

# Q2 Fiscal 2024 Earnings Call

PREPARED REMARKS | MAY 16, 2024



**MICHAEL SULLIVAN** | Corporate Vice President, Investor Relations

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Good afternoon everyone, and thank you for joining Applied's second quarter of fiscal 2024 earnings call. Joining me are Gary Dickerson, our President and CEO, and Brice Hill, 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 filing 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 our website at [ir.appliedmaterials.com](http://ir.appliedmaterials.com).

Before we begin, I have a calendar announcement. On Tuesday morning, July 9th, from 7:30 to 9 a.m., Applied will host a technology breakfast event at Semicon West in San Francisco. Joining us will be Dr. Prabu Raja, President of Applied's Semiconductor Products Group, along with Mark Fuselier, who is Senior Vice President of Technology and Product Engineering at AMD. After Mark shares AMD's AI computing technology vision, Applied's experts will share our advanced materials engineering roadmap for making future AI chips. We'll outline device architecture inflections in logic—including transistors, frontside wiring and backside power—along with DRAM, high-bandwidth memory, and other forms of advanced packaging. We hope you'll join us!

And with that introduction, I'd like to turn the call over to Gary Dickerson.

**GARY DICKERSON** | President and Chief Executive Officer

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Thank you, Mike.

With second quarter revenue and earnings towards the high-end of our guided range, Applied Materials continues to deliver strong performance in 2024, and we are in a great position to benefit from secular growth trends over the longer-term. Semiconductors are the foundation of huge technology trends reshaping the global economy. These trends are driving demand for more chip manufacturing capacity, as well as better chips with higher performance and improved energy-efficiency. Key inflections that underpin the semiconductor roadmap are enabled by Applied Materials and will support our ongoing outperformance as next-generation chip technologies move into high-volume production. In addition, the complexity of implementing the industry's roadmap and bringing new semiconductor technologies to market is driving earlier, deeper and broader collaboration with customers, as well as supporting double-digit growth for our service business.

In my prepared remarks today, I'll provide some examples of how Applied's innovations are helping to enable multi-trillion-dollar technology inflections, including AI. I'll explain how this translates to our performance in the near-term, and our future growth potential. I'll also describe how we are working with our customers and partners to accelerate major semiconductor inflections all the way from research and development to high-volume manufacturing, and by doing this, how we are capturing more value in our service business.

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## APPLIED IS AT THE FOUNDATION OF AI

I'll start with a big picture perspective. Tectonic shifts in technology—including AI, IoT and automation, electric and autonomous vehicles and clean energy—will transform virtually every area of the economy over the next several decades, and they all have one thing in common. They are built upon semiconductors. As these new technologies are deployed, they are driving growth and innovation across the semiconductor ecosystem. In terms of impact and scale, I believe AI will be the biggest technology inflection of our lifetimes. And at the heart of AI are some of the world's most sophisticated chips. In simple terms, the advanced chips that power AI datacenters are enabled by four key semiconductor technologies: Leading-edge logic, compute memory or high-performance DRAM, DRAM stacking technology, referred to as high-bandwidth memory or HBM and advanced packaging to connect the logic and memory chips together and create a 'system in a package'. Applied has process technology leadership in all four of these areas, and we have made significant investments in next-generation solutions to make possible the key device architecture inflections that are essential for our customers' future roadmaps.

In advanced logic, Applied has long-standing leadership in the materials engineering processes for both transistors and interconnects. The first nodes that use Gate-All-Around transistors are now transitioning to high-volume manufacturing. These new transistor process flows are considerably more complex, and the shift from FinFET to Gate-All-Around grows Applied's available market for the transistor module from around \$6 billion to approximately \$7 billion for every 100,000 wafer starts per month of capacity. With the Gate-All-Around transition, we are also gaining share and we are on track to capture over 50% of the process equipment spending for transistor steps. We also have very strong market share in interconnect, or the wiring used to transmit data at high speed and low power. Our available market for the wiring steps is approximately \$6 billion for each 100,000 wafer starts per month, and we expect it to grow by \$1 billion when Backside Power Delivery is introduced into volume manufacturing. Overall, we expect to generate more than \$2.5 billion of revenue from Gate-All-Around nodes this year and potentially more than double that in 2025.

In DRAM, one of the key approaches that memory makers are using to improve performance and power consumption is to implement logic technologies in the peripheral circuitry. Our deep capabilities in logic, combined with our strong position in DRAM patterning and our unique, co-optimized hard mask solutions for capacitor scaling, makes us the clear leader in process equipment for DRAM today and best positioned for future growth.

In the critical die-stacking technologies used in High Bandwidth Memory, we also have strong leadership positions, including in micro-bump and Through Silicon Via. Last quarter, we said that we expected our HBM packaging revenue to be four times larger in 2024 than in 2023. As we have recently seen customers accelerate their capacity plans for HBM, we now believe that our revenue could be six times higher this year, growing to more than \$600 million.

