

Q1 Fiscal 2022 Earnings Call

PREPARED REMARKS | FEBRUARY 16, 2022



MICHAEL SULLIVAN | Corporate Vice President, Investor Relations

Good afternoon everyone and thank you for joining Applied's first quarter of fiscal 2022 earnings call. Joining me are Gary Dickerson, our President and CEO, and Bob Halliday, 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-K 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. Applied will host its next Master Class on Thursday, April 21st at 9 o'clock Pacific Time. We'll cover patterning technologies for the chipmaking industry, including 2D scaling with EUV lithography, materials-enabled patterning of Gate All Around transistors, and 3D patterning control using eBeam technology and AI^x. We hope you'll join our technology experts for presentations and Q&A.

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

GARY DICKERSON | President and Chief Executive Officer

INTRODUCTION

Thank you, Mike.

This is an unprecedented period for Applied Materials and the semiconductor industry. Demand for semiconductors has never been stronger or broader and the supply chain's ability to fulfill this growing demand is constrained in the near-term. While the supply environment remains challenging, we landed our first fiscal quarter of 2022 towards the high-end of our guidance range and delivered our highest ever quarterly revenues. These results are a testament to the capabilities and commitment of our global team who are executing well and focused on doing everything possible to deliver for our customers.

The industry clearly has a long way to go before supply catches up with demand. Applied's orders for the quarter were an all-time high, beating our previous record by a half billion dollars. To ensure our own manufacturing capacity is not a limiting factor, we've made—and continue to make—strategic investments in our global infrastructure. This includes our state-of-the-art Logistics Service Center in Austin, Texas that we're bringing on-line this month.

Like many in the industry, the biggest challenge we face today is the availability of certain silicon components that go into subsystems within our products. We are working closely with our suppliers to find solutions and eliminate bottlenecks. I would like to thank them for their partnership as we

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collaborate in new ways to overcome near-term headwinds and build a stronger supply chain that better supports the future needs of the industry.

In today's call, I'll talk about our demand outlook, which is very strong and strengthening, I'll provide our longer-term perspective on the secular trends reshaping the semiconductor industry and, I'll give you some updates on the progress we're making against our strategic goals and how we're positioned to outperform our markets over the coming years. Later in the call, Bob will share his perspective on the state of the industry and our financial outlook.

DEMAND OUTLOOK

Let me start with market demand. It's clear that wafer fab equipment spending in 2021 was limited by supply with some unmet demand pushing into 2022. If we look at our Semiconductor Systems revenues from the second quarter of 2021 to the end of Q1 2022 and compare it to the prior 12-month period, they were up 43% year-on-year. We think this is a good approximation for industry growth in calendar 2021, which would put WFE in the mid-\$80 billion range. Demand is very strong and continues to grow. We believe wafer fab equipment spending could reach \$100 billion in 2022—and since we are already close to being sold out for the year, we also have a positive growth outlook for 2023.

Within WFE, Foundry-Logic spending grew faster than memory in 2021 and we see it growing faster than memory again in 2022. We believe Foundry-Logic made up more than 60% of total WFE investments last year, and will remain at these levels or increase as a percentage of the mix over the next several years. Innovation at the edge and in the cloud means that Foundry-Logic demand is broad-based and split relatively evenly between the most advanced nodes and ICAPS customers who serve the IoT, Communications, Automotive, Power electronics and Sensors markets.

SECULAR GROWTH

It is also important to put this near-term demand outlook in the context of the secular trends driving longer-term growth and structural changes in the industry. While digital transformation is already reshaping the global economy today, it will take decades to fully play out around the world, and at the foundation of this multi-trillion-dollar inflection is advanced silicon. Today, nine of the top ten most valuable companies in the world either design or build chips. Eight of the nine are now designing their own customized silicon in-house, and the other one manufactures a large percentage of the world's chips by value. I think this is a great example of the fundamental role silicon plays in driving the system-level power, performance and cost improvements that will unlock the full potential of digital transformation and the metaverse.

Back in 2018, we introduced our framework for describing the semiconductor industry's future technology roadmap. We called this the new PPACt playbook and said it had five key elements:

- New chip architectures like workload-specific ASICs
- New 3D structures like Gate All Around transistors, Backside Power Distribution
- Next-generation 3D NAND and 3D DRAM

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- New materials in gate, contact and interconnect
- New ways to shrink from EUV lithography to advanced patterning, and
- Advanced packaging from 2.5D Silicon Interposers to 3D chiplets and hybrid bonding

As the major technology inflections that make up the PPACt playbook take shape, it is clear this future roadmap is more multifaceted and complex than anything the industry has done before. This increasing complexity has positive implications for Applied Materials. First, we expect capital intensity to remain at the levels we have seen over recent years; and second, Applied's broad capabilities are more valuable because they allow us to address higher-order problems for customers and provide them with more complete solutions.

