

APPLIED MATERIALS INC /DE
Form 10-Q
August 24, 2017
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 30, 2017
or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number 000-06920
Applied Materials, Inc.
(Exact name of registrant as specified in its charter)
Delaware 94-1655526
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3050 Bowers Avenue, 95052-8039
P.O. Box 58039
Santa Clara, California (Zip Code)
(Address of principal executive offices)

(408) 727-5555

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
	Emerging growth company <input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards

provided pursuant to Section 13(a) of the Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No ☒

Number of shares outstanding of the issuer's common stock as of July 30, 2017: 1,066,487,165

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APPLIED MATERIALS, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED JULY 30, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLIED MATERIALS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(In millions, except per share amounts)

	Three Months Ended July 30, July 31, 2017 2016		Nine Months Ended July 30, July 31, 2017 2016	
	(Unaudited)			
Net sales	\$3,744	\$2,821	\$10,568	\$7,528
Cost of products sold	2,044	1,629	5,823	4,416
Gross profit	1,700	1,192	4,745	3,112
Operating expenses:				
Research, development and engineering	454	386	1,308	1,146
Marketing and selling	117	107	351	315
General and administrative	106	103	316	276
Total operating expenses	677	596	1,975	1,737
Income from operations	1,023	596	2,770	1,375
Interest expense	59	38	141	117
Interest and other income, net	14	6	28	15
Income before income taxes	978	564	2,657	1,273
Provision for income taxes	53	59	205	162
Net income	\$925	\$505	\$2,452	\$1,111
Earnings per share:				
Basic	\$0.86	\$0.47	\$2.28	\$1.00
Diluted	\$0.85	\$0.46	\$2.26	\$0.99
Weighted average number of shares:				
Basic	1,071	1,083	1,076	1,115
Diluted	1,083	1,093	1,087	1,123

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

	Three Months Ended July 30, 2017		Nine Months Ended July 31, 2017	
	July 31, 2016	July 30, 2016	July 31, 2016	July 30, 2016
	(Unaudited)			
Net income	\$925	\$ 505	\$2,452	\$1,111
Other comprehensive income, net of tax:				
Change in unrealized net gain on investments	10	17	25	21
Change in unrealized net loss on derivative instruments	1	(9)	1	(16)
Change in defined and postretirement benefit plans	(2)	—	(12)	—
Other comprehensive income, net of tax	9	8	14	5
Comprehensive income	\$934	\$ 513	\$2,466	\$1,116
See accompanying Notes to Consolidated Condensed Financial Statements.				

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APPLIED MATERIALS, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

(In millions)

	July 30, 2017	October 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$5,278	\$ 3,406
Short-term investments	1,953	343
Accounts receivable, net	2,258	2,279
Inventories	2,876	2,050
Other current assets	366	275
Total current assets	12,731	8,353
Long-term investments	1,059	929
Property, plant and equipment, net	996	937
Goodwill	3,357	3,316
Purchased technology and other intangible assets, net	461	575
Deferred income taxes and other assets	474	460
Total assets	\$19,078	\$ 14,570

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable, notes payable and accrued expenses	\$2,255	\$ 2,256
Customer deposits and deferred revenue	2,116	1,376
Total current liabilities	4,371	3,632
Long-term debt	5,303	3,125
Other liabilities	688	596
Total liabilities	10,362	7,353
Stockholders' equity:		
Common stock	11	11
Additional paid-in capital	6,950	6,809
Retained earnings	17,383	15,252
Treasury stock	(15,527)	(14,740)
Accumulated other comprehensive loss	(101)	(115)
Total stockholders' equity	8,716	7,217
Total liabilities and stockholders' equity	\$19,078	\$ 14,570

Amounts as of July 30, 2017 are unaudited. Amounts as of October 30, 2016 are derived from the October 30, 2016 audited consolidated financial statements.

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC

CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY

(In millions)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
Nine Months Ended July 30, 2017	Shares	Amount			Shares	Amount		
	(Unaudited)							
Balance at October 30, 2016	1,078	\$ 11	\$ 6,809	\$ 15,252	889	\$(14,740)	\$ (115)	\$ 7,217
Net income	—	—	—	2,452	—	—	—	2,452
Other comprehensive income, net of tax	—	—	—	—	—	—	14	14
Dividends	—	—	—	(321)	—	—	—	(321)
Share-based compensation	—	—	162	—	—	—	—	162
Issuance under stock plans, net of a tax benefit of \$51 and other	8	—	(21)	—	—	—	—	(21)
Common stock repurchases	(20)	—	—	—	20	(787)	—	(787)
Balance at July 30, 2017	1,066	\$ 11	\$ 6,950	\$ 17,383	909	\$(15,527)	\$ (101)	\$ 8,716
	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
Nine Months Ended July 31, 2016	Shares	Amount			Shares	Amount		
	(Unaudited)							
Balance at October 25, 2015	1,160	\$ 11	\$ 6,575	\$ 13,967	793	\$(12,848)	\$ (92)	\$ 7,613
Net income	—	—	—	1,111	—	—	—	1,111
Other comprehensive loss, net of tax	—	—	—	—	—	—	5	5
Dividends	—	—	—	(328)	—	—	—	(328)
Share-based compensation	—	—	150	—	—	—	—	150
Issuance under stock plans, net of a tax benefit of \$18 and other	11	—	(11)	—	—	—	—	(11)
Common stock repurchases	(90)	—	—	—	90	(1,721)	—	(1,721)
Balance at July 31, 2016	1,081	\$ 11	\$ 6,714	\$ 14,750	883	\$(14,569)	\$ (87)	\$ 6,819

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In millions)

	Nine Months Ended	
	July 30, 2017	July 31, 2016
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$2,452	\$1,111
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	302	289
Share-based compensation	162	150
Excess tax benefits from share-based compensation	(51)	(18)
Deferred income taxes	6	14
Other	15	20
Changes in operating assets and liabilities:		
Accounts receivable	26	(112)
Inventories	(825)	(192)
Other current and non-current assets	(114)	52
Accounts payable and accrued expenses	153	(84)
Customer deposits and deferred revenue	740	399
Income taxes payable	13	38
Other liabilities	31	2
Cash provided by operating activities	2,910	1,669
Cash flows from investing activities:		
Capital expenditures	(221)	(165)
Cash paid for acquisitions, net of cash acquired	(56)	(5)
Proceeds from sales and maturities of investments	1,822	681
Purchases of investments	(3,542)	(947)
Cash used in investing activities	(1,997)	(436)
Cash flows from financing activities:		
Debt borrowings, net of issuance costs	2,176	—
Debt repayments	(205)	(1,207)
Proceeds from common stock issuances	47	44
Common stock repurchases	(787)	(1,721)
Excess tax benefits from share-based compensation	51	18
Payments of dividends to stockholders	(323)	(336)
Cash provided by (used in) financing activities	959	(3,202)
Increase (decrease) in cash and cash equivalents	1,872	(1,969)
Cash and cash equivalents — beginning of period	3,406	4,797
Cash and cash equivalents — end of period	\$5,278	\$2,828
Supplemental cash flow information:		
Cash payments for income taxes	\$168	\$144
Cash refunds from income taxes	\$17	\$104
Cash payments for interest	\$110	\$110

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation

Basis of Presentation

In the opinion of management, the unaudited interim consolidated condensed financial statements of Applied Materials, Inc. and its subsidiaries (Applied or the Company) included herein have been prepared on a basis consistent with the October 30, 2016 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Applied's Annual Report on Form 10-K for the fiscal year ended October 30, 2016 (2016 Form 10-K). Applied's results of operations for the three and nine months ended July 30, 2017 are not necessarily indicative of future operating results. Applied's fiscal year ends on the last Sunday in October of each year. Fiscal 2017 and 2016 contain 52 weeks and 53 weeks, respectively, and the first nine months of fiscal 2017 and 2016 contained 39 weeks and 40 weeks, respectively.

Certain prior year amounts have been reclassified to conform to current year presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates. On an ongoing basis, Applied evaluates its estimates, including those related to accounts receivable and sales allowances, fair values of financial instruments, inventories, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of share-based awards, and income taxes, among others. Applied bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Revenue Recognition

Applied recognizes revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; seller's price to buyer is fixed or determinable; and collectability is probable. Applied's shipping terms are customarily FOB Applied shipping point or equivalent terms. Applied's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment or delivery, Applied recognizes revenue upon passage of title for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer technical acceptance; (3) for transactions where legal title does not pass at shipment or delivery, revenue is recognized when legal title passes to the customer, which is generally at customer technical acceptance; and (4) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred using the relative selling price method utilizing estimated sales prices until delivery of the deferred elements. Applied limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or adjustment. In cases where Applied has sold products that have been demonstrated to meet product specifications prior to shipment, Applied believes that at the time of delivery, it has an enforceable claim to amounts recognized as revenue. Spare parts revenue is generally recognized upon shipment, and services revenue is generally recognized over the period that the services are provided.

When a sales arrangement contains multiple elements, such as hardware and services and/or software products, Applied allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not

available, or estimated selling price (ESP) if neither VSOE nor TPE is available. Applied generally utilizes the ESP due to the nature of its products. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables, and to the software deliverables as a group, using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Recent Accounting Pronouncements

Accounting Standards Adopted

Debt Issuance Costs. In April 2015, the Financial Accounting Standard Board (FASB) issued authoritative guidance that requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability, consistent with debt discounts. Effective in the first quarter of fiscal 2017, Applied adopted the authoritative guidance retrospectively. The adoption of this guidance did not have a significant impact on Applied's consolidated financial statements. See Note 10 of Notes to Consolidated Condensed Financial Statements for additional discussion.

Fair Value Disclosures. In May 2015, the FASB issued authoritative guidance to remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The new guidance also removes the requirement of certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. The guidance became effective for Applied in the first quarter of fiscal 2017, with retrospective application. The adoption of this guidance only impacts disclosures in Applied's annual consolidated financial statements.