Across all device types, we now expect revenue from our advanced packaging product portfolio to grow to approximately \$1.7 billion this year. Looking further ahead, we see opportunities for this business to double again, as heterogenous integration is more widely adopted—beyond the AI datacenter—and we introduce new products that expand our served market.

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## MARKET AND APPLIED GROWTH

AI datacenter is just one example that illustrates how the major inflections that underpin the next generation of semiconductors are enabled by Applied Materials. Materials science and materials engineering are increasingly important to the industry's roadmap. Applied has invested early to develop a broad, unique, and connected portfolio of materials engineering solutions that are critical to enable major semiconductor inflections from AI high-performance computing to ICAPS edge computing. We are translating those investments into consistent outperformance. Recent *TechInsights* data confirms that in 2023 Applied grew faster than the wafer fab equipment market for the fifth year in a row. We accomplished this despite headwinds created by trade rules that we estimate restricted us from more than 10% of the China market during that period. While we have gained share overall, we are growing share within our served market even faster. This is important, because as logic devices become more three dimensional, future generations of DRAM come to market and advanced packaging becomes more prevalent, we expect materials engineering to become an even larger portion of overall wafer fab equipment.

## COMPLEXITY CREATES NEW OPPORTUNITIES

Another key component of Applied's strategy is to address the increasing complexity faced by the industry. First, we are driving earlier, deeper and broader collaboration with customers and partners. We are changing the industry's innovation model with the goal to accelerate mutual success rates and increase investment efficiencies. Our global EPIC platform, that we will build out over the next several years, is specifically designed to support high-velocity innovation and commercialization of next-generation technologies. Second, we are able to provide more complete and connected solutions that accelerate major device inflections. The portion of our revenue generated by integrated solutions has grown from approximately 20% in 2019 to 30% today. We expect demand for these 'fab-in-a-fab'-type solutions to continue growing, both at the leading-edge and from our ICAPS customers who are serving specialty IoT, communications, auto, power and sensor applications. And third, we are helping customers transfer new technology into high-volume manufacturing faster and then optimize performance, yield, output and cost in their factory operations. This is supporting double-digit growth of our service business. AGS delivered a new record for revenue this quarter—\$1.5 billion, with a significant portion of this coming from subscriptions in the form of long-term service agreements.

## SUMMARY

Before I hand over to Brice, I will quickly summarize:

Applied Materials continues to deliver strong performance in 2024 and we are in a great position to benefit from secular growth trends over the longer-term. Tectonic shifts in technology—including AI, IoT, EVs and clean energy—that are reshaping the global economy are built on semiconductors, driving demand for more chips and new chips with higher-performance and better energy-efficiency. Key device architecture inflections that underpin the semiconductor roadmap are enabled by Applied Materials. We expect this to support our ongoing outperformance as next-generation chip technologies—including Gate-All-Around logic nodes, high performance DRAM and HBM and Advanced Packaging—move into high-volume production. And finally, the increasingly complex

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industry roadmap is driving earlier, deeper and broader collaboration between Applied and our customers and partners, accelerating demand for our most advanced co-optimized and integrated solutions and supporting double-digit growth in our service business.

Now, I'll hand over to Brice.

## **BRICE HILL** | Senior Vice President, Chief Financial Officer

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Thank you, Gary. And I'd like to thank our teams for their focus and execution – which resulted in another strong quarter for revenue and gross margin.

Today, I'll discuss our overall business environment and share insights into our ICAPS business which serves the IoT, communications, auto, power and sensor markets. I'll describe our capital allocation strategy and operating model, demonstrating how we are driving profitable growth and attractive shareholder returns. I'll also summarize our Q2 results and provide our guidance for Q3.

### **BUSINESS ENVIRONMENT**

In calendar Q1, the global market for semiconductors grew 15% year-over-year and we are optimistic that the data center trends Gary outlined will help drive solid growth for the semiconductor industry. During the quarter, cloud service providers announced strong capital spending plans which is good news for our customers. In the market briefing we issued earlier this month, we forecast that the data center market will eventually become the number one driver of leading-edge foundry-logic wafer starts, surpassing PCs and then smartphones in the coming years.

Within our business, we had a strong quarter in fiscal Q2 across DRAM, advanced packaging, ICAPS and services. In February, we projected that factory utilization would increase across all device types, and it did. Gary discussed how the data center AI megatrend is driving strong demand for our technologies used in leading-edge logic, DRAM, high-bandwidth memory and other forms of advanced packaging.

