Q1 Fiscal 2024 Earnings Call

PREPARED REMARKS | FEBRUARY 15, 2024

MICHAEL SULLIVAN | Corporate Vice President, Investor Relations

Good afternoon everyone and thank you for joining Applied's first 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-K 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.

Before we begin, I have a calendar announcement. On Monday evening, February 26th, Applied will host a panel at the SPIE Advanced Lithography and Patterning conference in San Jose. Joining us will be leading experts from NVIDIA, Intel, imec and Siemens EDA. We'll also have demo stations with several new products and technologies we'll be introducing at the event. There won't be a webcast, so we hope you'll join us in San Jose!

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

GARY DICKERSON | President and Chief Executive Officer

INTRODUCTION

Thank you, Mike.

Applied Materials made a strong start to fiscal 2024, with first quarter revenue in the high end of our guidance, and earnings that exceeded our guided range. Our inflection-focused innovation strategy is delivering results. We have outperformed our markets for five consecutive years, and believe we are in a great position as customers transition major new chip innovations to high-volume production over the next several years. The breadth of our technology capabilities, combined with our deep customer relationships, allows us to see inflections early and accelerate key technology innovations that are critical to scaling AI, IoT, electric vehicles, and renewable energy. We have re-shaped and expanded our portfolio of solutions that enable next-generation transistors, new interconnect schemes including backside power delivery, high-performance DRAM including high-bandwidth memory, and specialty applications in the ICAPS market.

In my prepared remarks today, I'll provide some examples of how these inflections grow Applied's available market and are highly accretive to our share. I'll also talk about our long-term strategy to accelerate innovation and commercialization velocity through tighter collaboration with our customers and partners,

But to begin, let me share our latest perspective on the market environment.

MARKET OUTLOOK

In our discussions with customers, we are hearing that overall market dynamics are improving. There is a re-acceleration of capital investment by cloud companies, fab utilization is increasing across all device types, and memory inventory levels are normalizing.

In terms of Applied's business in 2024, we see leading-edge foundry-logic being stronger year-over-year, even though some important projects are delayed. We're forecasting ICAPS demand to be slightly lower than 2023 with weakness in some end markets being offset by strong regional investments, we expect our NAND revenues to be up year-on-year, but NAND to remain less than 10% of total wafer fab equipment spending, and we see continued strength in our DRAM business driven by customers ramping production of high-bandwidth memory.

POSITION AT KEY INFLECTIONS

High-bandwidth memory—where high-performance DRAM dies are stacked and connected to logic die with advanced packaging—is a key enabler for the AI datacenter. The dies used in high-bandwidth memory are more than two times larger than standard DRAM, which means that more than twice the capacity is needed to produce the same volume of chips. On top of this, the packaging steps needed for die-stacking further increase our total available market. High-bandwidth memory—or HBM—made up only about 5% of DRAM output in 2023 but is expected to grow at a 50% compound annual growth rate over the coming years.

DRAM is a great example of how our inflection-focused innovation approach is working. By focusing on the critically enabling process and packaging steps for next-generation technologies, Applied has significantly increased our share of the DRAM market. In 2023, we estimate that our DRAM share was more than 10 points higher than it was a decade earlier, and our DRAM revenues were larger than our two closest process equipment peers combined. We're also best positioned for future growth thanks to our leadership in logic technologies that have been implemented for DRAM peripheral circuitry applications to enable significantly increased I/O speed, our strong position in DRAM patterning, our unique, co-optimized hardmask solutions which are critical for capacitor scaling, and advanced packaging where we have strong leadership positions in micro-bump and through-silicon via that will enable multiple generations of high-bandwidth memory.

In fiscal 2024, we expect our HBM packaging revenues to be four times larger than last year, growing to almost half a billion dollars. And across all device types, we expect revenue from our advanced packaging product portfolio to grow to approximately $1.5 billion. Looking further ahead, we see opportunities for this business to double again as heterogenous integration is more widely adopted and we introduce new products that expand our served market.

Another key inflection that will transition to high-volume production beginning this year is gate-all-around transistors in leading-edge foundry-logic. These complex 3D structures can provide a more than 30% improvement in a chip's energy efficiency. This is especially enabling for high-performance AI datacenter applications. The shift from FinFET to gate-all-around grows Applied's available market by

$1 billion for every 100,000 wafer starts per month of capacity, and we are on track to gain share and capture over 50% of the spending for the process equipment used in this new transistor module.

