

Q1 Fiscal 2021 Earnings Call

PREPARED REMARKS | FEBRUARY 18, 2021



MICHAEL SULLIVAN | Corporate Vice President, Investor Relations

Good afternoon everyone.

And thank you for joining Applied's first quarter of fiscal 2021 earnings call. Joining me are Gary Dickerson, our President and CEO, and Dan Durn, our Chief Financial Officer.

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

Before we begin, I have a calendar announcement. On April the 6th, Applied plans to host a virtual investor meeting to discuss our markets, strategies and financial targets. We hope you'll save the date.

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

GARY DICKERSON | President and Chief Executive Officer

INTRODUCTION

Thanks Mike.

I am very pleased to report another quarter of record performance for Applied Materials. Since the beginning of our fiscal year, we've seen a continued acceleration of demand in our semiconductor business as major macro and industry trends fuel increasing consumption of silicon across a wide range of markets and applications. 2020 was an excellent year for Applied as we outperformed our markets while growing our earnings nearly twice as fast as revenue. We carry this strong momentum into 2021. Our broad portfolio and exposure to technology inflections, combined with the traction of our new products, put us in a great position to substantially outgrow our markets again this year and into the future.

I want to thank our employees and suppliers for everything they are doing to deliver for our customers and shareholders. Our operations and field teams are doing an incredible job as we run the company at record levels and successfully overcome significant logistics and other challenges created by the pandemic. In R&D, our teams are working in new ways to accelerate the time to market of critical innovations for our customers. And we are doing all of this while maintaining a relentless focus on keeping our colleagues and families safe.

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As Mike outlined, we plan to hold an investor meeting in early April. At that event we will provide our in-depth analysis of the major growth drivers and inflections that will shape our markets over the next five to 10 years and describe our strategy to deliver innovative new technologies to enable our customers' Power, Performance and Cost roadmaps, accelerate their time to market, and drive Applied's long-term profitable growth.

In today's call, I will focus my comments on the near-term, first covering the dynamics we currently see in the market and then highlighting some of our recent accomplishments that illustrate the momentum we have across the business.

NEAR-TERM MARKET DYNAMICS

Starting with a high-level view of our markets, we are seeing a diverse combination of macro and technology factors fueling very strong and sustainable demand for semiconductors. As the world continues to navigate the current challenges and prepares for a post-pandemic era, the digital transformation of the economy is being accelerated. Companies are re-thinking, and re-engineering, the way they operate, and there is an immense pull for advanced technology. In addition, consumers are making different choices about the way they spend their time, and the products and services they buy. I strongly believe many of the changes we're seeing today are irreversible, since new ways of working offer compelling advantages in terms of time and productivity.

Within the electronics ecosystem itself, key technology inflections are driving increasing silicon consumption. I'll highlight three examples: Cloud Service Providers are forecasting datacenter capex growth of more than 15% this year, on top of record spending in 2020. With the broader adoption of 5G handsets, silicon content in smartphones is growing at double-digit rates. And, in automotive – where there are known supply shortfalls – total semi consumption is expected to expand more than 15% this year.

Translating these factors to industry investments: In foundry-logic, leading-edge investments are very strong and have been well-articulated by our customers. On top of that, our ICAPS business – that serves the IoT, Communications, Auto, Power and Sensor markets – is expected to grow even faster and is on track to exceed \$3 billion of revenue for the fiscal year. In NAND, 2020 was a strong recovery year with spending up more than 30%, and in 2021, we expect customers to invest at modestly higher levels. In DRAM, supply-demand fundamentals look more favorable than NAND and, as a result, we still expect DRAM investments to outgrow NAND this year.

All of this adds-up to a very strong demand environment for wafer fab equipment and we believe this strength is sustainable well beyond 2021. Digital transformation touches every sector of the economy and is non-discretionary for many industries. In addition, industry investments appear disciplined. When you look at wafer fab equipment intensities – that's wafer fab equipment revenues as a percentage of semiconductor industry revenues – they are well below recent peaks in all three of the device segments – foundry-logic, NAND and DRAM.