Intangibles: Internal-Use Software. In April 2015, the FASB issued authoritative guidance for customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This guidance did not change accounting for service contracts. Applied adopted this guidance effective in the first quarter of fiscal 2017 prospectively to all arrangements entered into or materially modified after the effective date. The adoption of this guidance did not have a significant impact on Applied's consolidated financial statements.

Accounting Standards Not Yet Adopted

Share-Based Compensation: Modification Accounting. In May 2017, the FASB issued an update to clarify when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award changes as a result of the change in terms or conditions. This authoritative guidance will be applied prospectively to awards modified following adoption and will be effective for Applied in the first quarter of fiscal 2019 with early adoption permitted. The impact of the adoption of this guidance will depend on whether the Company makes any future modifications of share-based payment awards.

Receivables: Nonrefundable Fees and Other Costs. In March 2017, the FASB issued authoritative guidance that will shorten the amortization period for certain callable debt securities held at a premium to the earliest call date to more closely align with expectations incorporated in market pricing. This authoritative guidance will be effective for Applied in the first quarter of fiscal 2020 on a modified retrospective basis, with early adoption permitted. Applied is currently evaluating the impact of adopting this new accounting guidance on Applied's consolidated financial statements.

Retirement Benefits. In March 2017, the FASB issued authoritative guidance which requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019 on a retrospective basis, with early adoption permitted. The adoption of this guidance is only expected to result in reclassification of other components of net benefit costs outside of income from operations and is not expected to have a significant impact on Applied's consolidated financial statements.

Goodwill Impairment. In January 2017, the FASB issued authoritative guidance that simplifies the process required to test goodwill for impairment. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2021. Early adoption is permitted. The adoption of this guidance is not expected to have a significant impact on Applied's consolidated financial statements.

Income Taxes: Intra-Entity Asset Transfers. In October 2016, the FASB issued authoritative guidance that requires entities to recognize at the transaction date the income tax consequences of intercompany asset transfers other than inventory. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019, with early adoption permitted. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Classification of Certain Cash Receipts and Cash Payments. In August 2016, a new authoritative guidance was issued which addresses classification of certain cash receipts and cash payments related to the statement of cash flows. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019. The adoption of this guidance is not expected to have a significant impact on Applied's consolidated financial statements.

Financial Instruments: Credit Losses. In June 2016, the FASB issued authoritative guidance that modifies the impairment model for certain financial assets by requiring use of an expected loss methodology, which will result in more timely recognition of credit losses. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2021. Early adoption is permitted beginning in the first quarter of fiscal 2020. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

Share-Based Compensation. In March 2016, the FASB issued authoritative guidance that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2018. Upon adoption, Applied will elect to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period. The new standard will result in the recognition of excess tax benefits in provision for income taxes rather than paid-in capital prospectively, which is expected to increase volatility in Applied's results of operations. Applied will elect to apply the presentation requirements for cash flows related to excess tax benefits retrospectively. The presentation requirements for cash flows related to employee taxes paid for withheld shares will be presented as a financing activity retrospectively, as required. Applied expects cash flow from operations to increase, with a corresponding decrease in cash flow from financing activity as a result of the changes in the cash flow presentation.

Leases. In February 2016, the FASB issued authoritative guidance for lease accounting, which requires lessees to recognize lease assets and liabilities on the balance sheet for certain lease arrangements that are classified as operating leases under the previous standard, and to provide for enhanced disclosures. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2020 and should be applied using a modified retrospective approach. Early adoption is permitted. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

Financial Instruments: Classification and Measurement. In January 2016, the FASB issued authoritative guidance that requires equity investments that do not result in consolidation, and are not accounted for under the equity method, to be measured at fair value, and requires recognition of any changes in fair value in net income unless the investments qualify for a new practicability exception. For financial liabilities measured at fair value, the change in fair value caused by a change in instrument-specific credit risk will be required to be presented separately in other comprehensive income. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019. Early adoption is permitted only for the provisions related to the recognition of changes in fair value of financial liabilities caused by instrument-specific credit risk. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

Inventory Measurement. In July 2015, the FASB issued authoritative guidance that requires inventory to be measured at the lower of cost and net realizable value instead of at lower of cost or market. This guidance does not apply to inventory that is measured using last-in, first out (LIFO) or the retail inventory method but applies to all other inventory including those measured using first-in, first-out (FIFO) or the average cost method. Applied will adopt this authoritative guidance in the first quarter of fiscal 2018 prospectively to measurement of inventory after the effective date. The adoption of this guidance is not expected to have a significant impact on Applied's consolidated financial statements.

Revenue Recognition. In May 2014, the FASB issued authoritative guidance that requires revenue recognition to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which

the entity expects to be entitled in exchange for those goods or services. This new standard will supersede most current revenue recognition guidance, including industry-specific guidance. Entities will have the option of using either a full retrospective or modified retrospective approach to adopting the guidance. Under the modified approach, an entity would recognize the cumulative effect of initially applying the guidance with an adjustment to the opening balance of retained earnings in the period of adoption. In addition, the modified approach will require additional disclosures. In August 2015, the FASB issued an amendment to defer the effective date by one year and allow entities to early adopt no earlier than the original effective date. With this amendment, the guidance will be effective for Applied in the first quarter of fiscal 2019, which is the Company's planned adoption date. In fiscal 2016, Applied established a project steering committee and cross-functional implementation team to identify potential differences that would result from applying the requirements of the new standard to Applied's revenue contracts. In addition, the implementation team is also responsible for identifying and implementing changes to business processes, systems and controls to support recognition and disclosure under the new standard. Applied is continuing to evaluate the effect of this new guidance on Applied's financial position, results of operations and its ongoing financial reporting, including the selection of a transition method.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 2 Earnings Per Share

Basic earnings per share is determined using the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined using the weighted average number of common shares and potential common shares (representing the dilutive effect of stock options, restricted stock units, and employee stock purchase plan shares) outstanding during the period. Applied's net income has not been adjusted for any period presented for purposes of computing basic or diluted earnings per share due to the Company's non-complex capital structure.

	Three Months Ended July 30, 2017		Nine Months Ended July 30, 2017	
	2016		2016	
	(In millions, except per share amounts)			
Numerator:				
Net income	\$925	\$ 505	\$2,452	\$ 1,111
Denominator:				
Weighted average common shares outstanding	1,071	1,083	1,076	1,115
Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	12	10	11	8
Denominator for diluted earnings per share	1,083	1,093	1,087	1,123
Basic earnings per share	\$0.86	\$ 0.47	\$2.28	\$ 1.00
Diluted earnings per share	\$0.85	\$ 0.46	\$2.26	\$ 0.99
Potentially dilutive securities	—	—	—	—

Potentially dilutive securities attributable to outstanding stock options and restricted stock units are excluded from the calculation of diluted earnings per share where the combined exercise price, average unamortized fair value and assumed tax benefits upon the exercise of options and the vesting of restricted stock units are greater than the average market price of Applied common stock, and therefore their inclusion would be anti-dilutive.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 3 Cash, Cash Equivalents and Investments

Summary of Cash, Cash Equivalents and Investments

The following tables summarize Applied's cash, cash equivalents and investments by security type:

July 30, 2017	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	\$1,123	\$ —	\$ —	\$ 1,123
Cash equivalents:				
Money market funds	3,055	—	—	3,055
Municipal securities	437	—	—	437
Commercial paper, corporate bonds and medium-term notes	663	—	—	663
Total Cash equivalents	4,155	—	—	4,155
Total Cash and Cash equivalents	\$5,278	\$ —	\$ —	\$ 5,278
Short-term and long-term investments:				
U.S. Treasury and agency securities	\$628	\$ —	\$ 1	\$ 627
Non-U.S. government securities*	159	—	—	159
Municipal securities	893	1	—	894
Commercial paper, corporate bonds and medium-term notes	840	—	—	840
Asset-backed and mortgage-backed securities	316	—	—	316
Total fixed income securities	2,836	1	1	2,836
Publicly traded equity securities	24	76	—	100
Equity investments in privately-held companies	76	—	—	76
Total short-term and long-term investments	\$2,936	\$ 77	\$ 1	\$ 3,012
Total Cash, Cash equivalents and Investments	\$8,214	\$ 77	\$ 1	\$ 8,290

* Includes agency debt securities guaranteed by non-U.S. governments, which consist of Canada and Germany.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

October 30, 2016	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	\$1,103	\$ —	\$ —	\$ 1,103
Cash equivalents:				
Money market funds	1,889	—	—	1,889
U.S. Treasury and agency securities	10	—	—	10
Non-U.S. government securities*	10	—	—	10
Municipal securities	253	—	—	253
Commercial paper, corporate bonds and medium-term notes	141	—	—	141
Total Cash equivalents	2,303	—	—	2,303
Total Cash and Cash equivalents	\$3,406	\$ —	\$ —	\$ 3,406
Short-term and long-term investments:				
U.S. Treasury and agency securities	\$195	\$ —	\$ —	\$ 195
Non-U.S. government securities*	5	—	—	5
Municipal securities	408	—	—	408
Commercial paper, corporate bonds and medium-term notes	273	1	—	274
Asset-backed and mortgage-backed securities	253	1	1	253
Total fixed income securities	1,134	2	1	1,135
Publicly traded equity securities	26	44	3	67
Equity investments in privately-held companies	70	—	—	70
Total short-term and long-term investments	\$1,230	\$ 46	\$ 4	\$ 1,272
Total Cash, Cash equivalents and Investments	\$4,636	\$ 46	\$ 4	\$ 4,678

* Includes agency debt securities guaranteed by non-U.S. governments, which consist of Canada and Germany.

Maturities of Investments

The following table summarizes the contractual maturities of Applied's investments at July 30, 2017:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	\$1,927	\$ 1,927
Due after one through five years	593	593
No single maturity date**	416	492
	\$2,936	\$ 3,012

** Securities with no single maturity date include publicly-traded and privately-held equity securities, and asset-backed and mortgage-backed securities.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Gains and Losses on Investments

During the three and nine months ended July 30, 2017 and July 31, 2016, gross realized gains and losses on investments were not material.