On top of the opportunities created by the PPACt playbook, major supply-chain inflections are underway that are also positive for industry economics. This starts with a shift from a 'Just-In-Time' to a 'Just-In-Case' philosophy. The most visible example is in the automotive industry where the major car makers are quantifying the costs of lost business in 2021 and rapidly changing the way they work with suppliers of their most critical components.

We are also working differently with our customers. They are providing us with longer-term visibility, and we are collaborating more closely on capacity planning. In addition, the strategic and economic importance of semiconductors is being recognized at a national level. In the coming years, government support and incentives in the U.S., Europe and Japan will translate into regionalization of supply. As I've highlighted before, these regional supply chains will be more resilient, but also less capital efficient, which is an additional tailwind for us. Overall, our outlook for the next decade is very positive, we expect semiconductor and wafer fab equipment to grow significantly faster than the economy, with outsized opportunities for Applied Materials.

APPLIED STRATEGY + PROOF POINTS

To be ready for this exciting future, we have aligned our organization and investments around three strategic pillars:

- First, to be the PPACt enablement company and provide the foundation for customers' roadmaps for Power, Performance, Area, Cost and Time-to-Market
- Second, to shift more of our business to subscriptions, and
- Third, to generate incremental free cash flows and profitability from our businesses in adjacent markets

Earlier, I talked about key technology inflections that make up the PPACt playbook: Gate All Around, Backside Power Distribution, 3DNAND, 3DDRAM, new materials in the Gate, Contact and Interconnect, and Advanced Packaging. All of these inflections are primarily enabled by materials engineering—Applied's core strength—and, as a result, they grow our total available market. Thanks to our relentless focus on developing differentiated technology to enable these inflections, we are also in a great position to capture more of that growing TAM. For example, in the transition from FinFET to first-generation Gate All Around, our transistor TAM grows by more than a billion dollars per 100 thousand wafer starts per month, and based on our tool of record positions we expect to capture the majority of the inflection.

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We will provide more details about these inflections and how we expect them to play out in our 2022 Master Classes.

While current supply constraints mean that we can't fully realize the strength in our business, we are executing very well against our product roadmap, and there are clear leading indicators of our future growth potential. I'll highlight a few recent examples:

In Etch, we have recently won multiple new tool of record positions at advanced nodes in Foundry-Logic across all three leading-edge customers. This is significant because these wins are in areas we haven't served in the past and demonstrate how our next generation of etch solutions address customers' most challenging applications.

In Inspection and Metrology—where we have fewer supply chain constraints—our trailing 12-month revenues were up 68% year-on-year, and our eBeam revenues nearly doubled in that period. We expect to outperform the market again in 2022 with especially strong growth in optical wafer inspection combined with further extension of our eBeam leadership.

Beyond unit process excellence, Applied is able to combine the industry's broadest technology portfolio in unique ways to create co-optimized and fully integrated solutions. For example, co-optimization of hard mask deposition and etch is an enabling solution for high aspect ratio structures. Adoption of our co-optimized Draco solution is accelerating and on track to generate an incremental \$600 million of revenue this year, and we recently secured our first wins with a new carbon hard mask deposition and etch solution at a leading memory manufacturer.

Another key component of our technology portfolio is our digital tools that accelerate R&D, technology transfer and ramp, then optimize productivity in high-volume manufacturing. We are engaged with a broad range of customers, and this quarter we secured a new strategic penetration for R&D acceleration using our AI^x—Actionable Insight Accelerator—platform at a leading customer. As part of this engagement, we will use our unique sensor technology and proprietary machine learning algorithms for rapid process window tuning and process variability reduction.

SUBSCRIPTION REVENUE

We are also making progress on our multi-year journey to increase our subscription revenues. Within AGS, more than 60% of our parts and service revenue is generated from subscriptions in the form of long-term service agreements. The average tenure of these agreements is now 2.3 years, up from 1.9 years 12 months ago, and the renewal rate is over 90%. In addition, when we look at our combined software businesses in AGS and semi systems—which are also subscription-based—we expect them to generate more than \$300 million of revenue this year.

SUMMARY

Before I hand the call over to Bob, I'll quickly summarize:

Applied and our global teams are executing well in a challenging and dynamic environment and our near-term focus is on doing everything we can to expedite deliveries to our customers. Demand for

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semiconductors and wafer fab equipment remains strong and continues to grow. There is still a long way to go before supply catches up with demand. Our outlook for 2022 and beyond is very positive as long-term secular trends drive our markets structurally higher. In addition, the major technology inflections that make up the industry's PPACt roadmap expand Applied's addressable market opportunities, and our broad and differentiated technology portfolio puts us in a great position to capture a larger portion of our served markets in years to come.

With that, Bob it's over to you.

