

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



MICHAEL SULLIVAN | Corporate Vice President, Investor Relations

Good afternoon.

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

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

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

GARY DICKERSON | President and Chief Executive Officer

INTRODUCTION AND COVID-19 RESPONSE

Thanks Mike.

I would like to start today's call by addressing the topic at the forefront of everyone's mind – the COVID-19 pandemic – which has created unprecedented challenges around the world. My thoughts and best wishes go out to all of you, and especially those whose families have been directly affected by the illness.

As the situation has evolved over the past several months, our actions at Applied Materials have been guided by two key principles: First, maintaining the trust of our employees, customers, suppliers and partners – and second, focusing on driving initiatives that will allow us to emerge stronger over the longer-term.

As always, our number one priority is the health and wellbeing of our employees and their families. Our workforce remains highly productive. Many are working effectively from home, and for those working on-site we have implemented strict safety protocols in close collaboration with our medical advisors, customers and suppliers. In our factories, labs and logistics centers, we have changed physical layouts to allow for social distancing, introduced enhanced cleaning and sanitation procedures, implemented health screenings, and mandated the use of personal protective equipment. All our employees and contingent workers have continued to receive full pay and we have introduced additional incentives and benefits for employees supporting our critical operations.

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



While we have been working through certain supply chain constraints, we have remained laser-focused on the needs of our customers and doing what it takes to keep their factories running smoothly and their R&D programs on track. Across the company, I see amazing examples of our manufacturing, logistics and field operations teams going above and beyond to keep our customers and the industry moving forward in a difficult set of circumstances. We are also defining new ways of working with customers that not only provide solutions today but will also create significant benefits over the long-term.

Finally, in-line with Applied's long-held values to make a positive contribution to the communities where we live and work, we have created a global, charitable COVID fund. The purpose of this fund is to address immediate humanitarian needs and combat long-term effects on local communities and the nonprofit sector. We have also donated masks and equipment to medical facilities and, in addition, there have been numerous employee-driven initiatives across the company. It is inspiring to see these employees stepping forward to help, volunteering their time, skills and resources to demonstrate our shared passion to make a difference.

Now, let me turn to the agenda for today's call: I'll begin with a summary of our second quarter performance and near-term outlook. Then, I'll provide a longer-term perspective on our markets. And I'll finish with a summary of our strategy, highlighting some of our recent accomplishments. Later, Dan will give more color on our financial results, operational performance and business environment.

QUARTER AND NEAR-TERM ENVIRONMENT

Starting with our near-term business outlook, demand from our semiconductor customers remains strong. In fiscal Q2, our financial performance was negatively affected by our ability to ship systems to customers as shelter-in-place and lockdown orders impacted some of our suppliers' operations, particularly in the Bay Area and Malaysia. However, we are in a much better position today: Thanks to the flexibility in our global operations footprint we have been able to make adjustments and we continue to work closely with our suppliers to ensure they can meet our needs. Our supply chain remains a critical area of focus, as we enter our third quarter with record orders and a record backlog for our semiconductor and service businesses combined.

In terms of the semiconductor industry environment, I will focus my comments on what we currently see in the market and what we are hearing from customers. In foundry-logic, demand at the leading edge remains very healthy, with a strong commitment from these customers to build out their factories and push forward with their development roadmaps. However, we are seeing some pockets of weakness in specialty markets mainly as a result of a pullback in the automotive and industrial sectors.

In memory, there are no major changes to the outlook we provided last quarter. We continue to see a positive progression in the market with inventory levels approaching normal and improvements in pricing trends. As a result, we are seeing incremental strength in investment by memory customers as we move through the year.

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



Based on the visibility that we have today, underlying demand for semiconductor equipment is robust, and even when COVID-related effects are taken into account, we still believe that our semiconductor business can deliver strong double-digit growth for our fiscal year.

In display, we expect our FY20 revenues to be close to FY19, as the industry navigates the bottom of this spending cycle. Our display business remains solidly profitable even as we invest in next generation products ready for when the market picks up.

LONGER-TERM OUTLOOK

Looking further out, we are well-aware of global economic concerns. While I am not going to speculate on possible macro-scenarios, I will share some of the key assumptions that we're using to guide our strategy, which are based on carefully monitoring market indicators and staying very close to our customers.