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SEMICONDUCTOR BUSINESS

Turning to Applied's business performance, our semiconductor systems revenues for the first fiscal quarter were up 26% compared to the same period last year. At the midpoint of our Q2 guidance, Semi Systems will be up around 50% year-on-year and, based on our current outlook, we expect to again grow faster than the market for the year as a whole.

There are a number of factors contributing to this outstanding performance: First, our business is very well balanced across devices and customers. Second, we have the broadest portfolio of products and capabilities spanning materials creation, modification, removal and analysis. These technologies – combined with our ability to connect them in unique ways – are fundamental to enabling our customers' power, performance and cost roadmaps. And third, we have an incredible pipeline of new products and integrated solutions that are winning applications, expanding our served opportunities and reducing the time it takes our customers to bring important new innovations to market.

Node-over-node opportunity growth in both foundry-logic and memory favors Applied's leadership businesses including epi, thermal processing, CMP and PVD. In fact, we believe our PVD business can grow more than 40% this year and generate more than \$3 billion of revenue.

Our latest generation products have strong momentum, and more than 25% of our 2021 revenues will come from critical applications that we've targeted and won since 2018. Some highlights include: CVD, where we grew revenues 30% in 2020 and have strong customer pull for new, differentiated materials solutions that are highly enabling for advanced patterning. Conductor etch, where we are winning new applications in DRAM and foundry-logic that contributed to our 32% revenue growth in this market last year. Process Diagnostics and Control, where we believe we can grow more than 25% this fiscal year, on top of the 45% growth we delivered in 2020 – thanks to new optical wafer inspection and E-beam products that are still in the early stages of adoption. And Packaging, where we expect revenues to be up 50% year-on-year on top of strong growth in 2020.

Also, over the past few years, we have started introducing a new class of highly differentiated products that we call Integrated Materials Solutions or IMS. Our IMS products can combine multiple process technologies with on-board metrology and sensors within a single system and are capable of enabling unique films, structures and devices. We have numerous IMS engagements with our leading customers, and this year we will generate meaningful revenues from our initial IMS products.

SERVICES

Moving to service, AGS delivered another record quarter. Over the past five years, we have grown our services business at a compound annual growth rate of 12%, which is twice as fast as our installed base growth. In this period, we have increased the percentage of service and parts revenue generated by service agreements from around 40% to more than 60%.

These long-term agreements enable us to deliver more value to customers with our advanced service products while providing us with stickier and more predictable recurring revenue streams. Our renewal rates for these agreements are also very high at over 90%.

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DISPLAY

Finally, in Display, our outlook remains consistent with the view we shared in November. We expect 2021 revenues to be similar to 2020 as we continue to manage through the current market trough. We do see encouraging leading indicators of future growth including: Higher OLED adoption in the smartphone market with the vast majority of 5G handsets being equipped with OLED screens and, increasing OLED consumption beyond phones, in TVs and IT applications. We still believe OLED is a compelling technology and this inflection is a great catalyst for the display market that will create expanded opportunities for Applied.

SUMMARY

Before I hand the call over to Dan, I want to again thank all our employees for their outstanding contributions to Applied's success.

2021 is off to a great start with record results and outlook. We see strong and sustainable demand in our semiconductor business fueled by a combination of macro and technology drivers. We have great momentum thanks to our broad market exposure and differentiated portfolio of new products and, we believe we're in a great position to outperform our markets again this year.

Finally, we are looking forward to sharing our long-term vision for the industry and Applied Materials at our investor event in April.

Now Dan will give his perspective on the business environment and provide more color on our financial results, and operational performance. Dan.

DAN DURN | Senior Vice President, Chief Financial Officer

Thanks Gary.

Today, I'll begin by summarizing Applied's performance in Q1. Then, I'll share some of the key drivers of our growth relative to the market in calendar 2020 and I'll finish with our guidance for Q2.

Q1 PERFORMANCE

Beginning with our Q1 performance, Applied delivered record revenue and non-GAAP earnings per share. We grew revenue by 24% year over year and exceeded the high end of our guidance.

