condition or results of operations.

The Company's long-term debt bears interest at fixed rates; therefore, the Company's results of operations would only be affected by interest rate changes to the extent that variable rate short-term notes payable are outstanding. Due to the short-term nature and insignificant amount of the Company's notes payable, an immediate 10 percent change in interest rates would not have a material effect on the Company's results of operations over the next fiscal year.

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##### FOREIGN CURRENCY EXCHANGE RATE RISK

The Company uses financial instruments such as forward exchange contracts to hedge certain firm commitments denominated in foreign currencies and currency option contracts to hedge certain anticipated, but not yet committed, transactions expected to be denominated in foreign currencies. The Company does not use derivative financial instruments for trading or speculative purposes. Forward exchange contracts are denominated in the same currency as the underlying transaction (primarily Japanese yen and British pounds), and the terms of the forward foreign exchange contracts generally match the terms of the underlying transactions. As of October 25, 1998, the majority of the Company's outstanding forward exchange contracts are marked to market (see Note 2 of Notes to Consolidated Financial Statements), as are the underlying transactions being hedged; therefore, the impact of exchange rate changes on the forward contracts will be substantially offset by the impact of such changes on the underlying transactions. The effect of an immediate 10 percent change in exchange rates on the forward exchange contracts and the underlying hedged positions denominated in Japanese yen and British pounds would not be material to the Company's financial condition or results of operations. The Company's downside risk with respect to currency option contracts (Japanese yen) is limited to the premium paid for the right to exercise the option. Premiums paid for options outstanding as of October 25, 1998 were not material.

## 44 Applied Materials CONSOLIDATED STATEMENTS OF OPERATIONS

Fiscal year ended	1996	1997	1998
(In thousands, except per share amounts)			
Net sales	\$4,144,817	\$4,074,275	\$4,041,687
Cost of products sold	2,195,078	2,173,350	2,178,531
Gross margin			
Operating expenses:	1,949,739	1,900,925	1,863,156
Research, development and engineering	481,394	567,612	643,852
Marketing and selling	313,631	314,381	321,606
General and administrative	226,063	252,214	272,109
Non-recurring items	25,100	75,818	237,227
Income from operations			
Income from operations	903,551	690,900	388,362
Income from litigation settlements, net	--	69,000	15,000
Interest expense	20,733	20,705	45,309
Interest income	39,618	59,726	79,780
Income from continuing operations before taxes			
Income from continuing operations before taxes	922,436	798,921	437,833
Provision for income taxes	322,851	300,447	148,863
Income from continuing operations			
Income from continuing operations	599,585	498,474	288,970
Discontinued operations:			
Equity in net loss of joint venture	--	--	(17,911)
Provision for discontinued operations of joint venture	--	--	(40,157)
Net income			
Net income	\$599,585	\$498,474	\$230,902
Earnings per share:			
Basic--continuing operations	\$1.67	\$1.37	\$0.79
Basic--discontinued operations	--	--	(0.16)
Total basic			
Total basic	\$1.67	\$1.37	\$0.63
Diluted--continuing operations			
Diluted--continuing operations	\$1.63	\$1.32	\$0.76
Diluted--discontinued operations	--	--	(0.15)
Total diluted			
Total diluted	\$1.63	\$1.32	\$0.61
Weighted average number of shares:			
Basic	359,104	363,542	366,849
Diluted	367,214	377,838	378,508

See accompanying notes to the consolidated financial statements.

Fiscal year ended	1997	1998
(In thousands, except per share amounts)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$448,043	\$575,205
Short-term investments	1,094,912	1,188,351
Accounts receivable, less allowance for doubtful accounts of \$5,578 and \$630	1,110,885	764,472
Inventories	686,451	555,881
Deferred income taxes	324,568	337,906
Other current assets	105,498	97,140
Total current assets	3,770,357	3,518,955
Property, plant and equipment, net of accumulated depreciation	1,066,053	1,261,520
Other assets	234,356	149,217
Total assets	\$5,070,766	\$4,929,692
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Notes payable	\$55,943	\$644
Current portion of long-term debt	10,563	7,367
Accounts payable and accrued expenses	1,157,808	1,041,341
Income taxes payable	177,774	68,974
Total current liabilities	1,402,088	1,118,326
Long-term debt	623,090	616,572
Deferred income taxes	47,177	11,341
Other liabilities	56,240	62,832
Total liabilities	2,128,595	1,809,071
Commitments and contingencies		
	--	--
Stockholders' equity:		
Preferred stock; \$.01 par value per share; 1,000 shares authorized; no shares issued	--	--
Common stock; \$.01 par value per share; 1,100,000 shares authorized; 367,250 and 367,864 shares outstanding	3,672	3,679
Additional paid-in capital	850,902	792,145
Retained earnings	2,098,038	2,328,940
Cumulative translation adjustments	(10,441)	(4,143)
Total stockholders' equity	2,942,171	3,120,621
Total liabilities and stockholders' equity	\$5,070,766	\$4,929,692

See accompanying notes to the consolidated financial statements.

Common Stock						
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Cumulative Translation Adjustments	Total
(In thousands)						
Balance at October 29, 1995	358,556	\$3,586	\$758,263	\$999,979	\$21,675	\$1,783,503
Net issuance under stock plans, including tax benefits of \$11,894	4,284	43	40,338	--	--	40,381
Stock repurchases	(2,370)	(24)	(37,028)	--	--	(37,052)
Translation adjustments	--	--	--	--	(15,992)	(15,992)
Net income	--	--	--	599,585	--	599,585
Balance at October 27, 1996	360,470	3,605	761,573	1,599,564	5,683	2,370,425
Net issuance under stock plans, including tax benefits of \$82,543	9,434	94	167,499	--	--	167,593
Stock repurchases	(2,654)	(27)	(78,170)	--	--	(78,197)
Translation adjustments	--	--	--	--	(16,124)	(16,124)
Net income	--	--	--	498,474	--	498,474
Balance at October 26, 1997	367,250	3,672	850,902	2,098,038	(10,441)	2,942,171
Net issuance under stock plans, including tax benefits of \$26,112	5,477	55	94,527	--	--	94,582
Stock repurchases	(4,863)	(48)	(153,284)	--	--	(153,332)
Translation adjustments	--	--	--	--	6,298	6,298
Net income	--	--	--	230,902	--	230,902
Balance at October 25, 1998	367,864	\$3,679	\$792,145	\$2,328,940	\$ (4,143)	\$3,120,621

See accompanying notes to the consolidated financial statements.