Our ICAPS business is driven by three additional megatrends, notably IoT and edge computing, electric and autonomous vehicles and renewable energy. Across our ICAPS business, one of the largest demand drivers this year is edge computing, especially at the 28-nanometer node needed by smartphone companies and makers of IoT devices for industrial and home automation applications. A second large demand driver is power chips for electric vehicles where industry leaders are now establishing supply chains to support their long-term growth plans. A third driver is the power chips used to capture renewable solar and wind energy which are needed to achieve Net Zero goals in the decades ahead.

We believe our ICAPS business will remain a large portion of our overall foundry-logic business for several reasons. One, the megatrends we described will continue to increase unit demand for ICAPS chips. Two, we are innovating at the device level which creates better chips, stimulates new system sales, and extends Applied's position as the highest-value partner for our customers, and finally, we are

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introducing ICAPS products in additional market segments which will help us broaden our reach and gain share.

## CAPITAL ALLOCATION STRATEGY

Next, I'll summarize our capital allocation strategy and the results it enables. Our efficient business model generates healthy free cash flow. Our first priority is investing in R&D and capital infrastructure to enable profitable growth and our second priority is growing our dividend per share and using our buyback program to distribute excess free cash flow to shareholders. Specifically, over the past 10 fiscal years, we have reinvested more than \$20 billion in R&D and over \$5 billion in capital additions and distributed more than 90% of free cash flow to shareholders.

## OPERATING MODEL

Our capital allocation strategy supports our operating model which I'll summarize. First, we invest over \$3 billion in R&D each year collaborating closely with our customers to invent new semiconductor technologies that are critical to their competitive positions in the global megatrends we've described. Second, we design high-volume manufacturing systems that enable our customers to deploy these new chip and advanced packaging technologies at global scale. Third, we manage a global factory and supply chain network to manufacture these systems. Fourth, we service our systems which have decades of useful life helping customers maximize their return on investment by accelerating ramps and optimizing output, yield and cost. Fifth, we reinvest a high percentage of the profits from this activity back into R&D to develop more new technologies and solutions, and finally, we distribute excess cash to shareholders.

## AGS FUELS DIVIDEND GROWTH

An important point is that every tool we manufacture and ship grows our installed base and our service opportunity which leads to consistent and stable growth for Applied Global Services. In fact, AGS has delivered 19 consecutive quarters of year-over-year growth spanning two memory downcycles. Over 80% of AGS revenue comes from recurring services and parts sales about two-thirds of which is delivered under long-term service agreements that have a 90% renewal rate. Connecting this to our capital allocation strategy, AGS has continued to produce more than enough operating profit to fully fund our growing dividend. In March 2023, we announced a 23% increase in our dividend per share and in March of this year, we announced a 25% increase.

In summary, over the past ten fiscal years, our operating model has increased company revenue at a compound rate of over 13%, non-GAAP EPS at nearly 30%, free cash flow at 33% and dividends per share at nearly 12%. Also over this period, we reduced net shares outstanding by over 30%.

## Q2 RESULTS

Now I'll summarize our Q2 results.

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On a year-over-year basis, Net sales grew slightly to nearly \$6.65 billion. Non-GAAP gross margin grew 70 basis points to 47.5%. Non-GAAP opex grew 5% to \$1.23 billion and non-GAAP EPS grew 4.5% to \$2.09.

Turning to segment results, Semiconductor Systems revenue remained strong at \$4.9 billion and included record ion implant sales. Segment non-GAAP operating margin was 34.9%.

Applied Global Services revenue increased 7% year-over-year to \$1.53 billion and segment non-GAAP operating margin was 28.5%. Our tools under subscription agreement increased by 8% year-over-year and our installed base of chambers surpassed 200,000 for the first time.

Moving to Display, Q2 revenue was \$179 million and segment non-GAAP operating margin was 2.8%. We are becoming more confident that the OLED technology found in smartphones will be adopted in notebook PCs and tablets, whose larger screen sizes would spur an increase in capital investments.

Turning to cash flows in Q2, we generated nearly \$1.4 billion in operating cash flow and nearly \$1.14 billion in free cash flow. We distributed nearly \$1.1 billion to shareholders including \$266 million in dividends and \$820 million in buybacks. We repurchased 4.1 million shares at an average price of \$197.77.

## Q3 GUIDANCE

Now, I'll share our guidance for Q3.

We expect revenue of \$6.65 billion  $\pm$  \$400 million and non-GAAP EPS of \$2.01  $\pm$  \$0.18. Within this outlook, we expect Semi Systems revenue of around \$4.8 billion, AGS revenue of about \$1.57 billion and Display revenue of around \$245 million. We expect non-GAAP gross margin to be approximately 47% and non-GAAP operating expenses to be around \$1.26 billion. Finally, we are modeling a tax rate of 12.3%.

Thank you, and now Mike, let's begin the Q&A.