Clearly, consumer spending is a potential headwind for many sectors including the electronics industry. At the same time, the global pandemic is acting as an accelerator for key technology inflections that were already underway. Working From Home, Learning From Home and e-Commerce are driving investments in cloud data centers and communications infrastructure. We expect companies to build stronger business continuity plans which will include geographic redundancy and increased use of automation and IoT technologies. And, the adoption of AI and Big Data remains non-discretionary for many companies. As I have said before, these game-changing technologies will transform entire industries and there will be big winners and losers through the transition.

My personal view is that we will see significant and permanent changes in the way companies operate and prioritize their investments. In fact, this is already happening in our business and the ways we are working with customers.

Over the past several years, we made significant investments in state-of-the-art digital infrastructure, sensors and metrology, data science, machine learning and simulation. The combination of these technologies enables us to reduce product development cycles, speed up transfer of new technologies from lab to fab, and optimize cost, output and yield for our customers in volume production.

In the past few months, our field and R&D teams have been working with customers to further expand secure data sharing to enhance remote support and accelerate the deployment of these powerful new tools. In our own labs, we also have many examples of R&D teams increasing utilization and productivity of lab assets, by applying creative new strategies for remote operations.

While near-term actions are being driven by necessity, the long-term benefits of working this way are compelling as they provide significant time to market and cost advantages for Applied and our customers.

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



STRATEGY AND ACCOMPLISHMENTS

Our long-term perspective about AI and Big Data shaping the next decade is unchanged, and we see strong potential for certain elements of these inflections to scale faster than previously expected. As I have said before, to enable these new computing systems and unlock the potential of AI technologies major advances in the Power, Performance and Area-Cost – or PPAC – of semiconductor devices are needed. Based on recent input from customers, we have updated our PPAC framework to PPACt – where t stands for time to market – acknowledging the enormous value of speed.

Applied has by far the largest, broadest portfolio of technologies and products to accelerate the PPACt playbook which spans creating, shaping, modifying, analyzing and connecting structures and devices. We are the only company with process and metrology under one roof and we have highly differentiated silicon and packaging lab capabilities. As a result, we have a significant advantage in our ability to accelerate new PPACt innovations for the semiconductor ecosystem.

The capabilities we have built and the multi-year investments we have made are yielding results. According to VLSI Research's recently published report, we outperformed the market in both semiconductor equipment and services last year. Our performance in deposition technology was especially strong, with our PVD business gaining seven points of share.

We also have great momentum in metrology and inspection. Our process diagnostics and control group delivered record revenue in the first half of the year. One of the key contributors to this record performance is our new optical inspection system that we will be officially launching later this year.

SUMMARY

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

First, as we navigate the challenges created by COVID-19, we have rallied the company around two guiding principles: maintain the trust of employees, customers, suppliers and partners and focus on driving actions that ensure Applied Materials emerges stronger over the long-term.

Second, while we are mindful of potential macro-economic headwinds, based on what we see and hear today, semiconductor equipment demand remains robust and our supply chain is getting healthier.

Third, we remain fully committed to our strategy to accelerate the PPACt playbook and our pipeline of new innovative products and integrated processes has never been better.

Now, I will turn the call over to Dan.

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



DAN DURN | Senior Vice President, Chief Financial Officer

Q2 REVIEW

Thanks Gary.

Today, I'll summarize our second quarter results and activities; give you an update on the environment; and share our current expectations for the second half of our fiscal year.

As a reminder, on March 23rd, we suspended our Q2 guidance because the global response to COVID-19 was creating significant challenges across our supply chain, manufacturing operations and logistics. Due to the extreme uncertainty, we also decided to borrow against our revolving credit facility. We promised to provide our investors with an update on this earnings webcast, and I'll do that in a moment. This afternoon, we announced our Q2 results, which were below our original guidance, but solid -- considering the extreme challenges our teams faced due to COVID.

I'm proud of our employees for putting health and safety first -- and still doing everything possible to support our customers -- both in keeping our factories running, and by keeping our R&D programs moving. Despite the incremental challenges we experienced in the last six weeks of the quarter -- we delivered AGS and Display revenue that was higher than our original expectations in February. Our semi systems revenue was below our original outlook, and that was entirely due to COVID-related supply constraints. End demand remained strong, and while the environment remains fluid, we exited the quarter with the second-highest company backlog in our history, and record backlog for semi systems plus AGS combined.