Fiscal year ended	1996	1997	1998
(In thousands)			
Cash flows from operating activities:			
Net income	\$599,585	\$498,474	\$230,902
Loss from discontinued operations:			
Equity in net loss of joint venture	--	--	17,911
Provision for discontinued operations of joint venture	--	--	40,157
Adjustments required to reconcile income from continuing operations to cash provided by continuing operations:			
Acquired in-process research and development expense	--	59,500	32,227
Write-down of intangible assets	--	--	70,000
Bad debt expense	--	16,318	--
Depreciation and amortization	148,865	219,435	284,500
Deferred income taxes	(85,852)	(52,543)	(49,400)
Changes in assets and liabilities, net of amounts acquired:			
Accounts receivable	(43,789)	(332,047)	332,249
Inventories	(60,036)	(171,201)	133,791
Other current assets	23,369	(29,041)	(9,478)
Other assets	(3,183)	(8,525)	(9,366)
Accounts payable and accrued expenses	167,346	352,540	(159,471)
Income taxes payable	(73,938)	137,560	(106,142)
Other liabilities	19,662	11,242	8,504
Cash provided by continuing operations	692,029	701,712	816,384
Cash flows from investing activities:			
Capital expenditures, net of retirements	(452,535)	(339,364)	(448,607)
Cash paid for acquisitions, net of cash acquired	--	(246,333)	--
Cash paid for licensed technology	--	--	(32,227)
Proceeds from sales of short-term investments	707,620	664,194	779,356
Purchases of short-term investments	(857,877)	(1,125,362)	(872,795)
Cash used for investing	(602,792)	(1,046,865)	(574,273)
Cash flows from financing activities:			
Short-term borrowings, net	22,360	(21,731)	(54,811)
Long-term debt borrowings	29,832	407,568	--
Long-term debt repayments	(25,164)	(67,372)	(9,422)
Issuances of common stock, net	40,381	150,446	94,582
Repurchases of common stock	(37,052)	(78,197)	(153,332)
Cash provided by/(used for) financing	30,357	390,714	(122,983)
Effect of exchange rate changes on cash	(1,551)	(1,406)	8,034
Increase in cash and cash equivalents	118,043	44,155	127,162
Cash and cash equivalents--beginning of year	285,845	403,888	448,043
Cash and cash equivalents--end of year	\$403,888	\$448,043	\$575,205

Cash payments for interest were \$23,708, \$18,802 and \$46,296 in 1996, 1997 and 1998, respectively. Cash payments for income taxes were \$429,651, \$130,247 and \$264,886 in 1996, 1997 and 1998, respectively. See accompanying notes to the consolidated financial statements.



## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION** The consolidated financial statements include the accounts of Applied Materials, Inc. and its subsidiaries (the Company) after elimination of intercompany balances and transactions. The Company's 50 percent joint venture investment in Applied Komatsu Technology, Inc. (AKT) is accounted for using the equity method, and is included in accounts payable and accrued expenses. The Company's fiscal years presented are the 52 week periods that ended on the last Sunday of October in each year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

**CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS** All highly-liquid investments purchased with a remaining maturity of three months or less are considered to be cash equivalents. All of the Company's short-term investments are classified as available-for-sale as of the balance sheet dates. Investments classified as available-for-sale are recorded at fair value and any material temporary difference between an investment's cost and its fair value is presented as a separate component of stockholders' equity.

**INVENTORIES** Inventories are stated at the lower of cost or market, with cost determined on a first-in, first-out (FIFO) basis.

**PROPERTY, PLANT AND EQUIPMENT** Property, plant and equipment is stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives for financial reporting purposes are as follows: buildings and improvements, 5 to 33 years; demonstration and manufacturing equipment, 3 to 5 years; and furniture, fixtures and other equipment, 3 to 15 years. Leasehold improvements are amortized over the shorter of five years or the lease term.

**INTANGIBLE ASSETS** Purchased technology and goodwill are presented at cost, net of accumulated amortization, and are being amortized using the straight-line method over their estimated useful lives of eight years.

**LONG-LIVED ASSETS** The Company reviews long-lived assets and certain identifiable intangible assets to be held and used, or disposed of, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company assesses the impairment of long-lived assets, including purchased technology and goodwill, based upon the estimated future cash flows from these assets.

**REVENUE RECOGNITION** Revenue related to systems is generally recognized upon shipment, which usually precedes customer acceptance. A provision for the estimated future cost of system installation and warranty is recorded when revenue is recognized. Service revenue is generally recognized ratably over the period of the related contract.

**DERIVATIVE FINANCIAL INSTRUMENTS** The Company uses financial instruments such as forward exchange contracts to hedge certain firm commitments denominated in foreign currencies and currency option contracts to hedge certain anticipated, but not yet committed, transactions expected to be denominated in foreign currencies. The terms of the currency instruments used are generally consistent with the timing of the committed or anticipated transactions being hedged. The purpose of the Company's foreign currency management activity is to protect the Company from the risk that eventual cash flows from foreign currency denominated transactions may be adversely affected by changes in exchange rates. Gains and losses on forward exchange and option contracts are deferred and recognized in income when the related transactions being hedged are recognized. If the underlying transaction being hedged fails to occur, or occurs prior to the maturity of the financial instrument, the Company immediately recognizes the gain or loss on the associated financial instrument. Forward exchange contracts that have been marked to market are included in accounts payable and accrued expenses on the Company's consolidated balance sheet. To date, premiums paid for currency option contracts have not been material. The Company does not use derivative financial instruments for trading or speculative purposes.

**FOREIGN CURRENCY TRANSLATION** The Company's subsidiaries located in Japan and Europe operate primarily using local functional currencies. Accordingly, all assets and liabilities of these subsidiaries are translated using exchange rates in effect at the end of the period, and revenues and costs are translated using average exchange rates for the period. The resulting cumulative translation adjustments are presented as a separate component of stockholders' equity.

Subsidiaries located in Ireland, Italy, Israel, Korea, Taiwan, Southeast Asia and China use the U.S. dollar as their functional currency. Accordingly, assets and liabilities are translated using period-end exchange rates, except for inventories and property, plant and equipment, which are translated using historical rates. Revenues and costs are translated using average exchange rates for the period, except for costs related to those balance sheet items that are translated using historical rates. The resulting translation gains and losses are included in income as they are incurred.

**EMPLOYEE STOCK PLANS** In accordance with the provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," the Company may elect to continue to apply the provisions of Accounting Principles Board's Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and related interpretations in accounting for its employee stock option and stock purchase plans, or adopt the fair value method of accounting prescribed by SFAS 123. The Company has elected to continue to account for its stock plans using APB 25, and therefore is generally not required to recognize compensation expense in connection with these plans. Companies that continue to use APB 25 are required to present, in the notes to the consolidated financial statements, the pro forma effects on reported net income and earnings per share as if compensation expense had been recognized based on the fair value of options granted (see Note 10 of Notes to Consolidated Financial Statements).

**CONCENTRATIONS OF CREDIT RISK** Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, short-term investments, trade accounts receivable and derivative financial instruments used in hedging activities.

The Company invests in a variety of financial instruments such as certificates of deposit, municipal bonds and treasury bills, and, by policy, limits the amount of credit exposure with any one financial institution or commercial issuer.

The Company's customers consist of semiconductor manufacturers located throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral to secure accounts receivable. The Company maintains an allowance for doubtful accounts based on an assessment of the collectibility of such accounts.

The Company is exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments, but does not expect any counterparties to fail to meet their obligations.

**EARNINGS PER SHARE** The Company adopted Statement of Financial Accounting Standards No. 128 (SFAS 128), "Earnings Per Share," in the first fiscal quarter of 1998. Under the provisions of SFAS 128, primary earnings per share has been replaced by basic earnings per share, which does not include the dilutive effect of stock options in its calculation. In addition, fully diluted earnings per share has been replaced by diluted earnings per share. All prior period earnings per share amounts have been restated to reflect the requirements of SFAS 128. Basic earnings per share has been computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share has been computed using the weighted average number of common shares and equivalents (representing the dilutive effect of stock options) outstanding during the period. Net income has not been adjusted for any period presented for purposes of computing basic or diluted earnings per share.

For purposes of computing diluted earnings per share, weighted average common share equivalents do not include stock options with an exercise price that exceeds the average fair market value of the Company's common stock for the period. For fiscal 1998, options to purchase approximately 4,091,000 shares of common stock at an average price of \$36.91 were excluded from the computation.