At July 30, 2017 and October 30, 2016, gross unrealized losses related to Applied's investment portfolio were not material. Applied regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether an unrealized loss is considered to be temporary, or other-than-temporary and therefore impaired, include: the length of time and extent to which fair value has been lower than the cost basis; the financial condition, credit quality and near-term prospects of the investee; and whether it is more likely than not that Applied will be required to sell the security prior to recovery. Generally, the contractual terms of investments in marketable securities do not permit settlement at prices less than the amortized cost of the investments. Applied determined that the gross unrealized losses on its marketable fixed-income securities at July 30, 2017 and July 31, 2016 were temporary in nature and therefore it did not recognize any impairment of its marketable fixed-income securities during the three and nine months ended July 30, 2017 or July 31, 2016. Impairment charges on equity investments in privately-held companies during the three and nine months ended July 30, 2017 and July 31, 2016 were not material. These impairment charges are included in interest and other income, net in the Consolidated Condensed Statement of Operations.

Unrealized gains and temporary losses on investments classified as available-for-sale are included within accumulated other comprehensive income (loss), net of any related tax effect. Upon realization, those amounts are reclassified from accumulated other comprehensive income (loss) to results of operations.

Note 4 Fair Value Measurements

Applied's financial assets are measured and recorded at fair value, except for equity investments in privately-held companies. These equity investments are generally accounted for under the cost method of accounting and are periodically assessed for other-than-temporary impairment when events or circumstances indicate that an other-than-temporary decline in value may have occurred. Applied's nonfinancial assets, such as goodwill, intangible assets, and property, plant and equipment, are recorded at cost and are assessed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

Fair Value Hierarchy

Applied uses the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 — Quoted prices in active markets for identical assets or liabilities;

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Applied's investments consist primarily of debt securities that are classified as available-for-sale and recorded at their fair values. In determining the fair value of investments, Applied uses pricing information from pricing services that value securities based on quoted market prices and models that utilize observable market inputs. In the event a fair value estimate is unavailable from a pricing service, Applied generally obtains non-binding price quotes from brokers. Applied then reviews the information provided by the pricing services or brokers to determine the fair value of its short-term and long-term investments. In addition, to validate pricing information obtained from pricing services,

Applied periodically performs supplemental analysis on a sample of securities. Applied reviews any significant unanticipated differences identified through this analysis to determine the appropriate fair value.

Investments with remaining effective maturities of 12 months or less from the balance sheet date are classified as short-term investments. Investments with remaining effective maturities of more than 12 months from the balance sheet date are classified as long-term investments. As of July 30, 2017, substantially all of Applied's available-for-sale, short-term and long-term investments were recognized at fair value that was determined based upon observable inputs.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Assets Measured at Fair Value on a Recurring Basis

Financial assets (excluding cash balances) measured at fair value on a recurring basis are summarized below:

	July 30, 2017			October 30, 2016		
	Level 1	Level 2	Total	Level 1	Level 2	Total
(In millions)						
Assets:						
Money market funds	\$3,055	\$—	\$3,055	\$1,889	\$—	\$1,889
U.S. Treasury and agency securities	149	478	627	107	98	205
Non-U.S. government securities	—	159	159	—	15	15
Municipal securities	—	1,331	1,331	—	661	661
Commercial paper, corporate bonds and medium-term notes	—	1,503	1,503	—	415	415
Asset-backed and mortgage-backed securities	—	316	316	—	253	253
Publicly traded equity securities	100	—	100	67	—	67
Total	\$3,304	\$3,787	\$7,091	\$2,063	\$1,442	\$3,505

There were no transfers between Level 1 and Level 2 fair value measurements during the three and nine months ended July 30, 2017 or July 31, 2016. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of July 30, 2017 or October 30, 2016.

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Equity investments in privately-held companies are generally accounted for under the cost method of accounting and are periodically assessed for other-than-temporary impairment when an event or circumstance indicates that an other-than-temporary decline in value may have occurred. If Applied determines that an other-than-temporary impairment has occurred, the investment will be written down to its estimated fair value based on available information, such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. At July 30, 2017, equity investments in privately-held companies totaled \$76 million, of which \$67 million of these investments were accounted for under the cost method of accounting and \$9 million of investments had been measured at fair value on a non-recurring basis within Level 3 fair value measurements due to an other-than-temporary decline in value. At October 30, 2016, equity investments in privately-held companies totaled \$70 million, of which \$62 million of these investments were accounted for under the cost method of accounting and \$8 million of investments had been measured at fair value on a non-recurring basis within Level 3 fair value measurements due to an other-than-temporary decline in value.

Impairment charges on equity investments in privately-held companies during the three and nine months ended July 30, 2017 and July 31, 2016 were not material.

Other

The carrying amounts of Applied's financial instruments, including cash and cash equivalents, accounts receivable, notes payable - short term, and accounts payable and accrued expenses, approximate fair value due to their short maturities. At July 30, 2017, the carrying amount of long-term debt was \$5.3 billion and the estimated fair value was \$5.8 billion. At October 30, 2016, the carrying amount of long-term debt was \$3.1 billion and the estimated fair value was \$3.5 billion. The estimated fair value of long-term debt is determined by Level 2 inputs and is based primarily on quoted market prices for the same or similar issues. See Note 10 of the Notes to the Consolidated Condensed Financial Statements for further detail of existing debt.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 5 Derivative Instruments and Hedging Activities

Derivative Financial Instruments

Applied conducts business in a number of foreign countries, with certain transactions denominated in local currencies, such as the Japanese yen, euro, Israeli shekel and Taiwanese dollar. Applied uses derivative financial instruments, such as forward exchange contracts and currency option contracts, to hedge certain forecasted foreign currency denominated transactions expected to occur typically within the next 24 months. The purpose of Applied's foreign currency management is to mitigate the effect of exchange rate fluctuations on certain foreign currency denominated revenues, costs and eventual cash flows. The terms of currency instruments used for hedging purposes are generally consistent with the timing of the transactions being hedged.

During fiscal 2015, Applied entered into and settled a series of forward-starting interest rate swap agreements, with a total notional amount of \$600 million to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. These instruments were designated as cash flow hedges at inception and settled in conjunction with the issuance of debt in September 2015. The loss from the settlement of the interest rate swap agreement which was included in accumulated other comprehensive income (AOCI) in stockholders' equity is being amortized to interest expense over the term of the senior unsecured 10-year notes issued in September 2015.

During the second quarter of fiscal 2017, Applied entered into and settled interest rate lock agreements, with a total notional amount of \$700 million to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. These instruments were designated as cash flow hedges at inception and settled in conjunction with the issuance of debt in March 2017. The \$14 million loss from the settlement of the interest rate lock agreement which was included in AOCI in stockholders' equity is being amortized to interest expense over the term of the senior unsecured 10-year notes issued in March 2017.

Applied does not use derivative financial instruments for trading or speculative purposes. Derivative instruments and hedging activities, including foreign currency exchange and interest rate contracts, are recognized on the balance sheet at fair value. Changes in the fair value of derivatives that do not qualify for hedge treatment, as well as the ineffective portion of any hedges, are recognized currently in earnings. All of Applied's derivative financial instruments are recorded at their fair value in other current assets or in accounts payable and accrued expenses.

Hedges related to anticipated transactions are designated and documented at the inception of the hedge as cash flow hedges and foreign exchange derivatives are typically entered into once per month. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of AOCI in stockholders' equity and is reclassified into earnings when the hedged transaction affects earnings. The majority of the after-tax net income or loss related to foreign exchange derivative instruments included in AOCI at July 30, 2017 is expected to be reclassified into earnings within 12 months. Changes in the fair value of currency forward exchange and option contracts due to changes in time value are excluded from the assessment of effectiveness. Both ineffective hedge amounts and hedge components excluded from the assessment of effectiveness are recognized in earnings. If the transaction being hedged is no longer probable to occur, or if a portion of any derivative is deemed to be ineffective, Applied promptly recognizes the gain or loss on the associated financial instrument in earnings. The amount recognized due to discontinuance of cash flow hedges that were probable not to occur by the end of the originally specified time period was not significant for the three and nine months ended July 30, 2017 and July 31, 2016.

Additionally, forward exchange contracts are generally used to hedge certain foreign currency denominated assets or liabilities. These derivatives are typically entered into once per month and are not designated for hedge accounting treatment. Accordingly, changes in the fair value of these hedges are recorded in earnings to offset the changes in the fair value of the assets or liabilities being hedged.

The fair values of foreign exchange derivative instruments at July 30, 2017 and October 30, 2016 were not material.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

The effects of derivative instruments and hedging activities on the Consolidated Condensed Statements of Operations were as follows:

		Three Months Ended July 30, 2017		July 31, 2016	
		Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness Testing	Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness Testing
Location of Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income
(In millions)					
Derivatives in Cash Flow Hedging Relationships					
Foreign exchange contracts	Cost of products sold	\$6 \$ 1	\$ —	\$ (26) \$ (13)	\$ 1
Foreign exchange contracts	General and administrative	— 3	(1)	— 1	(1)
Interest rate contracts	Interest expense	— (1)	—	— (1)	—
Total		\$6 \$ 3	\$ (1)	\$ (26) \$ (13)	\$ —

		Nine Months Ended July 30, 2017		July 31, 2016	
		Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness Testing	Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness Testing
Location of Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income

(In millions)

Derivatives in Cash Flow Hedging Relationships

Foreign exchange contracts	Cost of products sold	\$24	\$ 7	\$ (3)	\$(49)	\$ (21)	\$ 1
Foreign exchange contracts	General and administrative	—	3	(2)	—	(1)	(2)
Interest rate contracts	Interest expense	(14)	(2)	—	—	(1)	—
Total		\$10	\$ 8	\$ (5)	\$(49)	\$ (23)	\$ (1)

Amount of Gain or (Loss)

Recognized in Income

Three Months Ended	Nine Months Ended
--------------------	-------------------

Location of Gain or (Loss) Recognized in Income

July 31, 2017	July 31, 2016	July 31, 2017	July 31, 2016
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(In millions)

Derivatives Not Designated as Hedging Instruments

Foreign exchange contracts	General and administrative	\$ 9	\$(31)	34	(67)
Total		\$ 9	\$(31)	\$ 34	\$(67)

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Credit Risk Contingent Features

If Applied's credit rating were to fall below investment grade, it would be in violation of credit risk contingent provisions of the derivative instruments discussed above, and certain counterparties to the derivative instruments could request immediate payment on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk related contingent features that were in a net liability position was immaterial as of July 30, 2017.