For the company as a whole in Q2 -- on a year over year basis -- we grew revenue by 12 percent -- increased non-GAAP operating profit by 23 percent -- and grew non-GAAP EPS by 27 percent -- to \$0.89 cents. During the quarter, we returned \$392 million dollars to shareholders in buybacks and dividends -- and announced a dividend increase of nearly 5 percent. We ended Q2 with nearly \$7.4 billion dollars on the balance sheet, including \$1.5 billion dollars in credit facility proceeds.

COVID ACTIONS, BALANCE SHEET AND CAPITAL ALLOCATION

Now, I'll share my assessment of the COVID environment, which includes several encouraging developments.

Our industry has been designated critical infrastructure in many parts of the world. All of our suppliers have now been able to resume operations -- and they are recovering to normal output. We've been in very close communications with our customers, and their demand indications remain strong. We're mindful of the macroeconomic impacts of COVID -- including job losses in the consumer and industrial sectors of the global economy. But governments have provided strong financial support to workers, businesses and the banking system.

As a result of our assessment of the environment, we fully repaid our revolving credit facility borrowings subsequent to the end of the quarter. We currently have approximately \$5.9 billion dollars of cash and

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



investments on the balance sheet, which is an increase of about \$200 million dollars compared to our Q1 balance.

We are continuing to prepare for the planned acquisition of Kokusai Electric. During Q2, we received Taiwan's clearance for the transaction, and we have one final approval pending, from China.

BUSINESS ENVIRONMENT

Turning to the business outlook, while I see positive signs, there is still potential for COVID-related disruptions around the world, and we're not providing revenue and earnings guidance for Q3. I know there is concern about the risk of further economic impacts and changes in customer investment patterns. But rather than speculate, I'll attempt to help our investors by providing visibility into what we are seeing across our operating segments.

SEMICONDUCTOR SYSTEMS

In semiconductor systems, our Q2 revenue would have been nearly \$650 million dollars higher absent COVID-related constraints. We hope to recover this revenue in Q3 and Q4 as the supply chain improves. In the second quarter, our semi systems orders were up significantly, and demand is broadening to more customers. Based on what we're hearing from our customers, we believe Q3 semi revenue could be up in the high single digits, sequentially – and higher again in Q4, resulting in strong, double-digit growth for the fiscal year.

APPLIED GLOBAL SERVICES

Our services business has proven highly resilient during the crisis – and we continue to generate a growing proportion of revenue from subscription-like, long-term service agreements. AGS posted its first billion-dollar quarter ever in Q2, with nearly 60 percent of revenue coming from service agreements. In Q3, we believe AGS revenue could be flat to slightly higher sequentially, and higher again in Q4. Within AGS, our semi parts and services business has grown to \$3.2 billion dollars, or 24 percent of our company's semi-related revenue.

VLSI Research has begun to size and compare the parts and service revenue of companies in the industry. Ours is the strongest among our peers, both on a dollar basis and as a percent of our semi-related revenue. Our total semiconductor installed base business – which includes parts, services, 200-millimeter systems, and 300-millimeter upgrades and refurbishes – has grown to become 38 percent of our semi-related revenue. This ratio is about 5 points higher than our peers.

DISPLAY AND ADJACENT MARKETS

As Gary indicated, we still expect our Display revenue to be nearly the same this year as last. We believe revenue is likely to be flat to slightly higher sequentially in Q3 -- and higher again in Q4.

Q2 Fiscal 2020 Earnings Call

PREPARED REMARKS | MAY 14, 2020



SUMMARY

In short, if the demand indications from our customers hold, and our supply chains continue to improve, then we should have second-half weighted revenue in each segment. Based on everything we see today, this would translate to sequential revenue growth and earnings growth in Q3, and then again in Q4.

So, in summary, while the situation remains fluid, and macroeconomic impacts are still unknown, our customers remain committed to their technology roadmaps -- and are signaling growth for Applied. We will remain vigilant, stay close to our customers, and be ready to respond quickly if the environment changes.

Once again, I'm incredibly proud of our employees for their strong commitment to health and safety, and their strong support of our customers, both in meeting today's demand at our factories and theirs, and innovating in our R&D labs to enable the technology of the future.

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