RECLASSIFICATIONS Certain amounts prior to fiscal 1998 have been reclassified to conform to the 1998 financial statement presentation.

RECENT ACCOUNTING PRONOUNCEMENTS In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 130 (SFAS 130), "Reporting Comprehensive Income," which establishes standards for the reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The Company will adopt SFAS 130 in the first fiscal quarter of 1999.

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosures About Segments of an Enterprise and Related Information," which changes the way public companies report information about operating segments. SFAS 131, which is based on a management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets and reports revenue. The Company is currently assessing the disclosure effects of adopting SFAS 131, which will be effective for the Company's fiscal 1999.

In February 1998, the FASB issued Statement of Financial Accounting Standards No. 132 (SFAS 132), "Employers' Disclosures about Pensions and Other Postretirement Benefits." SFAS 132 does not change the measurement or recognition of such plans, but does standardize the disclosure requirements for pensions and other postretirement benefits to the extent practicable. SFAS 132 also requires disclosure of additional information about changes in benefit obligations and fair values of plan assets, and eliminates certain other disclosures that were previously required. The Company will be required to adopt SFAS 132 in fiscal 1999.

In April 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 98-1 (SOP 98-1), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance regarding whether computer software is internal-use software, the capitalization of costs incurred for computer software developed or obtained for internal use and accounting for the proceeds of computer software originally developed or obtained for internal use and then subsequently sold to the public. The Company does not expect the impact of adopting SOP 98-1, which will be effective for the Company's fiscal 2000, to be material to its financial condition or results of operations.

In April 1998, the AICPA issued Statement of Position 98-5 (SOP 98-5), "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires companies to expense start-up and organization costs as incurred. SOP 98-5 broadly defines start-up activities and provides examples to help entities determine costs that are and are not within the scope of SOP 98-5. SOP 98-5 will be effective for the Company's fiscal 2000, and its initial application is to be reported as the cumulative effect of a change in accounting principle. The Company does not expect the impact of adopting SOP 98-5 to be material to its financial condition or results of operations.

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. The Company is in the process of assessing the effect of adopting SFAS 133, which will be effective for the Company's fiscal 2000.

## NOTE 2 FINANCIAL INSTRUMENTS

INVESTMENTS At October 26, 1997 and October 25, 1998, the fair value of the Company's short-term investments approximated cost. Accordingly, temporary differences between the short-term investment portfolio's fair value and its cost have not been presented as a separate component of stockholders' equity. Information about short-term investments is as follows:

	1997	1998
-----		
(In thousands)		
Obligations of states and political subdivisions	\$218,689	\$253,709
U.S. commercial paper, corporate bonds and medium-term notes	410,088	473,654
Bank certificates of deposit	233,794	138,053
U.S. treasury securities	176,764	211,094
Other debt securities	55,577	111,841
-----		
	\$1,094,912	\$1,188,351
-----		

Investments in debt and equity securities of \$218 million and \$183 million are included in cash and cash equivalents at October 26, 1997 and October 25, 1998, respectively.

Information about the contractual maturities of short-term investments at October 25, 1998 is as follows:

	Due in One Year or Less	Due After One Year Through Three Years	Due After Three Years	Total
-----				
(In thousands)				
Obligations of states and political subdivisions	\$ 52,042	\$134,397	\$67,270	\$253,709
U.S. commercial paper, corporate bonds and medium-term notes	294,449	134,730	44,475	473,654
Bank certificates of deposit	138,053	--	--	138,053
U.S. treasury securities	73,729	17,447	119,918	211,094
Other debt securities	19,108	54,007	38,726	111,841
-----				
	\$577,381	\$340,581	\$270,389	\$1,188,351
-----				

Gross unrealized holding gains and losses were not material as of October 26, 1997 or October 25, 1998. Gross realized gains and losses on sales of short-term investments were not material for the years ended October 27, 1996, October 26, 1997 or October 25, 1998. The Company manages its cash equivalents and short-term investments as a single portfolio of highly marketable securities that is intended to be available to meet the Company's current cash requirements.

DERIVATIVE FINANCIAL INSTRUMENTS The notional amounts of derivative financial instruments as of October 26, 1997 and October 25, 1998 were as follows:

	1997	1998
-----		
(In thousands)		
Forward exchange contracts to sell U.S. dollars for foreign currency (primarily yen)	\$224,956	\$ 88,248
Forward exchange contracts to sell foreign currency (primarily yen) for U.S. dollars	\$477,881	\$274,326
Currency option contracts to sell Japanese yen for U.S. dollars	\$429,257	\$189,380
Currency option contracts to sell U.S. dollars for British pounds	\$ 38,648	\$ --
-----		

All forward exchange and currency option contracts outstanding as of October 25, 1998 have remaining maturities of less than one year. Management believes that these contracts should not subject the Company to undue risk from foreign exchange movements because gains and losses on these contracts generally offset gains and losses on the underlying assets, liabilities and transactions being hedged.



FAIR VALUE OF FINANCIAL INSTRUMENTS For certain of the Company's financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, notes payable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their short maturities. Consequently, such financial instruments are not included in the following table that provides information about the carrying amounts and estimated fair values of other financial instruments, both on and off the balance sheets:

(In thousands)	1997		1998	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term debt, including current portion	\$633,653	\$647,983	\$623,939	\$656,603
Forward exchange contracts:				
Sell foreign currency	\$491,796	\$491,240	\$241,517	\$239,827
Buy foreign currency	\$217,016	\$216,779	\$99,293	\$99,293
Currency option contracts:				
Sell foreign currency	\$4,636	\$10,337	\$3,892	\$202
Buy foreign currency	\$525	\$351	\$--	\$--

The estimated fair value of long-term debt is based primarily on quoted market prices for the same or similar issues. The fair value of forward exchange and currency option contracts is based on quoted market prices of comparable instruments.

## NOTE 3 BALANCE SHEET DETAIL

(In thousands)	1997	1998
INVENTORIES:		
Customer service spares	\$207,938	\$239,139
Raw materials	106,406	98,180
Work-in-process	256,737	126,533
Finished goods	115,370	92,029
	\$686,451	\$555,881
PROPERTY, PLANT AND EQUIPMENT:		
Land	\$112,050	\$125,467
Buildings and improvements	561,803	712,740
Demonstration and manufacturing equipment	398,588	501,648
Furniture, fixtures and other equipment	329,178	384,069
Construction in progress	164,136	274,220
	1,565,755	1,998,144
Accumulated depreciation	(499,702)	(736,624)
	\$1,066,053	\$1,261,520
OTHER ASSETS:		
Purchased technology, net	\$186,127	\$91,218
Goodwill, net	13,438	11,614
Other	34,791	46,385
	\$234,356	\$149,217
ACCOUNTS PAYABLE AND ACCRUED EXPENSES:		
Accounts payable	\$347,584	\$182,616
Compensation and employee benefits	219,384	185,391
Installation and warranty	216,962	179,742
Restructuring	151	91,781
Other	373,727	401,811
	\$1,157,808	\$1,041,341

## NOTE 4 AKT JOINT VENTURE

In September 1993, the Company entered into an agreement with Komatsu, Ltd. to form AKT, a joint venture corporation that develops, manufactures and markets systems used to produce Flat Panel Displays (FPDs). The FPD market currently includes screens for laptop, notebook and palmtop computers, desktop monitors, digital/video cameras, portable televisions and instrument displays and may eventually include High Definition Television.