I'm pleased that we increased gross margin by around 100 basis points year over year, particularly since we're still experiencing COVID-related manufacturing protocols and logistics costs. We also generated record non-GAAP operating profit of nearly \$1.5 billion which was up 40% year over year. We increased non-GAAP EPS by 42% year over year to \$1.39.

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Our teams operated with discipline and this enabled Applied to deliver record free cash flow of \$1.3 billion which was up 47% year over year. We increased cash and investments on the balance sheet by nearly \$950 million to \$8.22 billion, as we await the regulatory decision for the Kokusai Electric transaction.

I look forward to updating you on our capital allocation plans when we get together for the Investor Meeting in April.

Q1 OPERATING SEGMENT TRENDS

Turning to the segments, our Semi Systems Group increased revenue by 26% year over year including new quarterly records in etch, metal deposition and CMP. Operating margin grew by 320 basis points year over year. Applied Global Services also delivered revenue above our expectations while reporting its highest operating margin of the past two years despite ongoing challenges related to COVID. The Display group exceeded its revenue target and increased operating margin by 590 basis points year over year.

Looking ahead, our demand outlook calls for growth. We currently expect all three of our segments to post higher revenue in the second half of our fiscal year.

CALENDAR 2020 HIGHLIGHTS

Next, I'll comment on our semiconductor equipment revenue performance in calendar 2020, which is equal to our Q2 of fiscal 2020 through Q1 of fiscal 2021. As I previewed on our November earnings call, 2020 was a memory growth year in which NAND equipment spending grew at nearly twice the rate of the overall market. DRAM customer spending also grew faster than the market; and foundry-logic investments grew slower than the overall market but still accounted for over 55% of total spending.

Applied has balanced share, and our revenue profile resembled the overall mix, with our highest growth in NAND at 34%. We grew by 27% in DRAM and 23% in foundry-logic and we believe we significantly outperformed in both of these end markets.

Within the Semi Systems Group, our growth was strongest in areas where we've made significant investments to drive the new playbook, to develop Integrated Materials Solutions for our customers and introduce new products where we have significant room to gain share. One of our fastest growth areas was in advanced packaging where we have the industry's broadest portfolio and by far the highest share. As Gary said, we expect this momentum to continue in 2021.

Our dollar growth was highest in CVD and etch which reflects the success we've had co-optimizing new CVD films with our Sym3 etch system to create unique patterning solutions across 3D NAND, DRAM and foundry-logic.

Among new products, our latest optical wafer inspection system grew by 44% in 2020, achieving over \$400 million in cumulative revenue. We'll officially introduce the new system in the near future to

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explain its unique architectural features, along with breakthrough AI capabilities, that are generating strong customer pull.

Turning to calendar 2021, we expect strong foundry-logic spending to continue. We also expect DRAM spending to grow at a faster pace than NAND. This 2021 mix expectation plays particularly well to Applied's technology innovations and strong product roadmap.

Q2 BUSINESS OUTLOOK

Now I'll share our Q2 business outlook. We expect company revenue to be approximately \$5.39 billion, plus or minus \$200 million. The midpoint would be up about 36% year over year. We expect non-GAAP EPS to be about \$1.50 plus or minus 6 cents, or up around 70% year over year.

Within this outlook, we project Semiconductor Systems revenue of \$3.85 billion, up around 50% year over year and AGS revenue of about \$1.14 billion, up around 12% year over year. These forecasts do not include any revenue from shipments that still require government licenses. We expect Display revenue of around \$370 million, with growth resuming in the second half.

We expect Applied's non-GAAP gross margin to be approximately 47%, or up around 240 basis points year over year and we expect non-GAAP OpEx to increase to \$890 million. Our Q2 guidance assumes a non-GAAP tax rate of 12% to 13% and a weighted average share count of around 929 million.

SUMMARY

In summary, I'm pleased that Applied delivered another quarter of record performance in Q1, with strong year-over-year growth in revenue and profitability. I'd like to join Gary in thanking our teams for supporting our customers under challenging circumstances and operating with discipline to generate higher margins and free cash flow. Execution by our employees has been and continues to be nothing short of superb in what is still a challenging COVID environment. We look forward to giving you more insights into our markets and our company's growth plans at the Investor Meeting in April.

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