BOB HALLIDAY | Senior Vice President, Chief Financial Officer

Thanks Gary.

I'd like to begin by thanking our teams and our partners for doing everything they could in a challenging supply chain environment. We still have a lot of work to do to satisfy our customers' needs and this is Job One for all of us.

I have three main messages for you today:

- One, demand for Applied's products is very strong and continues to grow
- Two, we remain supply chain limited, and we forecast gradual improvement over the course of the year
- Three, we expect to grow our revenue and earnings each quarter through the end of the calendar year, and we believe it is increasingly likely that 2023 will be another growth year

Next, I'll summarize our Q1 results. Then I'll provide details about the demand environment for Applied Materials, and finally, I'll share our guidance for fiscal Q2 and the rate of growth we expect to see throughout the year.

Q1 RESULTS

In Q1, we delivered strong year-over-year revenue and earnings growth and exceeded the midpoint of our guidance. The supply chain environment was challenging. Our teams collaborated broadly with partners upstream and downstream of Applied to maximize the supply of components to our manufacturing sites and service locations.

This work enabled us to deliver record Semiconductor Systems revenue, which we grew by 29% year-over-year. We grew fastest in foundry-logic year-over-year, and we continue to expect foundry-logic to outgrow WFE in 2022, with strength in both leading-edge and ICAPS. From a product perspective in Q1, we generated record quarterly revenue in process control, CVD and CMP and we achieved our highest-ever DRAM revenue. We also grew non-GAAP operating margin in Semi by 280 basis points year-over-year.

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In AGS, we grew revenue by 14% year-over-year and increased non-GAAP operating margin by 110 basis points. About three quarters of AGS's year-over-year growth was in recurring revenue. Our AGS services revenue grew sequentially and year-over-year. We increased our tools under comprehensive service agreement by 13% year-over-year and our subscription renewal rate was 92%. Our parts business met our expectations but could have been even higher. AGS includes our legacy 200mm equipment revenue which was below our expectations in Q1 due to supply chain constraints that prevented us from shipping to demand within the quarter. For the fiscal year, we continue to expect AGS to grow in the low double digits with potential upside depending on the supply chain recovery.

In Display, we exceeded our revenue goal in Q1 and increased non-GAAP operating margin by 280 basis points year-over-year.

Summarizing Applied's Q1 results on a year-over-year basis, we increased revenue by 21%, non-GAAP gross margin by 140 basis points, non-GAAP operating profit by 270 basis points, and non-GAAP EPS by 36%. In addition, we generated record free cash flow and distributed over \$2 billion to shareholders with \$1.8 billion in repurchases and \$214 million in dividends.

SUPPLY CHAIN IMPACT

Next, I'll address the impact of the supply environment on our business in the near term. Underlying demand for Applied's technology is very strong and growing, and we believe that as we work through the supply chain constraints, we will demonstrate the progress we're making toward our market share and gross margin targets.

Although we don't usually report backlog on a quarterly basis, I'm going to give some further color on today's call to help you understand our confidence. In Q1, our Semi Systems backlog increased by more than \$1.3 billion to a record \$8 billion. Moreover, the backlog includes a rich mix of products that are highly enabling to our customers' roadmaps. What this tells us is that in an unconstrained environment, we would have produced substantially higher revenue and demonstrated a healthy share gain in calendar 2021.

Also, absent the supply chain issues, our gross margin in fiscal 2022 would be very close to the targets in our 2024 financial model. We are laser-focused on improving the supply chain which will enable us to support our customers and demonstrate the strength of our business. As Gary outlined, we expect the WFE market to grow by over 15% in 2022 to \$100 billion or more. Even with the constraints, we expect to outgrow the market in our Semi business and carry sizeable backlog into 2023.

Q2 GUIDANCE

Now, I'll share our guidance for Q2. We expect to increase revenue to \$6.35 billion, ± 300 million which is up almost 14% year-over-year. We expect non-GAAP EPS in Q2 to be around \$1.90, ± 15 cents, which is up around 17% year-over-year.

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Within this outlook, we expect Semi Systems revenue of around \$4.6 billion, up 16% year-over-year, AGS revenue of around \$1.35 billion, up 12% year-over-year, and Display revenue of around \$380 million.

Applied's non-GAAP gross margin should decline to around 47% in Q2 as we absorb near-term cost pressures primarily related to expediting shipments to our customers. After Q2, we expect to gradually increase the gross margin by mitigating cost pressures and shipping a richer mix of high-margin products. Non-GAAP opex should be around \$1.015 billion in Q2 and our non-GAAP tax rate should be around 12%.

SUMMARY

Looking ahead, we expect we can grow revenues by increasing, mid-single-digit percentages each quarter through the end of the calendar year and based on customer conversations about semiconductor demand and technology inflections, we're increasingly optimistic that 2023 will be another growth year for the industry and especially for Applied.

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