During the fourth fiscal quarter of 1998, the Company decided to discontinue the operations of AKT. The operations of AKT will be wound down over a period not to exceed twelve months from the date of the decision to discontinue operations. As a result of this decision, AKT has stopped selling PVD and Etch systems and has ceased development efforts on new and next generation systems and technology. AKT will continue to offer its existing CVD product line for sale and will also provide existing customers with ongoing system support. The Company expects to provide a maximum of \$27.5 million of funding to AKT, \$20 million of which had already been provided as of the end of fiscal 1998, and has also guaranteed approximately \$20 million of AKT's bank debt. The Company believes it has sufficient reserves for the potential financial effects of its funding expectations and debt guarantee. The Company recorded, for its fourth fiscal quarter of 1998, after-tax costs of \$58 million, consisting of \$18 million for the Company's share of AKT's net losses prior to the decision to discontinue AKT's operations and \$40 million for net expenses and other obligations expected to be incurred during the wind-down period. There can be no assurance that the Company will not incur additional costs associated with the discontinuance of AKT's operations.

Royalties received by the Company on AKT sales did not materially affect the Company's results of operations for fiscal 1996, 1997 or 1998.

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## NOTE 5 NOTES PAYABLE

The Company has credit facilities for unsecured borrowings in various currencies up to \$600 million, of which \$500 million is a revolving credit agreement in the United States with a group of ten banks. This agreement consists of a \$250 million revolving line of credit agreement that expires in March 1999 and a \$250 million credit agreement that expires in March 2003. The agreement requires the Company to pay facility fees, allows for borrowings at various rates including the lead bank's prime reference rate and includes certain financial and other covenants with which the Company was in compliance as of October 25, 1998. No amount was outstanding under this agreement at the end of any fiscal year presented. The remaining \$100 million of credit facilities is primarily with Japanese and European banks at rates indexed to their prime reference rate. At October 26, 1997, \$56 million was outstanding under Japanese credit facilities at an average annual interest rate of 0.7 percent. At October 25, 1998, no material amounts were outstanding under these credit facilities.

## NOTE 6 LONG-TERM DEBT

Information with respect to the Company's long-term debt at October 26, 1997 and October 25, 1998 is as follows:

	1997	1998
(In thousands)		
Japanese debt, 1.72%-4.85%, maturing 1999-2011	\$60,653	\$50,939
6.65-7.00% medium-term notes due 2000-2005, interest payable March 15 and September 15	73,000	73,000
8% noncallable unsecured senior notes due 2004, interest payable March 1 and September 1	100,000	100,000
6.75% noncallable unsecured senior notes due 2007, interest payable April 15 and October 15	200,000	200,000
7.125% noncallable unsecured senior notes due 2017, interest payable April 15 and October 15	200,000	200,000
	633,653	623,939
Current portion	(10,563)	(7,367)
	\$623,090	\$616,572

\$43 million of Japanese debt is secured by property and equipment having a net book value of approximately \$63 million at October 25, 1998.

The Company has certain debt agreements containing covenants that limit additional borrowings by U.S. subsidiaries, liens placed on assets and certain sale and leaseback transactions. As of October 25, 1998, the Company was in compliance with all covenants.

As of October 25, 1998, aggregate debt maturities were as follows: \$7 million in fiscal 1999; \$37 million in fiscal 2000; \$10 million in fiscal 2001; \$5 million in fiscal 2002; \$5 million in fiscal 2003; and \$560 million thereafter.

## NOTE 7 NON-RECURRING ITEMS

Non-recurring operating expense items do not include litigation settlements and costs associated with AKT (see Note 8 and Note 4 of Notes to Consolidated Financial Statements). Non-recurring operating expense items for fiscal 1996, 1997 and 1998 included the following:

	1996	1997	1998
(In thousands)			
Acquired in-process research and development	\$--	\$59,500	\$32,227
Write-down of impaired assets	--	--	70,000
Restructuring	25,100	--	135,000
Bad debt expense	--	16,318	--
	\$25,100	\$75,818	\$237,227

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT During the first fiscal quarter of 1997, the Company acquired two companies, Opal, Inc. and Orbot Instruments, Ltd. (Orbot), in separate transactions for \$293 million, consisting primarily of cash, and recognized \$59.5 million of acquired in-process research and development expense. With the exception of this charge, the transactions did not have a material effect on the Company's results of operations for fiscal 1997. During fiscal 1998, the Company determined that certain intangible assets recorded in connection with these acquisitions were impaired (see "Write-down of Impaired Assets" below). There can be no assurance that the Company will not incur additional charges in connection with these or other acquisitions (see "Management's Discussion and Analysis--Trends, Risks and Uncertainties").



During the first fiscal quarter of 1998, the Company entered into an agreement with Trikon Technologies, Inc. for a non-exclusive, worldwide, perpetual license of MORI(TM) plasma source and Forcefill(TM) deposition technology. Because the development of this technology had not yet reached technological feasibility at the time of its acquisition and had no alternative future use, the Company recognized \$32 million, including transaction costs, of acquired in-process research and development expense at the time of its acquisition.

**WRITE-DOWN OF IMPAIRED ASSETS** During the fourth fiscal quarter of 1998, the Company determined that the carrying value of certain purchased technology exceeded its net realizable value as a result of rapid changes in technology and a reduced demand outlook caused by significant changes in business conditions. This determination was supported by the results of an independent analysis prepared by a nationally-recognized valuation firm. In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," the Company recorded a pre-tax charge of \$70 million for this impairment in asset value.

**RESTRUCTURING** During the fourth fiscal quarter of 1996, the Company recorded a pre-tax restructuring charge of \$25 million in connection with a reduction of its workforce and related consolidation of facilities. These actions were taken in response to a downturn in the semiconductor industry.

During fiscal 1998, the Company recorded a pre-tax restructuring charge of \$135 million, consisting of \$75 million for headcount reductions and \$60 million for consolidation of facilities and related fixed assets. These restructuring actions occurred in the Company's third and fourth fiscal quarters, and were taken to align the Company's cost structure with prevailing market conditions and to create a more flexible and efficient organization that is well-positioned for an industry recovery. During the third fiscal quarter of 1998, the Company completed a voluntary separation plan that resulted in a headcount reduction of approximately 800 employees, or six percent of its global workforce, for a cost of \$25 million. The majority of employees who terminated employment were located in California and Texas. During the fourth fiscal quarter of 1998, the Company eliminated approximately 2,000 additional positions, or 15 percent of its global workforce, for a cost of \$50 million. Approximately 1,350 of these positions were eliminated in California and Texas, with the remainder being eliminated from other locations worldwide.

Total cash outlays for fiscal 1998 restructuring activities will be \$105 million. The remaining \$30 million of restructuring costs consists of non-cash charges primarily for asset write-offs. During fiscal 1998, \$42 million of cash was used for restructuring costs. The majority of the remaining cash outlays of \$63 million is expected to occur in fiscal 1999.

Restructuring activity for fiscal 1998 was as follows:

	Severance and Benefits	Facilities	Total
-----			
(In thousands)			
Fiscal 1996 provision	\$19,329	\$5,771	\$25,100
Amount utilized in fiscal 1996	(13,238)	(348)	(13,586)
-----			
Balance, October 27, 1996	6,091	5,423	11,514
Amount utilized in fiscal 1997	(6,091)	(5,272)	(11,363)
-----			
Balance, October 26, 1997	--	151	151
Provision for fiscal 1998	74,812	60,188	135,000
Amount utilized in fiscal 1998	(39,526)	(3,844)	(43,370)
-----			
Balance, October 25, 1998	\$35,286	\$56,495	\$91,781
-----			

**BAD DEBT EXPENSE** During fiscal 1997, the Company determined that its outstanding accounts receivable balance from Thailand-based Submicron Technology PCL (SMT) was not collectible. Therefore, the Company repossessed systems previously sold to SMT and recorded \$16 million of bad debt expense.