Entering into derivative contracts with banks exposes Applied to credit-related losses in the event of the banks' nonperformance. However, Applied's exposure is not considered significant.

Note 6 Accounts Receivable, Net

Applied has agreements with various financial institutions to sell accounts receivable and discount promissory notes from selected customers. Applied sells its accounts receivable without recourse. Applied, from time to time, also discounts letters of credit issued by customers through various financial institutions. The discounting of letters of credit depends on many factors, including the willingness of financial institutions to discount the letters of credit and the cost of such arrangements.

Applied sold \$211 million and \$360 million of accounts receivable during the three and nine months ended July 30, 2017, respectively. Applied sold \$57 million accounts receivable during the three and nine months ended July 31, 2016. Applied did not discount letters of credit issued by customers or discount promissory notes during the three and nine months ended July 30, 2017 and July 31, 2016. Financing charges on the sale of receivables and discounting of letters of credit are included in interest expense in the accompanying Consolidated Condensed Statements of Operations and were not material for all periods presented.

Accounts receivable are presented net of allowance for doubtful accounts of \$51 million at July 30, 2017 and October 30, 2016. Applied sells its products principally to manufacturers within the semiconductor and display industries. While Applied believes that its allowance for doubtful accounts is adequate and represents its best estimate as of July 30, 2017, it continues to closely monitor customer liquidity and industry and economic conditions, which may result in changes to Applied's estimates.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 7 Balance Sheet Detail

July 30, October 30,
2017 2016

(In millions)

Inventories

Customer service spares	\$520	\$ 452
Raw materials	634	474
Work-in-process	466	393
Finished goods	1,256	731
	\$2,876	\$ 2,050

Included in finished goods inventory are \$347 million at July 30, 2017, and \$190 million at October 30, 2016, of newly-introduced systems at customer locations where the sales transaction did not meet Applied's revenue recognition criteria as set forth in Note 1. Finished goods inventory includes \$255 million and \$197 million of evaluation inventory at July 30, 2017 and October 30, 2016, respectively.

July 30, October 30,
2017 2016

(In millions)

Other Current Assets

Prepaid income taxes and income taxes receivable	\$82	\$ 87
Prepaid expenses and other	284	188
	\$366	\$ 275

Useful Life July 30, October 30,
2017 2016

(In years) (In millions)

Property, Plant and Equipment, Net

Land and improvements		\$159	\$ 159
Buildings and improvements	3-30	1,284	1,261
Demonstration and manufacturing equipment	3-5	1,112	992
Furniture, fixtures and other equipment	3-15	581	547
Construction in progress		111	84
Gross property, plant and equipment		3,247	3,043
Accumulated depreciation		(2,251)	(2,106)
		\$996	\$ 937

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

July 30, October 30,
2017 2016

(In millions)

Accounts Payable, Notes Payable and Accrued Expenses

Accounts payable	\$935	\$ 813
Notes payable, short-term	—	200
Compensation and employee benefits	594	517
Warranty	192	153
Dividends payable	107	108
Income taxes payable	12	101
Other accrued taxes	41	50
Interest payable	59	31
Other	315	283
	\$2,255	\$ 2,256

July 30, October 30,
2017 2016

(In millions)

Customer Deposits and Deferred Revenue

Customer deposits	\$408	\$ 471
Deferred revenue	1,708	905
	\$2,116	\$ 1,376

Applied typically receives deposits on future deliverables from customers in the Display and Adjacent Markets segment and, in certain instances, may also receive deposits from customers in the Applied Global Services segment.

July 30, October 30,
2017 2016

(In millions)

Other Liabilities

Deferred income taxes	\$8	\$ 1
Income taxes payable	389	337
Defined and postretirement benefit plans	193	182
Other	98	76
	\$688	\$ 596

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 8 Business Combinations

During the first nine months of fiscal 2017, Applied completed two acquisitions to complement Applied's existing product offerings and to provide opportunities for future growth within Applied's Display and Adjacent Markets segment.

Pro forma results of operations for these acquisitions have not been presented because they are not material to Applied's consolidated results of operations. The acquired businesses are included in the results for the Display and Adjacent Markets segment.

The following table represents the preliminary aggregated purchase price allocation for acquisitions completed in the nine months ended July 30, 2017:

	Estimated Fair Values (In millions)
Fair value of net assets acquired	\$ 17
Goodwill	44
Purchased technology	31
Purchase price allocated	\$ 92

Intangible assets are being amortized on a straight-line basis over an estimated weighted-average useful life of 3.5 years. Total transaction costs related to these acquisitions were not material and were expensed as incurred in general and administrative expenses in the Consolidated Condensed Statement of Operations.

Note 9 Goodwill, Purchased Technology and Other Intangible Assets

Goodwill and Purchased Intangible Assets

Applied's methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the purchase price over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. Applied assigns assets acquired (including goodwill) and liabilities assumed to one or more reporting units as of the date of acquisition. Typically, acquisitions relate to a single reporting unit and thus do not require the allocation of goodwill to multiple reporting units. If the products obtained in an acquisition are assigned to multiple reporting units, the goodwill is distributed to the respective reporting units as part of the purchase price allocation process.

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The process of evaluating the potential impairment of goodwill and intangible assets requires significant judgment, especially in emerging markets. Applied regularly monitors current business conditions and considers other factors including, but not limited to, adverse industry or economic trends, restructuring actions and lower projections of profitability that may impact future operating results. To test goodwill for impairment, Applied first performs a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, Applied then performs the two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. Under the two-step goodwill impairment test, Applied would in the first step compare the estimated fair value of each reporting unit to its carrying value. Applied determines the fair value of each of its reporting units based on a weighting of income and market approaches. If the carrying value of a reporting unit exceeds its fair value,

Applied would then perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If Applied determines that the carrying value of a reporting unit's goodwill exceeds its implied fair value, Applied would record an impairment charge equal to the difference.

As of July 30, 2017, Applied's reporting units include Transistor and Interconnect Group, Patterning and Packaging Group, and Imaging and Process Control Group, which combine to form the Semiconductor Systems reporting segment, Applied Global Services, and Display and Adjacent Markets.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

The evaluation of goodwill and intangible assets for impairment requires the exercise of significant judgment. In the event of future changes in business conditions, Applied will be required to reassess and update its forecasts and estimates used in future impairment analyses. If the results of these future analyses are lower than current estimates, a material impairment charge may result at that time.

Details of goodwill and other indefinite-lived intangible assets as of July 30, 2017 and October 30, 2016 were as follows:

	July 30, 2017			October 30, 2016		
	Other			Other		
	Goodwill	Intangible Assets	Total	Goodwill	Intangible Assets	Total
	(In millions)					
Semiconductor Systems	\$2,151	\$ —	\$2,151	\$2,151	\$ —	\$2,151
Applied Global Services	1,007	—	1,007	1,010	5	1,015
Display and Adjacent Markets	199	18	217	155	20	175
Carrying amount	\$3,357	\$ 18	\$3,375	\$3,316	\$ 25	\$3,341

From time to time, Applied makes acquisitions of companies related to existing or new markets for Applied. During the first nine months of fiscal 2017, goodwill increased by \$41 million primarily due to acquisitions completed in the first nine months of fiscal 2017. See Note 8, Business Combinations, for further details.

Other intangible assets that are not subject to amortization consist primarily of in-process technology, which will be subject to amortization upon commercialization. The fair value assigned to in-process technology was determined using the income approach taking into account estimates and judgments regarding risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. If an in-process technology project is abandoned, the acquired technology attributable to the project will be written-off.

A summary of Applied's purchased technology and intangible assets is set forth below:

	July 30, 2017	October 30, 2016
	(In millions)	
Purchased technology, net	\$315	\$ 409
Intangible assets - finite-lived, net	128	141
Intangible assets - indefinite-lived	18	25
Total	\$461	\$ 575

Finite-Lived Purchased Intangible Assets

Applied amortizes purchased intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from 1 to 15 years.

Applied evaluates long-lived assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset group may not be recoverable. Applied assesses the fair value of the assets based on the amount of the undiscounted future cash flow that the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset, plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When Applied identifies an impairment, Applied reduces the carrying value of the group of assets to comparable market values, when available and appropriate, or to its estimated fair value based on a discounted cash flow approach.

