# Q3 Fiscal 2020 Earnings Call

CEO AND CFO PREPARED REMARKS | AUGUST 13, 2020

## GARY DICKERSON | President and Chief Executive Officer

### INTRODUCTION

This time last quarter, I started the Call by outlining the steps we were taking inside Applied Materials to navigate the COVID-19 pandemic. Our actions have been guided by two key principles:
First – Maintaining the trust of our employees, customers, suppliers and partners and Second – Focusing on strategic initiatives that will allow us to emerge stronger over the longer-term.

Today, I am pleased to report that both our manufacturing operations and R&D labs are running smoothly – at pre-COVID levels of productivity. I would like to acknowledge the exceptional contributions, resilience and creativity of our employees and suppliers who have rapidly adapted to new ways of working to deliver this quarter's outstanding results.

A few weeks ago, at SEMICON West, I outlined Applied's vision for the next decade. I talked about the critical role semiconductors will play in shaping a better future for everyone, the advances in technology needed to unlock the potential of Artificial Intelligence, and how materials engineering will enable the industry's new PPACt playbook – to advance Power, Performance, Area-Cost and Time-to-market.

I also announced Applied's new 10-year goals and roadmap for environmental sustainability which is part of our commitment to grow our business responsibly and make possible a better future.
Having covered our long-term perspective in detail at that event, today I am going to focus my comments on current market dynamics and provide additional insights into our product portfolio and business momentum.

### MARKET ENVIRONMENT

Starting with the market environment – we remain mindful of global economic concerns and that consumer spending is a potential headwind for many sectors including the electronics industry.
With that said, demand for semiconductors has strengthened over recent months. As the world adapts to the challenges created by the pandemic, several major technology inflections are being accelerated. Work-from-home, home schooling and on-line retail are driving investments in cloud data centers and communications infrastructure, many organizations are building stronger business continuity plans and increasing the use of automation and IoT technologies, and because AI has the potential to transform entire industries, its adoption remains non-discretionary for many companies.

In wafer fab equipment, we expect overall foundry-logic spending to grow this year even with soft demand in specialty nodes that serve automotive and industrial markets. At the leading-edge, we see a strong commitment from customers to build out their fabs and aggressively drive their R&D roadmaps. This give us confidence these levels of spending are sustainable in 2021 and beyond.

As I have described before, with the slowing of traditional 2D Moore's Law scaling, there will be a transition from general purpose computing to customized solutions tailored for specific applications or workloads. Recent announcements by leading systems companies illustrate this inflection very well. Custom-designed silicon and diversification of architectures play to the strengths of the foundries and underpin their ongoing investments. In memory, we see investments for the year growing slightly faster than in foundry-logic as customers push forward with their technology roadmaps. We also see the growth rate in DRAM being very similar to NAND.

Against this backdrop of a strengthening demand, our semiconductor systems revenues are up 18 percent on a trailing 12-month basis, and – at the mid-point of our fourth quarter guidance – will be up 25 percent for our fiscal year.

## SEMICONDUCTOR SYSTEMS

Next, I'll explain what's driving our outperformance today and how, by focusing on our customers' highest value problems, we are positioned to grow faster than our markets over the next several years.

The process complexity required to produce leading-edge transistors and interconnects continues to grow and new innovations in materials and structures are fundamental to driving higher performance and lower power consumption. This plays directly to the strengths of Applied's traditional leadership areas, namely creating and modifying materials and structures. For example, our deposition businesses, CVD, PVD and Epi, generated more than 5.2 billion dollars of revenue in calendar 2019 and, according to VLSI's data, gained eight points of market share.

In our growth businesses that focus on shaping and analyzing materials and structures, we have strong momentum. We are the fastest growing company in etch, even though we do not currently serve the dielectric market segment. At the mid-point of our guidance, our etch revenues will be up nearly 30 percent this fiscal year. Since we launched our Sym3 system in 2015, we have shipped more than 5,000 chambers and we recently introduced Sym3 Y which is the most advanced etch system we've ever built. This system provides extremely high materials selectivity as well as precise depth and profile control needed to form the densely packed, high-aspect-ratio structures in next generation 3D NAND, DRAM and logic devices.