## NOTE 8 LITIGATION SETTLEMENTS

During fiscal 1997, the Company settled certain outstanding litigation with Novellus Systems, Inc. (Novellus) and General Signal Corporation (GSC). In connection with the Novellus settlement, the Company received \$80 million in damages for past patent infringement, and was awarded the right to receive ongoing royalties for certain system shipments subsequent to the date of the settlement. In connection with the GSC settlement, the Company paid \$11 million and acquired ownership from GSC of five patents regarding "cluster tool" architecture.

During the first fiscal quarter of 1998, the Company settled all outstanding litigation with ASM International N.V. (ASM). As a result of this settlement, the Company received a convertible note for \$80 million, against which \$15 million was collected in November 1997. Because of the impact of the current industry downturn on ASM's financial condition and liquidity, ASM was not able to pay the \$65 million remaining balance at the maturity date. Therefore, the Company determined based on known facts and circumstances that collection of the note was doubtful, and recorded, for the fourth fiscal quarter of 1998, a \$65 million pre-tax charge to fully reserve the outstanding note. The net effect of the ASM settlement is \$15 million of non-operating income for fiscal 1998. Subsequent to the end of fiscal 1998, ASM secured financing and made a partial payment to the Company (see Note 14 of Notes to Consolidated Financial Statements).

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## NOTE 9 COMMON STOCK

STOCK REPURCHASE PROGRAM In March 1996, the Board of Directors authorized the Company to systematically repurchase up to 5,000,000 shares of its common stock in the open market through February 1999 to reduce the dilution from the Company's employee benefit and incentive plans such as the stock option and employee stock purchase plans. In December 1997, the Board of Directors rescinded the limitation on the number of shares and extended the authorization to March 2001. In fiscal 1996, 1,970,000 shares were repurchased under this plan at an average price of \$14.97 per share. In fiscal 1997, 2,654,000 shares were repurchased under this plan at an average price of \$29.46 per share. In fiscal 1998, 4,863,000 shares were repurchased under this plan at an average price of \$31.53 per share.

The Company also repurchased 400,000 shares of its common stock in the open market in fiscal 1996 at an average price of \$18.88 per share in accordance with a separate authorization from the Board of Directors to fund certain stock-based employee benefit plans.

## NOTE 10 EMPLOYEE BENEFIT PLANS

STOCK OPTIONS The Company grants options to key employees and non-employee directors to purchase shares of its common stock, at future dates, at the fair market value on the date of grant. Options generally vest over one to four years, and generally expire no later than seven years from the date of grant. There were 12,554,000, 12,445,000 and 12,762,000 shares available for grant at the end of fiscal 1996, 1997 and 1998, respectively. Stock option activity was as follows:

	1996	Weighted Average Exercise Price	1997	Weighted Average Exercise Price	1998	Weighted Average Exercise Price
(In thousands, except per share amounts)						
Outstanding, beginning of year	27,938	\$10.51	30,564	\$10.05	34,057	\$15.16
Granted	16,894	14.79	13,324	21.21	26,848	29.14
Exercised	(3,074)	3.52	(7,744)	6.00	(4,041)	8.08
Canceled	(11,194)	20.32	(2,087)	12.82	(4,231)	24.29
Outstanding, end of year	30,564	\$10.05	34,057	\$15.16	52,633	\$22.10
Exercisable, end of year	9,584	\$ 5.53	8,298	\$8.51	12,772	\$13.46

The following table summarizes information with respect to options outstanding and exercisable at October 25, 1998:

Range of exercise prices	Options Outstanding		Options Exercisable		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Number of Shares	Weighted Average Exercise Price
(In thousands, except per share amounts)					
\$0.01-\$9.96	4,209	\$7.98	2.3	3,909	\$ 7.95
\$9.97-\$19.93	17,206	13.36	4.2	6,911	12.07
\$19.94-\$29.89	17,350	25.63	6.3	1,194	23.84
\$29.90-\$39.85	12,959	31.89	6.1	502	34.22
\$39.86-\$49.81	909	45.99	5.7	256	46.27
	52,633	\$22.10	5.3	12,772	\$13.46

During 1996, the Company canceled options to purchase 9,802,728 shares. The canceled options were originally granted between June 15, 1995 and May 21, 1996 at exercise prices ranging from \$13.10 to \$26.25 per share. New options to purchase 9,802,728 shares at exercise prices ranging from \$11.94 to \$14.25 per share were then granted. All vesting under the canceled options was lost and new vesting periods were started. Executive officers of the Company were not permitted to cancel options.

During the first fiscal quarter of 1998, the Company granted to each employee (excluding officers) an option to purchase 200 shares, for a total grant of approximately 2,900,000 shares. This grant was made in recognition of the Company's 30th anniversary. Also, later in fiscal 1998, the Company granted to each employee (excluding executives) an option to purchase 200 shares, for a total grant of approximately 2,500,000 shares. This grant was made to address employee morale and retention concerns in light of the prolonged industry downturn and necessary Company restructuring actions. Neither of these grants required stockholder approval.

EMPLOYEE STOCK PURCHASE PLAN The Company sponsors two employee stock purchase plans (ESPP) for the benefit of U.S. and international employees. The U.S. plan is qualified under Section 423 of the Internal Revenue Code. Under the ESPP, substantially all employees may purchase the Company's common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value at the beginning or end of each six-month offering period. Stock purchases under the ESPP are limited to 10 percent of

an employee's compensation, up to a maximum of \$12,750, in any plan year. During fiscal 1996, 1997 and 1998, 771,346, 1,697,284 and 1,436,165 shares, respectively, were issued under the ESPP. As of October 25, 1998, 4,095,205 shares were reserved for future issuance under the ESPP.

**STOCK-BASED COMPENSATION** The Company has adopted the disclosure-only provisions of SFAS 123. Accordingly, no compensation cost has been recognized for any of the Company's stock option plans. If compensation cost for the Company's stock option plan and ESPP had been determined based on the grant date fair value for awards in fiscal 1996, 1997 and 1998 consistent with the provisions of SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	1996	1997	1998
(In thousands, except per share amounts)			
Net income as reported	\$599,585	\$498,474	\$230,902
Pro forma net income	\$589,750	\$466,395	\$146,094
Earnings per share as reported:			
Basic	\$1.67	\$1.37	\$0.63
Diluted	\$1.63	\$1.32	\$0.61
Pro forma earnings per share:			
Basic	\$1.64	\$1.28	\$0.40
Diluted	\$1.61	\$1.23	\$0.39

The effects on the above pro forma disclosures of applying SFAS 123 are not likely to be representative of the effects on pro forma disclosures of future years. Since SFAS 123 is applicable only to stock options granted subsequent to December 15, 1995, the pro forma effects will not be fully reflected until fiscal 2000.

In calculating pro forma compensation, the fair value of each stock option grant and stock purchase right is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for stock option and ESPP grants in fiscal 1996, 1997 and 1998:

	Stock Options			ESPP		
	1996	1997	1998	1996	1997	1998
Dividend yield	None	None	None	None	None	None
Expected volatility	55%	55%	55%	55%	55%	55%
Risk free interest rate	6.11%	6.27%	5.33%	6.01%	6.39%	5.93%
Expected lives	3.6	3.6	3.7	.5	.5	.5

Using the Black-Scholes option-pricing model, the weighted average estimated fair value of employee stock options granted was \$6.78 in fiscal 1996, \$10.96 in fiscal 1997 and \$13.54 in fiscal 1998. The weighted average estimated fair value of purchase rights granted under the ESPP was \$6.02 in fiscal 1996, \$7.31 in fiscal 1997 and \$9.61 in fiscal 1998.