Intangible assets, such as purchased technology, are generally recorded in connection with a business acquisition. The value assigned to intangible assets is usually based on estimates and judgments regarding expectations for the success and life cycle of products and technology acquired. Applied evaluates the useful lives of its intangible assets each reporting period to determine whether events and circumstances require revising the remaining period of amortization. In addition, Applied reviews intangible assets for impairment when events or changes in circumstances indicate their carrying value may not be recoverable. Management considers such indicators as significant differences in actual product acceptance from the estimates, changes in the competitive and economic environments, technological advances, and changes in cost structure.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Details of finite-lived intangible assets were as follows:

	July 30, 2017			October 30, 2016		
	Purchased Technology	Other Intangible Assets	Total	Purchased Technology	Other Intangible Assets	Total
(In millions)						
Gross carrying amount:						
Semiconductor Systems	\$1,449	\$ 252	\$1,701	\$1,449	\$ 252	\$1,701
Applied Global Services	33	44	77	28	44	72
Display and Adjacent Markets	146	38	184	115	36	151
Corporate and Other	—	9	9	1	9	10
Gross carrying amount	\$1,628	\$ 343	\$1,971	\$1,593	\$ 341	\$1,934
Accumulated amortization:						
Semiconductor Systems	\$(1,169)	\$(127)	\$(1,296)	\$(1,043)	\$(113)	\$(1,156)
Applied Global Services	(28)	(44)	(72)	(27)	(44)	(71)
Display and Adjacent Markets	(116)	(35)	(151)	(113)	(34)	(147)
Corporate and Other	—	(9)	(9)	(1)	(9)	(10)
Accumulated amortization	\$(1,313)	\$(215)	\$(1,528)	\$(1,184)	\$(200)	\$(1,384)
Carrying amount	\$315	\$ 128	\$443	\$409	\$ 141	\$550

Details of amortization expense by segment were as follows:

	Three Months Ended		Nine Months Ended	
	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016

	(In millions)			
Semiconductor Systems	\$46	\$ 47	\$138	\$ 139
Applied Global Services	—	—	1	1
Display and Adjacent Markets	3	—	4	—
Corporate & Other	—	—	—	2
Total	\$49	\$ 47	\$143	\$ 142

Amortization expense was charged to the following categories:

	Three Months Ended		Nine Months Ended	
	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016

	(In millions)			
Cost of products sold	\$44	\$ 42	\$128	\$ 126
Research, development and engineering	—	—	1	1
Marketing and selling	5	5	14	15

Total	\$49	\$ 47	\$143	\$ 142
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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

As of July 30, 2017, future estimated amortization expense is expected to be as follows:

	Amortization Expense (In millions)
2017 (remaining 3 months)	\$ 49
2018	194
2019	53
2020	48
2021	36
Thereafter	63
Total	\$ 443

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 10 Borrowing Facilities and Debt

Applied has credit facilities for unsecured borrowings in various currencies of up to \$1.6 billion, of which \$1.5 billion is comprised of a committed revolving credit agreement with a group of banks that is scheduled to expire in September 2020. This agreement provides for borrowings in United States dollars at interest rates keyed to one of various benchmark rates selected by Applied for each advance, plus a margin based on Applied's public debt rating and includes financial and other covenants. Remaining credit facilities in the amount of approximately \$72 million are with Japanese banks. Applied's ability to borrow under these facilities is subject to bank approval at the time of the borrowing request, and any advances will be at rates indexed to the banks' prime reference rate denominated in Japanese yen. No amounts were outstanding under any of these facilities at both July 30, 2017 and October 30, 2016, and Applied has not utilized these credit facilities.

In March 2017, Applied issued senior unsecured notes in the aggregate principal amount of \$2.2 billion and used a portion of the net proceeds to redeem the outstanding \$200 million in principal amount of its 7.125% senior notes due in October 2017 at a redemption price of \$205 million in May 2017. After adjusting for the carrying value of debt issuance costs and discounts, Applied recorded a \$5 million loss on the prepayment of the \$200 million debt, which is included in interest and other income, net in the Consolidated Condensed Statement of Operations for the third quarter of fiscal 2017.

Debt outstanding as of July 30, 2017 and October 30, 2016 was as follows:

	Principal Amount		Effective Interest Rate	Interest Pay Dates
	July 30, 2017	October 30, 2016		
	(In millions)			
Short-term debt:				
7.125% Senior Notes Due 2017	\$ —	\$ 200	7.190%	April 15, October 15
Total short-term debt	—	200		
Long-term debt:				
2.625% Senior Notes Due 2020	600	600	2.640%	April 1, October 1
4.300% Senior Notes Due 2021	750	750	4.326%	June 15, December 15
3.900% Senior Notes Due 2025	700	700	3.944%	April 1, October 1
3.300% Senior Notes Due 2027	1,200	—	3.342%	April 1, October 1
5.100% Senior Notes Due 2035	500	500	5.127%	April 1, October 1
5.850% Senior Notes Due 2041	600	600	5.879%	June 15, December 15
4.350% Senior Notes Due 2047	1,000	—	4.361%	April 1, October 1
	5,350	3,150		

Total unamortized discount	(13)	(7)
Total unamortized debt issuance costs ¹	(34)	(18)
Total long-term debt	5,303		3,125	
Total debt	\$ 5,303		\$ 3,325	

¹ Balances reflect the effects of the retrospective adoption of the authoritative guidance in the first quarter of fiscal 2017, which required debt issuance costs to be presented as a direct reduction from the carrying amount of the related debt liability. These amounts were originally recorded under Other Assets.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 11 Stockholders' Equity, Comprehensive Income and Share-Based Compensation

Accumulated Other Comprehensive Income (Loss)

Changes in the components of AOCI, net of tax, were as follows:

	Unrealized Gain (Loss)	Unrealized Gain	Derivative Instruments	Defined and Postretirement Benefit Plans	Cumulative Translation Adjustments	Total
	on Investments Net	Qualifying as Cash Flow Hedges				
	(in millions)					
Balance at October 30, 2016	\$30	\$ (18)		\$ (141)	\$ 14	\$(115)
Other comprehensive income (loss) before reclassifications	23	6		—	—	29
Amounts reclassified out of AOCI	2	(5)		(12)	—	(15)
Other comprehensive income (loss), net of tax	25	1		(12)	—	14
Balance at July 30, 2017	\$55	\$ (17)		\$ (153)	\$ 14	\$(101)

	Unrealized Gain (Loss)	Unrealized Gain	Derivative Instruments	Defined and Postretirement Benefit Plans	Cumulative Translation Adjustments	Total
	on Investments Net	Qualifying as Cash Flow Hedges				
	(in millions)					
Balance at October 25, 2015	\$14	\$ (15)		\$ (105)	\$ 14	\$(92)
Other comprehensive income (loss) before reclassifications	21	(31)		—	—	(10)
Amounts reclassified out of AOCI	—	15		—	—	15
Other comprehensive income (loss), net of tax	21	(16)		—	—	5
Balance at July 31, 2016	\$35	\$ (31)		\$ (105)	\$ 14	\$(87)

The tax effects on net income of amounts reclassified from AOCI for the three and nine months ended July 30, 2017 and July 31, 2016 were not material.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Stock Repurchase Program

On June 9, 2016, Applied's Board of Directors approved a common stock repurchase program authorizing up to \$2.0 billion in repurchases. At July 30, 2017, \$995 million remained available for future stock repurchases under this repurchase program.

The following table summarizes Applied's stock repurchases for the three and nine months ended July 30, 2017 and July 31, 2016:

	Three Months Ended July 30, July 31, 2017 2016		Nine Months Ended July 30, July 31, 2017 2016	
	(in millions, except per share amount)			
Shares of common stock repurchased	9	9	20	90
Cost of stock repurchased	\$375	\$196	\$787	\$1,721
Average price paid per share	\$44.34	\$21.88	\$39.48	\$19.22

Applied records treasury stock purchases under the cost method using the first-in, first-out (FIFO) method. Upon reissuance of treasury stock, amounts in excess of the acquisition cost are credited to additional paid in capital. If Applied reissues treasury stock at an amount below its acquisition cost and additional paid in capital associated with prior treasury stock transactions is insufficient to cover the difference between the acquisition cost and the reissue price, this difference is recorded against retained earnings.

Dividends

In June 2017, March 2017 and December 2016, Applied's Board of Directors declared quarterly cash dividends in the amount of \$0.10 per share. Dividends paid during the nine months ended July 30, 2017 and July 31, 2016 totaled \$323 million and \$336 million, respectively. Applied currently anticipates that cash dividends will continue to be paid on a quarterly basis, although the declaration of any future cash dividend is at the discretion of the Board of Directors and will depend on Applied's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination by the Board of Directors that cash dividends are in the best interests of Applied's stockholders.

Share-Based Compensation

Applied has a stockholder-approved equity plan, the Employee Stock Incentive Plan, which permits grants to employees of share-based awards, including stock options, restricted stock, restricted stock units, performance shares and performance units. In addition, the plan provides for the automatic grant of restricted stock units to non-employee directors and permits the grant of share-based awards to non-employee directors and consultants. Share-based awards made under the plan may be subject to accelerated vesting under certain circumstances in the event of a change in control of Applied. Applied also has two Employee Stock Purchase Plans, one generally for United States employees and a second for employees of international subsidiaries (collectively, ESPP), which enable eligible employees to purchase Applied common stock.

During the three and nine months ended July 30, 2017 and July 31, 2016, Applied recognized share-based compensation expense related to stock options, ESPP shares, restricted stock, restricted stock units, performance shares and performance units. The effect of share-based compensation on the results of operations was as follows:

Three Months Ended	Nine Months Ended
--------------------------	----------------------

July 31, July 31, July 31,
2017 2016 2017 2016

	(In millions)			
Cost of products sold	\$18	\$ 14	\$51	\$ 46
Research, development, and engineering	20	18	61	56
Marketing and selling	7	7	21	20
General and administrative	10	9	29	28
Total share-based compensation	\$55	\$ 48	\$162	\$ 150

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

The cost associated with share-based awards that are subject solely to time-based vesting requirements, less expected forfeitures, is recognized over the awards' service period for the entire award on a straight-line basis. The cost associated with performance-based equity awards is recognized for each tranche over the service period, based on an assessment of the likelihood that the applicable performance goals will be achieved.

At July 30, 2017, Applied had \$348 million in total unrecognized compensation expense, net of estimated forfeitures, related to grants of share-based awards and shares issued under Applied's ESPP, which will be recognized over a weighted average period of 2.6 years. At July 30, 2017, there were 91 million shares available for grants of share-based awards under the Employee Stock Incentive Plan, and an additional 22 million shares available for issuance under the ESPP.

Restricted Stock Units, Restricted Stock, Performance Shares and Performance Units

A summary of the changes in restricted stock units, restricted stock, performance shares and performance units outstanding under Applied's equity compensation plans during the nine months ended July 30, 2017 is presented below:

	Weighted Average Shares Grant Date Fair Value
(In millions, except per share amounts)	
Outstanding at October 30, 2016	25 \$ 18.28
Granted	8 \$ 31.28
Vested	(10) \$ 16.39
Canceled	(1) \$ 20.63
Outstanding at July 30, 2017	22 \$ 23.59

At July 30, 2017, 1 million additional performance-based awards could be earned upon achievement of certain levels of Applied's total shareholder return relative to a peer group at a future date and upon achievement of specified performance goals.