We are also the fastest growing company in the metrology and inspection market. At the mid-point of our guidance, revenue for our Process Diagnostics and Control business will be up more than 40 percent in fiscal 2020. We are winning share in optical wafer inspection and E-beam with new products that are in early stages of adoption and have significant traction with leading customers.

Applied has by far the broadest product portfolio in the industry – spanning materials creation, modification, shaping, analysis and packaging. This allows us to see inflections early and develop more complete solutions for customers – from co-optimizing deposition and removal processes, all the way to our integrated materials solutions that combine multiple process and metrology technologies within a single system to address our customers' most complex challenges.

In addition, our business is very well balanced across device segments. In foundry, where we are traditionally very strong, we are seeing our available market grow node-over-node and we are positioned to outperform the market as these new technologies ramp in high volume manufacturing.

In DRAM, our share is even higher than in foundry-logic. Over the past five years, we have gained 25 points of DRAM patterning share and still have significant potential to grow. We have recently won multiple process tool of record positions for future node transitions including multi-patterning, hard-mask, and hard-mask open applications. In addition, the industry's upcoming transition to high-speed DDR5 is enabled by advanced logic-like features including high-k metal gate. This grows the available market in areas where Applied has clear technology leadership.

### SERVICES

Another area where we are delivering more value to customers and have strong growth momentum is our aftermarket businesses. If we look at Applied Global Services plus 300mm upgrades, revenues are up 21 percent compared to the same period in 2019. Within AGS, 60 percent of our service and spare parts business comes from predictable, recurring revenue streams in the form of long-term service agreements. This year, the renewal rate for these long-term agreements is in excess of 90 percent which is clear validation of the value customers see in our advanced service products.

### DISPLAY

In Display, our revenue outlook for fiscal 2020 is unchanged at 1.6 billion dollars and we expect 2021 to be similar. However, we are seeing some encouraging signs in the high-end of the market – specifically robust demand for 8K screens and the adoption of OLED in TVs. We remain optimistic about the long-term opportunities for Applied in the display market as we focus on addressing future technology inflections and expanding our available market.

### NEW WAYS OF WORKING

Finally, I'll highlight how we're working differently inside the company, as well as with our customers and suppliers. COVID-19 restrictions have stimulated many changes in the way companies in the industry are operating. For example, since March we have provided thousands of digital support sessions using AR and video, held more than 900 training sessions with field support engineers using VR and Live Distance Learning, and, fully restored R&D lab productivity while bringing only a fraction of our engineering staff on-site.

I strongly believe that 'innovate anywhere' provides substantial long-term benefits by eliminating waste, saving time and money, and reducing the industry's carbon footprint. Over the past several years, Applied has been making 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 accelerate product development cycles, speed up transfer of new technologies from lab to fab, and optimize cost, output and yield for our customers in high-volume production.

### SUMMARY

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

First, thanks to the extraordinary hard work of our employees and suppliers, we are operating the company at pre-COVID levels of productivity, while maintaining stringent protocols to keep our workplaces safe and healthy.

Second, while we are mindful of potential macro-economic headwinds, semiconductor equipment demand is strengthening, and the longer-term industry growth drivers remain firmly in place. Based on what we hear from our customers, we believe current spending levels will be sustained or even higher in 2021.

Third, our strategy to accelerate the PPACt playbook is yielding results for our customers and Applied. Today, we are outperforming the market overall and especially in key growth areas, including etch and inspection. Looking ahead, I am very excited about the innovative new products and integrated solutions we will bring to market this year and beyond.

Now, I will turn the call over to Dan.

## DAN DURN | Senior Vice President, Chief Financial Officer

Thanks Gary.

Today, I'll summarize our Q3 results; give you more insights into the performance trends Gary outlined; and share our business outlook for Q4.

### Q3 REVIEW

I'm pleased that despite challenges related to COVID-19, our teams delivered double-digit year-over-year revenue growth across Semiconductor Systems, AGS and Display.

Our installed base business, which includes AGS plus 300-millimeter upgrades, grew by 11 percent sequentially and 21 percent year over year, and now represents about a third of our company's total revenue. For the company as a whole, we grew revenue by 23 percent year-over-year and generated non-GAAP earnings of one dollar and six cents, up 43 percent year-on-year. We anticipate continued momentum in our fiscal Q4 and Q1.