**EMPLOYEE BONUS PLANS** The Company has various employee bonus plans. A profit sharing plan provides for the distribution of a percentage of pre-tax profits to substantially all of the Company's employees, up to a maximum percentage of compensation. Another plan awards annual bonuses to the Company's executive staff based on the achievement of profitability and other specific performance criteria. The Company also has agreements with certain key technical employees that provide for additional compensation related to the success of new product development and achievement of specified profitability criteria. Charges to expense under these plans were \$113 million in fiscal 1996, \$126 million in fiscal 1997 and \$111 million in fiscal 1998.

**EMPLOYEE SAVINGS AND RETIREMENT PLAN** The Employee Savings and Retirement Plan is qualified under Section 401(k) of the Internal Revenue Code. The Company contributes a percentage of the amount of salary deferral contributions made by each participating employee. Company contributions are invested in the Company's common stock and become 20 percent vested upon an employee's third year of service, and vest 20 percent per year of service thereafter until becoming fully vested upon seven years of service. The Company's matching contributions under this plan were \$15 million in fiscal 1996, \$13 million in fiscal 1997 and \$18 million in fiscal 1998.

**DEFINED BENEFIT PLANS OF FOREIGN SUBSIDIARIES** Certain of the Company's foreign subsidiaries have defined benefit pension plans covering substantially all of their eligible employees. The benefits under these plans are based on years of service and final average compensation levels. Funding is limited by the local statutory requirements of the countries in which the subsidiaries are located. Expenses under these plans were \$7 million, consisting principally of service cost, for fiscal 1996, 1997 and 1998. At October 25, 1998, the aggregate accumulated benefit obligation was \$28 million, the projected benefit obligation was \$47 million, and the fair value of plan assets was \$16 million.

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**NOTE 11 INCOME TAXES**

The components of income from continuing operations before taxes were as follows:

	1996	1997	1998
-----			
(In thousands)			
U.S.	\$697,659	\$678,049	\$383,210
Foreign	224,777	120,872	54,623
-----			
Income from continuing operations before taxes	\$922,436	\$798,921	\$437,833
-----			

The components of the provision for income taxes were as follows:

	1996	1997	1998
-----			
(In thousands)			
Current:			
U.S.	\$266,693	\$261,120	\$133,852
Foreign	99,739	60,594	44,267
State	39,122	31,276	20,144
-----			
	405,554	352,990	198,263
-----			
Deferred:			
U.S.	(70,382)	(51,939)	(34,277)
Foreign	(6,289)	1,207	(5,456)
State	(6,032)	(1,811)	(9,667)
-----			
	(82,703)	(52,543)	(49,400)
-----			
Provision for income taxes	\$322,851	\$300,447	\$148,863
-----			

The Company's effective income tax rate was 35 percent for fiscal 1996, 37.6 percent for fiscal 1997 and 34 percent for fiscal 1998. The 37.6 percent effective income tax rate for fiscal 1997 was higher than the expected rate of 35 percent due to the non-deductible nature of a \$59.5 million charge for acquired in-process research and development. The reduction to a 34 percent effective income tax rate for fiscal 1998 is attributable to several factors, including a reduction in state income taxes, U.S. based income tax credits and a shift in the geographic composition of pre-tax income to entities operating in countries with lower tax rates.

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal income tax rate of 35 percent as follows:

	1996	1997	1998
-----			
(In thousands)			
Tax provision at U.S. statutory rate	\$322,851	\$279,622	\$153,242
Acquired in-process research and development	--	20,825	--
Effect of foreign operations taxed at various rates	997	6,633	5,486
State income taxes, net of federal benefit	21,509	19,152	6,810
Research tax credits	(3,624)	(6,540)	(8,141)
FSC benefit	(24,266)	(17,645)	(14,991)
Other	5,384	(1,600)	6,457
-----			
Provision for income taxes	\$322,851	\$300,447	\$148,863
-----			

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of net deferred income tax assets were as follows:

	1997	1998
-----		
(In thousands)		
Deferred income tax assets:		
Inventory reserves and basis difference	\$74,642	\$86,296
Warranty and installation reserves	71,103	59,194
Accrued liabilities	145,394	153,923
Restructuring accrual	--	32,370
Other	33,429	6,123
Deferred income tax liabilities:		
Depreciation	(11,554)	(638)
Purchased technology	(38,598)	(19,159)
Other	2,975	8,456
-----		
Net deferred income tax assets	\$277,391	\$326,565
-----		

U.S. income taxes have not been provided for approximately \$44 million of cumulative undistributed earnings of certain non-U.S. subsidiaries. The Company intends to reinvest these earnings indefinitely in operations outside of the United States.

## NOTE 12 INDUSTRY SEGMENT AND FOREIGN OPERATIONS

The Company operates exclusively in the semiconductor wafer fabrication equipment industry. The Company's selling and support services operations are its principal revenue-producing activities. For geographical reporting, revenues are attributed to the geographic location in which the customer is located, and costs directly and indirectly incurred in generating revenues are similarly attributed. Corporate assets consist primarily of cash equivalents and short-term investments. Corporate operating expenses consist primarily of general and administrative expenses not allocable to specific geographic regions.

During fiscal 1996, 1997 and 1998, no individual customer accounted for greater than 10 percent of the Company's net sales.

	Net Sales	Income/(loss) from Operations	Total Assets
-----			
(In thousands)			
1996:			
North America*	\$1,270,359	\$ 344,343	\$1,566,000
Europe	685,887	113,865	291,223
Japan	1,008,597	288,853	614,805
Korea	567,116	124,866	118,159
Taiwan	406,143	125,312	119,665
Asia-Pacific	206,715	63,780	60,906
Corporate	--	(157,468)	867,229
-----			
Consolidated	\$4,144,817	\$903,551	\$3,637,987
-----			
1997:			
North America*	\$1,500,926	\$454,616	\$2,263,706
Europe	600,227	62,814	386,623
Japan	749,706	101,421	621,111
Korea	333,380	77,831	152,114
Taiwan	696,312	214,382	232,295
Asia-Pacific	193,724	27,760	97,279
Corporate	--	(247,924)	1,317,638
-----			
Consolidated	\$4,074,275	\$ 690,900	\$5,070,766
-----			
1998:			
North America*	\$1,549,337	\$377,293	\$2,342,926
Europe	645,570	69,845	358,518
Japan	677,737	65,157	469,138
Korea	166,511	26,206	119,944
Taiwan	816,730	254,382	159,346
Asia-Pacific	185,802	40,400	53,200
Corporate	--	(444,921)	1,426,620
-----			
Consolidated	\$4,041,687	\$388,362	\$4,929,692
-----			

\*Primarily the United States.

Intercompany transfers of products from North America (primarily the United States) to other regions were \$1.8 billion in fiscal 1996, \$1.7 billion in fiscal 1997 and \$1.6 billion in fiscal 1998, and from Europe were \$122 million in fiscal 1996, \$102 million in fiscal 1997 and \$198 million in fiscal 1998. Transfers and commission arrangements between geographic areas are at prices sufficient to recover a reasonable profit. At October 25, 1998, net accounts receivable were \$268 million from customers located in North America, \$80 million from Europe, \$235 million from Japan, \$93 million from Taiwan, \$54 million from Korea and \$34 million from Asia-Pacific.