During the first quarter of fiscal 2017, certain executive officers were granted awards that are subject to the achievement of specified performance goals. These awards become eligible to vest only if performance goals are achieved and will vest only if the grantee remains employed by Applied through each applicable vesting date. Certain awards require the achievement of positive operating profit and vest ratably over three years. Other awards require the achievement of targeted levels of operating margin and wafer fabrication equipment market share, and the number of shares that may vest in full after three years ranges from 0% to 200% of the target amount.

The fair value of these awards is estimated on the date of grant. If the goals are achieved, the awards will vest, provided that the grantee remains employed by Applied through each scheduled vesting date. If the performance goals are not met as of the end of the performance period, no compensation expense is recognized and any previously recognized compensation expense is reversed. The expected cost is based on the awards that are probable to vest and is reflected over the service period and reduced for estimated forfeitures.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Employee Stock Purchase Plans

Under the ESPP, substantially all employees may purchase Applied common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value of Applied common stock at the beginning or end of each 6-month purchase period, subject to certain limits. Applied issued 2 million shares during the nine months ended July 30, 2017 and 3 million shares during the nine months ended July 31, 2016. Compensation expense is calculated using the fair value of the employees' purchase rights under the Black-Scholes model. Underlying assumptions used in the model are outlined in the following table:

	Nine Months Ended	
	July 30, 2017	July 31, 2016
ESPP:		
Dividend yield	1.09%	2.07%
Expected volatility	24.9%	29.8%
Risk-free interest rate	0.78%	0.49%
Expected life (in years)	0.5	0.5
Weighted average estimated fair value	\$8.08	\$4.47

Changes in the warranty reserves are presented below:

	Three Months Ended July 30, 2017		Nine Months Ended July 30, 2017	
	2016	2016	2017	2016
	(In millions)			
Beginning balance	\$182	\$121	\$153	\$126
Warranties issued	41	35	123	91
Change in reserves related to preexisting warranty	1	7	3	(9)
Consumption of reserves	(32)	(24)	(87)	(69)
Ending balance	\$192	\$139	\$192	\$139

Applied products are generally sold with a warranty for a 12-month period following installation. The provision for the estimated cost of warranty is recorded when revenue is recognized. Parts and labor are covered under the terms of the warranty agreement. The warranty provision is based on historical experience by product, configuration and geographic region. Quarterly warranty consumption is generally associated with sales that occurred during the preceding four quarters, and quarterly warranty provisions are generally related to the current quarter's sales.

In the ordinary course of business, Applied provides standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated by either Applied or its subsidiaries. As of July 30, 2017, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately \$67 million. Applied has not recorded any liability in connection with these guarantee agreements beyond that required to appropriately account for the underlying transaction being guaranteed. Applied does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these guarantee agreements.

Applied also has agreements with various banks to facilitate subsidiary banking operations worldwide, including overdraft arrangements, issuance of bank guarantees, and letters of credit. As of July 30, 2017, Applied has provided parent guarantees to banks for approximately \$140 million to cover these arrangements.

In 2010, the Seoul Eastern District Court began hearings on indictments brought by the Seoul Prosecutor's Office for the Eastern District of Korea (the Prosecutor's Office) alleging that employees of several companies improperly received and used confidential information belonging to Samsung Electronics Co., Ltd. (Samsung), a major Applied customer based in Korea. The individuals charged included the former head of Applied Materials Korea (AMK), who at the time of the indictment was a vice president of Applied Materials, Inc., and certain other AMK employees. Neither Applied nor any of its subsidiaries was named as a party to the proceedings. Hearings on these matters concluded in November 2012 and the Court issued its decision on February 7, 2013. As part of the ruling, nine AMK employees (including the former head of AMK) were acquitted of all charges, while one AMK employee was found guilty on some of the charges and received a suspended jail sentence. The Prosecutor's Office and various individuals appealed the matter to the High Court. On June 20, 2014, the High Court rendered its decision, finding all defendants

not guilty, including all ten AMK employees. The prosecutor has appealed the High Court decision to the Korean Supreme Court.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Other Matters

From time to time, Applied receives notification from third parties, including customers and suppliers, seeking indemnification, litigation support, payment of money or other actions by Applied in connection with claims made against them. In addition, from time to time, Applied receives notification from third parties claiming that Applied may be or is infringing or misusing their intellectual property or other rights. Applied also is subject to various other legal proceedings and claims, both asserted and unasserted, that arise in the ordinary course of business.

Although the outcome of the above-described matters, claims and proceedings cannot be predicted with certainty, Applied does not believe that any will have a material effect on its consolidated financial condition or results of operations.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 15 Industry Segment Operations

Applied's three reportable segments are: Semiconductor Systems, Applied Global Services, and Display and Adjacent Markets. As defined under the accounting literature, Applied's chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Applied's management organization structure as of July 30, 2017 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to Applied's reportable segments.

The Semiconductor Systems reportable segment includes semiconductor capital equipment for etch, rapid thermal processing, deposition, chemical mechanical planarization, metrology and inspection, wafer packaging, and ion implantation.

The Applied Global Services segment provides integrated solutions to optimize equipment and fab performance and productivity, including spares, upgrades, services, certain remanufactured earlier generation equipment and factory automation software for semiconductor, display and other products.

The Display and Adjacent Markets segment includes products for manufacturing liquid crystal displays (LCDs), organic light-emitting diodes (OLEDs), upgrades and flexible coating systems and other display technologies for TVs, personal computers, smart phones, and other consumer-oriented devices.

Each operating segment is separately managed and has separate financial results that are reviewed by Applied's chief operating decision-maker. Each reportable segment contains closely related products that are unique to the particular segment. Segment operating income is determined based upon internal performance measures used by Applied's chief operating decision-maker. The chief operating decision-maker does not evaluate operating segments using total asset information.

Applied derives the segment results directly from its internal management reporting system. The accounting policies Applied uses to derive reportable segment results are substantially the same as those used for external reporting purposes. Management measures the performance of each reportable segment based upon several metrics including net sales and operating income. Management uses these results to evaluate the performance of, and to assign resources to, each of the reportable segments.

The Corporate and Other category includes revenues from products, as well as costs of products sold, for fabricating solar photovoltaic cells and modules, and certain operating expenses that are not allocated to its reportable segments and are managed separately at the corporate level. These operating expenses include costs related to share-based compensation; certain management, finance, legal, human resources, and research, development and engineering functions provided at the corporate level; and unabsorbed information technology and occupancy. In addition, Applied does not allocate to its reportable segments restructuring and asset impairment charges and any associated adjustments related to restructuring actions, unless these actions pertain to a specific reportable segment. Segment operating income also excludes interest income/expense and other financial charges and income taxes. Management does not consider the unallocated costs in measuring the performance of the reportable segments.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Net sales and operating income (loss) for each reportable segment were as follows:

	Three Months Ended		Nine Months Ended	
	Net Sales	Operating Income (Loss)	Net Sales	Operating Income (Loss)
(In millions)				
July 30, 2017:				
Semiconductor Systems	\$2,532	\$ 874	\$7,086	\$ 2,372
Applied Global Services	786	213	2,186	585
Display and Adjacent Markets	410	91	1,223	290
Corporate and Other	16	(155)	73	(477)
Total	\$3,744	\$ 1,023	\$10,568	\$ 2,770
July 31, 2016:				
Semiconductor Systems	\$1,786	\$ 511	\$4,746	\$ 1,140
Applied Global Services	657	175	1,896	489
Display and Adjacent Markets	313	63	754	142
Corporate and Other	65	(153)	132	(396)
Total	\$2,821	\$ 596	\$7,528	\$ 1,375

The reconciling items included in Corporate and Other were as follows:

	Three Months Ended		Nine Months Ended	
	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016
(In millions)				
Unallocated net sales	\$16	\$ 65	\$73	\$ 132
Unallocated cost of products sold and expenses	(116)	(170)	(388)	(378)
Share-based compensation	(55)	(48)	(162)	(150)
Total	\$(155)	\$(153)	\$(477)	\$(396)

The following customers accounted for at least 10 percent of Applied's net sales for the nine months ended July 30, 2017, and sales to these customers included products and services from multiple reportable segments.

	Percentage of Net Sales	
Samsung Electronics Co., Ltd.	22	%
Taiwan Semiconductor Manufacturing Company Limited	17	%

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following management’s discussion and analysis is provided in addition to the accompanying consolidated condensed financial statements and notes to assist in understanding Applied’s results of operations and financial condition. Financial information as of July 30, 2017 should be read in conjunction with the financial statements for the fiscal year ended October 30, 2016 contained in the Company’s Form 10-K filed December 15, 2016.

This report contains forward-looking statements that involve a number of risks and uncertainties. Examples of forward-looking statements include those regarding Applied’s future financial or operating results, cash flows and cash deployment strategies, declaration of dividends, share repurchases, business strategies and priorities, costs and cost controls, products, competitive positions, management’s plans and objectives for future operations, research and development, strategic acquisitions and investments, growth opportunities, restructuring activities, backlog, working capital, liquidity, investment portfolio and policies, taxes, supply chain, manufacturing, properties, legal proceedings and claims, customer demand and spending, end-use demand, market and industry trends and outlooks, general economic conditions and other statements that are not historical facts, as well as their underlying assumptions. Forward-looking statements may contain words such as “may,” “will,” “should,” “could,” “would,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “potential” and “continue,” the negative of these terms, or other comparable terminology. All forward-looking statements are subject to risks and uncertainties and other important factors, including those discussed in Part II, Item 1A, “Risk Factors,” below and elsewhere in this report. These and many other factors could affect Applied’s future financial condition and operating results and could cause actual results to differ materially from expectations based on forward-looking statements made in this document or elsewhere by Applied or on its behalf. Forward-looking statements are based on management’s estimates, projections and expectations as of the date hereof, and Applied undertakes no obligation to revise or update any such statements.