Major advances in leading-edge foundry-logic and DRAM are also driving the need for more and better metrology and inspection to be integrated into the manufacturing flow. We have developed industry-leading cold field emission (CFE) e-beam technology that enables highly sensitive 2D and 3D imaging at up to 10 times higher speeds. We expect our CFE systems revenue to grow by a factor of four in 2024 and represent 50% of our total e-beam systems sales.

The incredible innovation we see in the industry today is not limited to the leading edge. In recent years, ICAPS customers have invested about 10% of their revenues—or about $30 billion annually—in research and development to accelerate the roadmap for IoT, Communications, Automotive, Power, and Sensor technologies. ICAPS technology depends less on shrinking device features, and customer investments are heavily weighted towards new structures, new materials and new integration approaches, playing to the core strengths of Applied. ICAPS is another area where we saw market inflections early, and five years ago we formed a dedicated team to focus on the needs of these customers. Since then, we have released more than 20 new ICAPS products that target the highest value device innovations in these markets, and we have a robust development pipeline of unit process and integrated solutions.

GROWING TECHNOLOGY COMPLEXITY FAVORS APPLIED MATERIALS

While major end market inflections such as AI and IoT, electric vehicles, and renewable energy are already driving semiconductor growth and innovation, it is important to recognize they are still in the early stages of adoption. For example, high-performance GPUs for AI datacenters only represent 6% of leading-edge foundry-logic wafer starts today. The full potential of technologies like AI cannot be unlocked without next-generation chips with better performance, power and cost.

The technology roadmap for semiconductors is rich with possibilities and opportunities, but also incredibly complex. No company is better placed to address this complexity than Applied Materials. With the industry's broadest and deepest portfolio of capabilities and products, we have a unique ability to combine, co-optimize and integrate our technologies to develop highly differentiated solutions for our customers. To bring these advances to market faster, we are also 'innovating the way we innovate' by driving earlier and deeper collaboration with our customers and partners. We are expanding our global innovation network that will connect into the EPIC Center we're building in Silicon Valley. During the quarter, we announced an expansion of our long-term partnership with LETI which is focused on accelerating ICAPS innovation, and we launched a new collaboration with MIT which is centered around next-generation power electronics.

STRONG AND FAST-GROWING SERVICE BUSINESS

As industry complexity rises, we are also delivering more value to customers with our advanced services that enable our customers to accelerate R&D, transfer new technology into volume manufacturing faster, and then optimize yield, output and cost in their factories. AGS has delivered 18 consecutive quarters of year-on-year growth. Revenue for the first quarter was up 8% versus the same

period last year and the business is now at a $6 billion annual run rate. AGS has the opportunity for double-digit growth this year, and we believe we can sustain this growth rate into the future. A significant portion of AGS revenue is generated from subscriptions. We have almost 17,000 tools under service agreements—up 8% year-on-year—and these agreements have a very high renewal rate—over 90%.

SUMMARY

Before I pass the call over to Brice, I will quickly summarize. Applied Materials outperformed our markets in 2023 for the fifth consecutive year and we delivered strong results in the first quarter of 2024. The positions we've established at key industry inflections will support continued outperformance as customers ramp next-generation chip technologies into high-volume production. We are strengthening R&D collaboration with customers and partners to drive innovation and commercialization velocity, improvements in mutual success rate, and R&D investment efficiencies. And we see growing demand for our advanced services that are helping customers manage increasing complexity in their business as the industry scales.

Now, I'll hand over to Brice.

BRICE HILL | Senior Vice President, Chief Financial Officer

Thank you, Gary. And I'd like to thank our teams for delivering strong revenue and margins this quarter and making further improvements in our operating performance.

On today's call, I'll discuss our value creation strategy and the results it is producing. Then, I'll summarize our growth thesis and why we believe we will outperform our markets in the years ahead. Finally, I'll summarize our Q1 results and provide our guidance for Q2.

VALUE CREATION STRATEGY

I'll begin by discussing how our assets and strategy create value for shareholders. Applied has the broadest and deepest process equipment portfolio and expertise in the industry. We are highly invested in collaborating with our customers, allocating $3 billion in annual R&D to invent new solutions to the most critical semiconductor manufacturing challenges. Increasingly, the only way to solve these challenges is by co-optimizing and integrating our chamber technologies in new ways. In addition, identifying new materials and processes early and collaborating closely with customers leads to faster results, a higher probability of success, greater efficiency, and stronger financial returns.