During the third quarter, we shipped a significant proportion of the backlog that we couldn't satisfy in Q2 due to COVID-related supply chain disruptions. Our demand has remained strong, and our Q3 ending backlog was nearly unchanged from the prior quarter. The industry's supply chain performance continues to improve and despite ongoing logistical challenges in Q3, we increased our non-GAAP gross margin by 40 basis points sequentially and 100 basis points year on year. We also delivered sequential operating margin gains -- in both Semiconductor Systems and AGS. Non-GAAP opex was in line with our targets, and we allocated 69 percent to research and development. We increased non-GAAP operating profit to 1.16 billion dollars, up 41 percent year-over-year.

In May, we successfully issued $1.5 billion dollars of senior notes at historically low rates and later redeemed $1.35 billion dollars of maturities that were due in October 2020 and June 2021. These transactions extended our weighted average maturities by about 5 years and reduced the average coupon of our notes outstanding.

During the quarter, we returned $402 million dollars to shareholders in dividends and buybacks. We remain strongly committed to our shareholder distribution program and to closing the Kokusai Electric transaction. We're having constructive discussions to close the final regulatory approval we need. We continue to expect the transaction to be immediately accretive to our non-GAAP financial results and we look forward to providing you with a new financial model soon after we close the proposed transaction.

## INVESTMENTS AND 1H CY20 PERFORMANCE

Next, I'll expand on the performance trends Gary highlighted in his remarks.

We've discussed our conviction in the attractiveness of our markets and the opportunity we have to generate strong returns by consistently investing for growth. The investments we've made in recent years are resulting in momentum that's already visible today and will accelerate as new nodes ramp over the next several years.

Let's examine how Applied's revenue is profiling in the first half of the calendar year, which is our fiscal Q2 plus fiscal Q3. Compared to the same period last year, our semiconductor systems revenue is up 23 percent. This compares very favorably with our closest peers.

In foundry, we're significantly outperforming in the market. We're winning critical new applications in advanced patterning and we're working closely with customers to develop next-generation transistors and interconnects – using innovative approaches like our Integrated Materials Solutions. This is strengthening our leadership in foundry-logic, and also giving us new application wins in memory, where we're out-performing in the market as well. In fact, we believe we'll be the number-one company in DRAM conductor etch this year, winning greater than 50 percent of the available market. We look forward to demonstrating more growth as DRAM spending improves and demonstrate Applied's unique ability to perform well in a variety of spending environments.

Based on discussions with our customers, we expect our momentum to continue throughout the calendar year. Specifically, we believe our revenue in both foundry-logic and memory will be second-half weighted, leading to another year of growth and outperformance for Applied. This strength in our systems business is fuel for growth in our installed base business which is also on track to be up in the second half and into the future. As new systems go off warranty, we have opportunities to win subscription-like, long-term service agreements, which are a significant growth multiplier for our parts and service revenue.

## BUSINESS OUTLOOK

Now I'll share our fiscal Q4 business outlook.

We expect company revenue to be approximately $4.6 billion dollars, plus or minus $200 million dollars. The midpoint of the range would be up by around 23 percent, year over year. We expect non-GAAP EPS to be about $1 dollar and 17 cents, plus or minus 6 cents.

Within this outlook, we expect Semiconductor Systems revenue to be approximately $3.025 billion dollars, which would be up about 31 percent year over year. Applied Global Services revenue should be about $1.07 billion dollars, or up about 10 percent year over year and Display revenue should be around $475 million dollars. Non-GAAP gross margin should be about 45.7 percent, or up nearly two points year-on-year and non-GAAP OpEx should be around $820 million dollars.

## SUMMARY

In summary, Applied delivered double-digit revenue growth across all of our segments in Q3, with strong operating leverage. We're pleased to see how the investments we've made are translating to growth and relative outperformance, both in foundry-logic, and also in memory where we've made significant investments in recent years. The company is also positioned to weather cycles better than ever, with our installed base now driving a third of our revenue, and 60 percent of our parts and service business coming through subscriptions. And I'm incredibly proud of our teams for driving our innovation and increasing our shipments and customer support all while driving strong shareholder returns in a very challenging environment.