Overview

Applied provides manufacturing equipment, services and software to the global semiconductor, display, and related industries. Applied’s customers include manufacturers of semiconductor wafers and chips, liquid crystal and other displays, and other electronic devices. These customers may use what they manufacture in their own end products or sell the items to other companies for use in advanced electronic components. Applied operates in three reportable segments: Semiconductor Systems, Applied Global Services, and Display and Adjacent Markets. A summary of financial information for each reportable segment is found in Note 15 of Notes to Consolidated Condensed Financial Statements. A discussion of factors that could affect Applied’s operations is set forth under “Risk Factors” in Part II, Item 1A, which is incorporated herein by reference. Product development and manufacturing activities occur primarily in the United States, Europe, Israel, and Asia. Applied’s broad range of equipment and service products are highly technical and are sold primarily through a direct sales force.

Applied’s results are driven primarily by worldwide demand for semiconductors and displays, which in turn depends on end-user demand for electronic products. Each of Applied’s businesses is subject to variable industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for chips, display technologies and other electronic devices, as well as other factors, such as global economic and market conditions, and the nature and timing of technological advances in fabrication processes. In addition, a significant driver in the semiconductor and display industries is end-demand for mobile consumer products, which is characterized by seasonality that impacts the timing of customer investments in manufacturing equipment and, in turn, Applied’s business. In light of these conditions, Applied’s results can vary significantly year-over-year, as well as quarter-over-quarter.

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The following tables present certain significant measurements for the periods indicated:

	Three Months Ended			Nine Months Ended		
	July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change
(In millions, except per share amounts and percentages)						
Net sales	\$3,744	\$2,821	\$ 923	\$10,568	\$7,528	\$3,040
Gross margin	45.4 %	42.3 %	3.1 points	44.9 %	41.3 %	3.6 points
Operating income	\$1,023	\$596	\$ 427	\$2,770	\$1,375	\$1,395
Operating margin	27.3 %	21.1 %	6.2 points	26.2 %	18.3 %	7.9 points
Net income	\$925	\$505	\$ 420	\$2,452	\$1,111	\$1,341
Earnings per diluted share	\$0.85	\$0.46	\$ 0.39	\$2.26	\$0.99	\$1.27

Fiscal 2017 and 2016 contains 52 weeks and 53 weeks, respectively, and the first nine months of fiscal 2017 and 2016 contained 39 weeks and 40 weeks, respectively.

Mobility, and the increasing technological functionality of mobile devices, continues to be a strong driver of semiconductor industry spending. During the first nine months of fiscal 2017, memory manufacturers invested in technology upgrades and new capacity, both of which were driven by the transition from planar NAND to 3D NAND, and an overall increase in demand for memory for high performance storage in data-centers and increasing smartphone content. Foundry customers also invested in technology upgrades and new capacity to meet demand for advanced mobile chips. Applied anticipates healthy spending levels in all semiconductor categories to continue, as memory manufacturers scale 3D NAND, and foundry customers invest in leading edge and trailing geometries. Display equipment spending reflects continued investment in new technology and manufacturing capacity expansion for mobile applications, such as OLED displays, as well as demand for new equipment for making larger LCD TVs.

Results of Operations

Net Sales

Net sales for the periods indicated were as follows:

	Three Months Ended			Nine Months Ended		
	July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change
(In millions, except percentages)						
Semiconductor Systems	\$2,532	\$1,786	\$ 746	\$7,086	\$4,746	\$2,340
Applied Global Services	786	657	129	2,186	1,896	290
Display and Adjacent Markets	410	313	97	1,223	754	469
Corporate and Other	16	65	(49)	73	132	(59)
Total	\$3,744	\$2,821	\$ 923	\$10,568	\$7,528	\$3,040

For the third quarter and first nine months of fiscal 2017 compared to the same periods in the prior year, net sales increased primarily due to increased customer investments in all segments, with majority of the increases resulting from investments in semiconductor equipment. The Semiconductor Systems segment's relative share of total net sales increased in the third quarter and first nine months of fiscal 2017 compared to the same periods in the prior year, and continued to represent the largest contributor of net sales.

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Net sales by geographic region, determined by the location of customers' facilities to which products were shipped, were as follows:

	Three Months Ended						Nine Months Ended							
	July 30, 2017		July 31, 2016		Change		July 30, 2017		July 31, 2016		Change			
	(In millions, except percentages)													
Taiwan	\$607	16	%	\$741	26	%	(18)%	\$2,573	24	%	\$1,689	22	%	52%
China	774	21	%	571	20	%	36%	2,149	20	%	1,818	24	%	18%
Korea	1,265	34	%	472	17	%	168%	2,877	27	%	1,251	17	%	130%
Japan	444	12	%	321	11	%	38%	1,011	10	%	915	12	%	10%
Southeast Asia	104	2	%	303	11	%	(66)%	310	3	%	642	9	%	(52)%
Asia Pacific	3,194	85	%	2,408	85	%	33%	8,920	84	%	6,315	84	%	41%
United States	359	10	%	289	10	%	24%	1,059	10	%	854	11	%	24%
Europe	191	5	%	124	5	%	54%	589	6	%	359	5	%	64%
Total	\$3,744	100	%	\$2,821	100	%	33%	\$10,568	100	%	\$7,528	100	%	40%

The changes in net sales from customers in all regions in the third quarter and first nine months of fiscal 2017 compared to fiscal 2016 primarily reflected changes in semiconductor equipment customer mix. In addition, the increase in net sales from customers in China also reflected increased investments from display manufacturing equipment customers.

Gross Margin

Gross margins for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change

Gross margin 45.4% 42.3 % 3.1 points 44.9% 41.3 % 3.6 points

Gross margin in the third quarter and first nine months of fiscal 2017 increased compared to the same periods in the prior year, primarily due to increase in net sales and favorable product mix.

Gross margin during the three months ended July 30, 2017 and July 31, 2016 included \$18 million and \$14 million of share-based compensation expense, respectively. Gross margin during the nine months ended July 30, 2017 and July 31, 2016 included \$51 million and \$46 million of share-based compensation expense, respectively.

Research, Development and Engineering

Research, Development and Engineering (RD&E) expenses for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change

(In millions)

Research, development and engineering \$454 \$ 386 \$ 68 \$1,308 \$1,146 \$ 162

Applied's future operating results depend to a considerable extent on its ability to maintain a competitive advantage in the equipment and service products it provides. Development cycles range from 12 to 36 months depending on whether the product is an enhancement of an existing product, which typically has a shorter development cycle, or a new product, which typically has a longer development cycle. Most of Applied's existing products resulted from internal development activities and innovations involving new technologies, materials and processes. In certain

instances, Applied acquires technologies, either in existing or new product areas, to complement its existing technology capabilities and to reduce time to market.

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Management believes that it is critical to continue to make substantial investments in RD&E to assure the availability of innovative technology that meets the current and projected requirements of its customers' most advanced designs. Applied has maintained and intends to continue its commitment to investing in RD&E in order to continue to offer new products and technologies.

RD&E expenses increased during the third quarter and first nine months of fiscal 2017 compared to the same periods in the prior year, primarily due to additional headcount and increased R&D program spending in Semiconductor Systems and Display and Adjacent Market segments. This increase reflects Applied's ongoing investment in product development initiatives, consistent with the Company's strategy. RD&E expenses during the three months ended July 30, 2017 and July 31, 2016 included \$20 million and \$18 million of share-based compensation expense, respectively. RD&E expenses during the nine months ended July 30, 2017 and July 31, 2016 included \$61 million and \$56 million of share-based compensation expense, respectively.

Marketing and Selling

Marketing and selling expenses for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30,	July 31,	Change	July 30,	July 31,	Change
2017	2016		2017	2016	

(In millions)

Marketing and selling \$117 \$ 107 \$ 10 \$351 \$ 315 \$ 36

Marketing and selling expenses increased in the third quarter and first nine months of fiscal 2017 compared to the same periods in fiscal 2016, primarily due to additional headcount. Marketing and selling expenses during the three months ended July 30, 2017 and July 31, 2016 each included \$7 million of share-based compensation expense.

Marketing and selling expenses during the nine months ended July 30, 2017 and July 31, 2016 included \$21 million and \$20 million of share-based compensation expense, respectively.

General and Administrative

General and administrative (G&A) expenses for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30,	July 31,	Change	July 30,	July 31,	Change
2017	2016		2017	2016	

(In millions)

General and administrative \$106 \$ 103 \$ 3 \$316 \$ 276 \$ 40

G&A expenses in the third quarter of fiscal 2017 increased slightly compared to the same period in the prior year.

G&A expenses increased in the first nine months of fiscal 2017 compared to the same period in the prior year primarily due to higher variable compensation and additional headcount.

G&A expenses during the three months ended July 30, 2017 and July 31, 2016 included \$10 million and \$9 million of share-based compensation expense, respectively. G&A expenses during the nine months ended July 30, 2017 and July 31, 2016 included \$29 million and \$28 million of share-based compensation expense, respectively.

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Interest Expense and Interest and Other Income (loss), net

Interest expense and interest and other income (loss), net for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30, July 31, Change			July 30, July 31, Change		
2017 2016			2017 2016		

(In millions)

Interest expense	\$59	\$ 38	\$ 21	\$141	\$ 117	\$ 24
Interest and other income, net	\$14	\$ 6	\$ 8	\$28	\$ 15	\$ 13

Interest expenses incurred were primarily associated with the senior unsecured notes issued in June 2011, September 2015, and March 2017. Interest expense in the third quarter and first nine months of fiscal 2017 increased compared to the same periods in fiscal 2016, primarily due to the issuance of senior unsecured notes in March 2017.

Interest and other income, net in the third quarter and first nine months of fiscal 2017 increased compared to the same periods in fiscal 2016 primarily driven by higher interest income from investments. The increase in the third quarter of fiscal 2017 compared to the same period in the prior year was partially offset by the \$5 million loss from redemption of \$200 million in principal amount of senior unsecured notes recorded in the third quarter of fiscal 2017, while the increase in first nine months of fiscal 2017 compared to the same period in the prior year was partially offset by higher impairment of strategic investments.