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#### NOTE 13 COMMITMENTS AND CONTINGENCIES

The Company leases certain of its facilities and equipment under noncancelable operating leases and has options to renew most leases, with rentals to be negotiated. The Company also leases certain office and general operating facilities in Santa Clara, California, under an agreement that provides for monthly payments based on the London interbank offering rate (LIBOR) or the relevant commercial paper (CP) rate. In accordance with this agreement, the Company must maintain compliance with covenants identical to those contained in its credit facilities. At the end of these leases, the Company is required to acquire the properties at their original cost or arrange for these properties to be acquired by a third party. The Company is contingently liable under 82 percent first-loss clauses for up to approximately \$53 million as of October 25, 1998. Management believes that these contingent liabilities will not have a material adverse effect on the Company's financial condition or results of operations.

Total rent expense for fiscal 1996, 1997 and 1998 was \$66 million, \$69 million and \$71 million, respectively. Future minimum lease payments at October 25, 1998 are: \$62 million for fiscal 1999; \$41 million for fiscal 2000; \$31 million for fiscal 2001; \$31 million for fiscal 2002; \$33 million for fiscal 2003 and \$120 million thereafter.

During fiscal 1998, approximately \$488 million of trade notes and accounts receivable from certain U.S. and Japanese customers were sold, subject to certain recourse provisions, at a discount to financial institutions. As of October 25, 1998, \$268 million of these sold receivables were outstanding. The Company does not expect the recourse provisions to have a material effect on its financial condition or results of operations.

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#### LEGAL MATTERS

The Company, as plaintiff, filed a patent infringement lawsuit against Varian Associates, Inc. (Varian), alleging infringement of several of the Company's patents for physical vapor deposition (PVD) technology. As a result of Novellus' acquisition of Varian's thin film PVD business unit, this lawsuit has been amended to include Novellus as a defendant. Varian denied all allegations and counterclaimed for declaratory judgment of invalidity and unenforceability and alleged conduct by the Company violative of the antitrust laws. Novellus filed suit against the Company alleging infringement of three patents for PVD technology that were formerly owned by Varian. Finally, Varian filed suit against the Company alleging a broad range of conduct in violation of federal antitrust laws and state unfair competition and business practice laws. Discovery has commenced in both cases. No trial dates have been set.

During fiscal 1998, the Company settled all outstanding litigation with ASM International N.V. (see Note 8 of Notes to Consolidated Financial Statements).

As a result of the acquisition of Orbot, the Company is defending a lawsuit brought by KLA Instruments Corp. (KLA) against Orbot. KLA alleges that Orbot infringes a patent for mask and reticle inspection equipment. Limited discovery has occurred; no trial date has been set.



In April 1997, the Company initiated separate lawsuits against AST Elektronik GmbH and AST Elektronik USA, Inc. (collectively "AST") and AG Associates, Inc. (AG), alleging infringement of certain patents concerning rapid thermal processing technology. In October 1997, AST and AG each filed counterclaims alleging infringement by the Company of patents concerning related technology. The Company and AST recently resolved their dispute concerning these patents on mutually acceptable terms and conditions. The Company is continuing its litigation against AG. Discovery is in process and trial is set for July 1999. In addition, on August 5, 1998, AG filed a lawsuit in California against the Company alleging infringement of another patent relating to rapid thermal processing technology, and, on August 13, 1998, AG filed a lawsuit in Delaware against the Company alleging infringement of two other patents concerning related technology. The Company has moved to have the Delaware case transferred to California. No trial dates have been set.

In November 1997, OKI Electric Industry, Co., Ltd. (OKI) filed suit against the Company's subsidiary, Applied Materials Japan (AMJ), in Tokyo District Court in Japan, alleging that AMJ is obligated to indemnify OKI for a portion of the patent license royalties paid by OKI to Texas Instruments, Inc. Several hearings have been held, but no trial date has been set.

The Company is subject to various other legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business. Although the outcome of these claims cannot be predicted with certainty, management does not believe that any of these legal matters will have a material adverse effect on the Company's financial condition or results of operations.

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#### NOTE 14 SUBSEQUENT EVENTS

**ACQUISITION** On October 12, 1998, the Company announced that it entered into an agreement to acquire Consilium, Inc. (Consilium), a leading independent supplier of integrated semiconductor and electronics manufacturing execution systems software and services, in a stock-for-stock merger. The acquisition was consummated on December 11, 1998, and will be accounted for as a pooling of interests. Each share of Consilium's stock was exchanged for 0.165 of a share of the Company's common stock. The Company expects to issue approximately 2 million shares of its common stock to complete this transaction. Consilium's historical financial condition and results of operations are not material in relation to the Company's historical financial condition and results of operations.

**SUBSEQUENT PAYMENT FROM ASM** During the first fiscal quarter of 1999, and subsequent to the original maturity date of the note, the Company received a \$20 million payment against its \$65 million outstanding note receivable from ASM. The \$65 million note receivable was fully reserved as of the end of fiscal 1998; accordingly, the \$20 million cash receipt will be reported as pre-tax non-operating income for the first fiscal quarter of 1999. ASM's payment was made in accordance with a restructuring of ASM's obligations under a November 1997 litigation settlement agreement. Pursuant to the new agreement, ASM agreed to pay \$20 million upon completion of the restructuring, \$10 million on November 2, 1999 and \$35 million no later than November 2, 2000. The Company will recognize income related to the remaining balance of the note receivable on a cash receipts basis going forward. Certain other obligations of ASM were also modified; however, these modifications are not expected to be material to the Company's financial condition or results of operations.

## NOTE 15 UNAUDITED QUARTERLY CONSOLIDATED FINANCIAL DATA

(in thousands, except per share amounts)	Quarter				Fiscal Year
	First	Second	Third	Fourth	
1997:					
Net sales	\$835,776	\$900,862	\$1,057,241	\$1,280,396	\$4,074,275
Gross margin	\$371,656	\$414,017	\$498,896	\$616,356	\$1,900,925
Income from continuing operations*	\$29,577	\$102,131	\$186,631	\$180,135	\$498,474
Discontinued operations	--	--	--	--	--
Net income	\$29,577	\$102,131	\$186,631	\$180,135	\$498,474
Earnings per share:					
Continuing operations	\$0.08	\$0.27	\$0.49	\$0.47	\$1.32
Discontinued operations	--	--	--	--	--
Total	\$0.08	\$0.27	\$0.49	\$0.47	\$1.32
1998:					
Net sales	\$1,307,685	\$1,176,316	\$884,491	\$673,195	\$4,041,687
Gross margin	\$629,441	\$554,289	\$394,389	\$285,037	\$1,863,156
Income/(loss) from continuing operations**	\$228,893	\$141,221	\$47,517	\$(128,661)	\$288,970
Discontinued operations	--	--	--	(58,068)	(58,068)
Net income/(loss)	\$228,893	\$141,221	\$47,517	\$(186,729)	\$230,902
Earnings/(loss) per share:					
Continuing operations	\$0.60	\$0.37	\$0.13	\$(0.35)	\$0.76
Discontinued operations	--	--	--	(0.16)	(0.15)
Total	\$0.60	\$0.37	\$0.13	\$(0.51)	\$0.61

\* Income from continuing operations includes one-time items, on an after-tax basis, of: \$59,500 unfavorable for the first fiscal quarter, \$41,393 favorable for the third fiscal quarter and \$7,510 unfavorable for the fourth fiscal quarter.