The benefits of our value creation strategy are being demonstrated in our financial results. We generated record equipment sales of $20.7 billion in calendar 2023, including legacy equipment reported in AGS, and we extended our strong position in DRAM with record calendar year sales of over $4.3 billion. In fact, over the past 10 years, the company has gained over 10 points of DRAM share and

multiple points of overall share. This has contributed to Applied delivering a fifth straight year of overall WFE share gains and one of the best share outcomes of the past 20 years.

Over the same 10 fiscal years, we've grown 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 increased return on invested capital from 8% to 35% and reduced net shares outstanding by over 30%.

GROWTH THESIS

Next I'll summarize our growth thesis. As we look out over the planning horizon, we expect semiconductors to grow significantly faster than GDP. Second, we expect the equipment market to grow as fast or faster than semiconductors over time, driven by increasing technical complexity. Third, we expect Applied's equipment business to outgrow the market and fourth, we expect our services business to grow as fast or faster than our equipment business.

I'll take a moment to support the third pillar of our thesis: that Applied's equipment business will outgrow the market. The reason is that our technologies enable the key semiconductor advances needed to drive growth in AI, IoT and renewable energy.

Looking ahead to the semiconductor process inflections that will play out over the next several years, the company is extremely well positioned. In data center AI, we are #1 in process equipment for advanced logic and compute memory, both standard DRAM and high-bandwidth memory. We also have line of sight to share of 50% or more in gate-all-around transistors, backside power delivery and advanced packaging. We are equally strong in edge AI and IoT, with the #1 position in ICAPS silicon which is used to sense and convert analog information and transmit it to the cloud. We are also innovating rapidly in ICAPS technology for the global energy transformation, including through new agreements with partners like LETI and MIT, which Gary described.

In summary, we feel confident that our unique assets and collaboration strategy position Applied to continue to outpace our markets and deliver strong shareholder returns as these major inflections play out over the next several years.

Q1 RESULTS

Now I'll summarize our Q1 results.

On a year-over-year basis, net sales declined slightly to $6.7 billion. Non-GAAP gross margin grew 110 basis points to 47.9%. Non-GAAP opex grew 5.6% to $1.23 billion and non-GAAP EPS grew nearly 5% to $2.13.

Turning to our segment results, Semiconductor Systems revenue was strong at $4.91 billion and included record DRAM and etch system sales. Segment non-GAAP operating margin was 35.7%. While our operating expenses are primarily focused on R&D programs for emerging technology

inflections, we are also investing to expand and diversify our manufacturing, logistics, and supply chain to efficiently serve future growth.

Applied Global Services delivered record revenue and its 18th consecutive quarter of year-over-year growth. AGS revenue increased approximately 8% year-over-year to nearly $1.48 billion, and segment non-GAAP operating margin was 28.3%. Our installed base surpassed 49,000 tools during the quarter and grew to nearly 200,000 chambers. Around two-thirds of AGS recurring services and parts revenue was delivered as subscription agreements. Finally, AGS continued to produce more than enough operating profit to fund Applied's growing dividend.

Moving to Display, Q1 revenue was $244 million dollars, and segment non-GAAP operating profit was 10.2%. We continue to look forward to our opportunity in the upcoming OLED IT growth inflection.

Turning to cash flows in Q1, we generated $2.3 billion in operating cash flow and $2.1 billion in free cash flow. We distributed $966 million to shareholders, including $266 million in dividends and $700 million in buybacks. We repurchased nearly 5 million shares at an average price of $152.60.

Please note that our Q1 results include the following:

First, as we discussed in our recent 10-K report, we increased the estimated useful lives of our plant and equipment, and this increased non-GAAP EPS by 3 cents.

Also effective Q1, we refined the way we allocate stock-based compensation, moving the majority of the expenses from corporate unallocated to the operating segments, which gives managers greater visibility over costs. While the change has no impact on company operating profit or EPS, it reduces segment operating profit and corporate unallocated costs proportionally. To help you with your segment models, our quarterly earnings presentation includes a table showing what operating profits would have been in fiscal 2022 and in each quarter of fiscal 2023 on a like basis.

Finally, the reduction in depreciation and share-based compensation in cost of sales increased gross margin by approximately 40 basis points.

Q2 GUIDANCE

Now, I'll share our guidance for Q2. We expect revenue to be $6.5 billion ± $400 million and we expect non-GAAP EPS of $1.97 ± $0.18. Within this outlook, we expect Semi Systems revenue of around $4.8 billion, AGS revenue of about $1.5 billion, and Display revenue of around $150 million. We expect non-GAAP gross margin to be approximately 47.3% and non-GAAP operating expenses to be around $1.235 billion. We are modeling a tax rate of 12.5%.

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