\*\* Income from continuing operations includes one-time items, on an after-tax basis, of: \$31,530 favorable for the first fiscal quarter, \$23,100 unfavorable for the third fiscal quarter and \$155,100 unfavorable for the fourth fiscal quarter.

TO THE STOCKHOLDERS AND BOARD OF DIRECTORS OF APPLIED MATERIALS, INC.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Applied Materials, Inc. and its subsidiaries as of October 26, 1997 and October 25, 1998 and the results of their operations and their cash flows for each of the three years in the period ended October 25, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PricewaterhouseCoopers  
PricewaterhouseCoopers

San Jose, California  
November 17, 1998, except as to Note 14, which is as of December 23, 1998.

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STOCK PRICE HISTORY

Fiscal year	1997		1998	
	High	Low	High	Low
First quarter	24 5/32	12 15/16	38 7/16	26 1/8
Second quarter	27 7/32	22 1/16	38 7/8	30 1/4
Third quarter	46 5/16	25 7/16	39 1/2	27 3/16
Fourth quarter	54	33 7/16	35 1/8	22 3/8

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The preceding table sets forth the high and low closing sale prices as reported on the Nasdaq National Market during the last two years.

## SUBSIDIARIES OF APPLIED MATERIALS, INC.

LEGAL ENTITY NAME		PLACE OF INCORPORATION
Applied Materials Japan, Inc.		Japan
Applied Materials Europe BV	(1)	Netherlands
Applied Materials International BV		Netherlands
Applied Acquisition Subsidiary		California
Applied Materials (Holdings)	(2)	California
Applied Materials Asia-Pacific, Ltd.	(3)	Delaware
Applied Materials Israel, Ltd.	(4)	Israel
Opal, Inc.		Delaware
AM Japan LLC		Delaware
-----		
(1) Applied Materials Europe BV owns the following subsidiaries:		
Applied Materials GmbH		Germany
Applied Materials France SARL		France
Applied Materials Ltd.		United Kingdom
Applied Materials Ireland Ltd.		Ireland
Applied Materials Sweden AB		Sweden
Applied Materials Israel Services (1994) Ltd.		Israel
Applied Materials Italy Srl.		Italy
Applied Materials Belgium S.A.		Belgium
-----		
(2) Applied Materials (Holdings) owns the following subsidiary:		
Applied Implant Technology, Ltd.		California
-----		
(3) Applied Materials Asia-Pacific, Ltd. owns the following subsidiaries:		
Applied Materials Korea, Ltd.		Korea
Applied Materials Taiwan, Ltd.		Taiwan
Applied Materials South East Asia Pte., Ltd.	(a)	Singapore
Applied Materials China, Ltd.	(b)	Hong Kong
AMAT (Thailand) Limited		Thailand
-----		
(4) Applied Materials Israel, Ltd. owns the following subsidiaries:		
Integrated Circuit Testing GmbH		Germany
Orbot Instruments Pacific, Ltd.		Hong Kong
-----		
(a) Applied Materials South East Asia Pte., Ltd. owns the following subsidiary:		
Applied Materials (AMSEA) Sdn Bhd		Malaysia
-----		
(b) Applied Materials China, Ltd. owns the following subsidiary:		
Applied Materials China Tianjin Co. Ltd.		P.R. China

## 50-50 JOINT VENTURE OF APPLIED MATERIALS, INC.

LEGAL ENTITY NAME	PLACE OF INCORPORATION
Applied Komatsu Technology, Inc.	Japan

## Consent of Independent Accountants

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-8 (Nos. 2-69114; 2-77987; 2-77988; 2-85545; 2-94205; 33-24530; 33-52072; 33-52076; 33-63847; 33-64285; 333-21367; 333-31289; 333-31291; 333-45007; 333-45011; 333-69193) of Applied Materials, Inc. of our report dated November 17, 1998, except as to Note 14, which is dated as of December 23, 1998, appearing on page 66 of the Annual Report to Stockholders which is incorporated in this Annual Report on Form 10-K. We also consent to the inclusion of our report on the Financial Statement Schedule, which appears on page 19 of this Annual Report on Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP  
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PricewaterhouseCoopers LLP

San Jose, California  
January 20, 1999

## POWER OF ATTORNEY

The undersigned directors and officers of Applied Materials, Inc. (the Company), a Delaware corporation, hereby constitute and appoint James C. Morgan and Joseph R. Bronson, and each of them with full power to act without the other, the undersigned's true and lawful attorney-in-fact, with full power of substitution and resubstitution, for the undersigned and in the undersigned's name, place and stead in the undersigned's capacity as an officer and/or director of the Company, to execute in the name and on behalf of the undersigned an annual report of the Company on Form 10-K for the fiscal year ended October 25, 1998 (the "Report"), under the Securities and Exchange Act of 1934, as amended, and to file such Report, with exhibits thereto and other documents in connection therewith and any and all amendments thereto, with the Securities and Exchange Commission, granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing necessary or desirable to be done and to take any other action of any type whatsoever in connection with the foregoing which, in the opinion of such attorney-in-fact, may be of benefit to, in the best interest of, or legally required of, the undersigned, it being understood that the documents executed by such attorney-in-fact on behalf of the undersigned pursuant to this Power of Attorney shall be in such form and shall contain such terms and conditions as such attorney-in-fact may approve in such attorney-in-fact's discretion.

IN WITNESS WHEREOF, I have hereunto set my hand this 11th day of December, 1998.

/s/MICHAEL H. ARMACOST

-----  
Michael H. Armacost  
Director

/s/ALFRED J. STEIN

-----  
Alfred J. Stein  
Director

/s/DEBORAH A. COLEMAN

-----  
Deborah A. Coleman  
Director

/s/JAMES C. MORGAN

-----  
James C. Morgan  
Chairman, Chief Executive Officer  
and Director  
(Principal Executive Officer)

/s/HERBERT M. DWIGHT, JR.

-----  
Herbert M. Dwight, Jr.  
Director

/s/DAN MAYDAN

-----  
Dan Maydan  
President and Director

/s/PHILIP V. GERDINE

-----  
Philip V. Gerdine  
Director

/s/JOSEPH R. BRONSON

-----  
Joseph R. Bronson  
Senior Vice President, Office of  
the President, Chief Financial  
Officer and Chief Administrative  
Officer (Principal Financial Officer)

/s/TSUYOSHI KAWANISHI

-----  
Tsuyoshi Kawanishi  
Director

/s/MICHAEL K. O'FARRELL

-----  
Michael K. O'Farrell  
Vice President, Global Controller and  
Chief Accounting Officer  
(Principal Accounting Officer)

/s/PAUL R. LOW

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Paul R. Low  
Director

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED OCTOBER 25, 1998.

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12-MOS	
	OCT-25-1998
	OCT-25-1998
	575,205
	1,188,351
	765,102
	630
	555,881
	3,518,955
	1,998,144
	736,624
	4,929,692
1,118,326	
	616,572
	0
	0
	3,679
	3,116,942
4,929,692	
	4,041,687
	4,041,687
	2,178,531
	2,178,531
	643,852
	0
	45,309
	437,833
	148,863
288,970	
	58,068
	0
	0
	230,902
	0.63
	0.61

ITEM CONSISTS OF RESEARCH, DEVELOPMENT AND ENGINEERING EXPENSES.

ITEM CONSISTS OF BASIC EARNINGS PER SHARE.