Income Taxes

Provision for income taxes and effective tax rates for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30, July 31, Change			July 30, July 31, Change		
2017 2016			2017 2016		

(In millions, except percentages)

Provision for income taxes	\$53	\$ 59	\$ (6)	\$205	\$ 162	\$ 43
Effective tax rate	5.4 %	10.5 %	(5.1) points	7.7 %	12.7 %	(5.0) points

Applied's provision for income taxes and effective tax rate are affected by the geographical composition of pre-tax income which includes jurisdictions with differing tax rates, conditional reduced tax rates and other income tax incentives. It is also affected by events that are not consistent from period to period, such as changes in income tax laws and the resolution of prior years' income tax filings.

The effective tax rate for the third quarter of fiscal 2017 was lower than the same period in the prior year primarily due to the recognition of previously unrecognized foreign tax credits and changes in the geographical composition of income.

The effective tax rate for the first nine months of fiscal 2017 was lower than in the same period in the prior year primarily due to the recognition of previously unrecognized foreign tax credits, favorable resolutions to income tax liabilities for uncertain tax positions during the first nine months of fiscal 2017, unfavorable resolutions to income tax liabilities for uncertain tax positions during the first nine months of fiscal 2016, and changes in the geographical composition of income. These were partially offset by the reinstatement of the U.S. R&D tax credit during the first nine months of fiscal 2016 which was retroactive to its expiration in December of the prior year.

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Segment Information

Applied reports financial results in three segments: Semiconductor Systems, Applied Global Services, and Display and Adjacent Markets. A description of the products and services, as well as financial data, for each reportable segment can be found in Note 15 of Notes to Consolidated Condensed Financial Statements.

The Corporate and Other category includes revenues from products, as well as costs of products sold, for fabricating solar photovoltaic cells and modules and certain operating expenses that are not allocated to its reportable segments and are managed separately at the corporate level. These operating expenses include costs for share-based compensation; certain management, finance, legal, human resource, and RD&E functions provided at the corporate level; and unabsorbed information technology and occupancy. In addition, Applied does not allocate to its reportable segments restructuring and asset impairment charges and any associated adjustments related to restructuring actions, unless these actions pertain to a specific reportable segment.

The results for each reportable segment are discussed below.

Semiconductor Systems Segment

The Semiconductor Systems segment includes semiconductor capital equipment for deposition, etch, ion implantation, rapid thermal processing, chemical mechanical planarization, metrology and inspection, and wafer level packaging. Development efforts are focused on solving customers' key technical challenges in transistor, interconnect, patterning and packaging performance as devices scale to advanced technology nodes. The mobility trend remains the largest influence on industry spending, as it drives semiconductor device manufacturers to continually improve their ability to deliver high-performance, low-power processors and affordable memories.

The market for Semiconductor Systems has been characterized by continued investment by semiconductor manufacturers. During the first nine months of fiscal 2017, memory manufacturers invested in technology upgrades and new capacity, both of which were driven by the transition from planar NAND to 3D NAND and overall increase in demand for memory. Foundry customers also invested in technology upgrades and new capacity to meet demand for advanced mobile chips.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended			Nine Months Ended			
	July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change	
(In millions, except percentages and ratios)							
Net sales	\$2,532	\$1,786	\$746 42%	7,086	4,746	\$2,340 49%	
Operating income	\$874	\$511	\$363 71%	2,372	1,140	\$1,232 108%	
Operating margin	34.5 %	28.6 %	5.9 points	33.5 %	24.0 %	9.5 points	

Net sales for Semiconductor Systems by end use application for the periods indicated were as follows:

	Three Months Ended		Nine Months Ended	
	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016
Foundry	39 %	37 %	43 %	34 %
Dynamic random-access memory (DRAM)	15 %	11 %	17 %	19 %
Flash memory	38 %	41 %	32 %	35 %
Logic and other	8 %	11 %	8 %	12 %
	100 %	100 %	100 %	100 %

Net sales for the third quarter and first nine months of fiscal 2017 increased compared to the same periods in the prior year primarily due to higher spending from foundry and memory customers. Operating income and operating margin for the third quarter and first nine months of fiscal 2017 increased compared to the same periods in the prior year

primarily due to favorable changes in product mix and higher net sales, partially offset by higher RD&E expenses. In the third quarter of fiscal 2017, three customers accounted for approximately 53 percent of this segment's total net sales, with one customer accounting for approximately 31 percent of this segment's total net sales.

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The following regions accounted for at least 30 percent of total net sales for the Semiconductor Systems segment for one or more of the periods indicated:

Three Months Ended			Nine Months Ended		
July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change

(In millions, except percentages)

Taiwan	\$444	18%	\$547	31%	(19)%	\$2,096	30%	\$1,218	26%	72%
Korea	\$997	39%	\$283	16%	252%	\$2,254	32%	\$840	18%	168%

Applied Global Services Segment

The Applied Global Services segment provides integrated solutions to optimize equipment and fab performance and productivity, including spares, upgrades, services, certain remanufactured earlier generation equipment and factory automation software for semiconductor, display and solar products. Customer demand for products and services is fulfilled through a global distribution system with trained service engineers located in close proximity to customer sites.

Industry conditions that affect Applied Global Services' sales of spares and services are principally semiconductor manufacturers' wafer starts, as well as utilization rates.

Certain significant measures for the periods indicated were as follows:

Three Months Ended			Nine Months Ended		
July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change

(In millions, except percentages and ratios)

Net sales	\$786	\$657	\$129	20%	\$2,186	\$1,896	\$290	15%
Operating income	\$213	\$175	\$38	22%	\$585	\$489	\$96	20%
Operating margin	27.1 %	26.6 %	0.5 points		26.8 %	25.8 %	1.0 points	

Net sales for the third quarter and first nine months of fiscal 2017 increased compared to the same periods in the prior year primarily due to higher customer spending for spares and services. Operating income and operating margin for the third quarter and first nine months of fiscal 2017 compared to the same periods in the prior year increased due to higher net sales. In the third quarter of fiscal 2017, one customer accounted for approximately 13 percent of this segment's total net sales.

There was no region that accounted for at least 30 percent of total net sales for the Applied Global Services segment for any of the periods presented.

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Display and Adjacent Markets Segment

The Display and Adjacent Markets segment encompasses products for manufacturing liquid crystal displays (LCDs), organic light-emitting diodes (OLEDs), upgrades and flexible coating systems and other display technologies for TVs, personal computers (PCs), tablets, smart phones, and other consumer-oriented devices. The segment is focused on expanding its presence through technologically-differentiated equipment for manufacturing large-scale TVs; emerging markets such as OLED, low temperature polysilicon (LTPS), metal oxide, and touch panel sectors; and development of products that provide customers with improved performance and yields. Display industry growth depends primarily on consumer demand for increasingly larger and more advanced TVs as well as larger and higher resolution displays for next generation mobile devices, including OLED.

The market environment for Applied's Display and Adjacent Markets segment has been characterized by increasing demand for manufacturing equipment for high-end mobile devices and TV manufacturing equipment, although these markets remain susceptible to cyclical conditions. Uneven order and revenue patterns in the Display and Adjacent Markets segment can cause significant fluctuations quarter-over-quarter, as well as year-over-year.

Certain significant measures for the periods presented were as follows:

	Three Months Ended			Nine Months Ended			
	July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change	
(In millions, except percentages and ratios)							
Net sales	\$410	\$313	\$97 31%	\$1,223	754	\$469 62%	
Operating income	\$91	\$63	\$28 44%	\$290	142	\$148 104%	
Operating margin	22.2 %	20.1 %	2.1 points	23.7 %	18.8 %	4.9 points	

Net sales for the third quarter of fiscal 2017 increased compared to prior year primarily due to higher customer investments in TV display manufacturing equipment, while net sales for the first nine months of fiscal 2017 increased compared to the same period in the prior year primarily due to higher customer investments in mobile and TV display manufacturing equipment. Operating income and operating margin for the third quarter and first nine months of fiscal 2017 increased compared to the same periods in the prior year, reflecting higher net sales, partially offset by increased RD&E spending. In the third quarter of fiscal 2017, three customers accounted for approximately 63 percent of this segment's total net sales, with one customer accounting for approximately 33 percent of this segment's total net sales. The following regions accounted for at least 30 percent of total net sales for the Display and Adjacent Markets segment for one or more of the periods presented:

	Three Months Ended			Nine Months Ended		
	July 30, 2017	July 31, 2016	Change	July 30, 2017	July 31, 2016	Change
(In millions, except percentages)						
China	\$19848%	\$86 27%	130%	\$70057%	\$32643%	115%
Korea	\$16841%	\$14346%	17%	\$37631%	\$26535%	42%

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Financial Condition, Liquidity and Capital Resources

Applied's cash, cash equivalents and investments consist of the following:

	July 30, October 30, 2017 2016	
	(In millions)	
Cash and cash equivalents	\$5,278	\$ 3,406
Short-term investments	1,953	343
Long-term investments	1,059	929
Total cash, cash-equivalents and investments	\$8,290	\$ 4,678

Sources and Uses of Cash

A summary of cash provided by (used in) operating, investing, and financing activities is as follows:

	Nine Months Ended July 30, July 31, 2017 2016	
	(In millions)	
Cash provided by operating activities	\$2,910	\$1,669
Cash used in investing activities	\$(1,997)	\$(436)
Cash provided by (used in) financing activities	\$959	\$(3,202)

Operating Activities

Cash from operating activities for the nine months ended July 30, 2017 was \$2.9 billion, which reflects net income adjusted for the effect of non-cash charges and changes in working capital components. Non-cash charges included depreciation, amortization, share-based compensation and deferred income taxes. Cash provided by operating activities increased from the first nine months of fiscal 2016 to the first nine months of fiscal 2017 primarily due to higher net income and increases in customer deposits and deferred revenue, offset by a higher increase in inventory. Applied has agreements with various financial institutions to sell accounts receivable and discount promissory notes from selected customers. Applied sells its accounts receivable without recourse. Applied, from time to time, also discounts letters of credit issued by customers through various financial institutions. The discounting of letters of credit depends on many factors, including the willingness of financial institutions to discount the letters of credit and the cost of such arrangements. Applied sold \$360 million and \$57 million of accounts receivable during the nine months ended July 30, 2017 and July 31, 2016, respectively. Applied did not discount promissory notes or utilize programs to discount letters of credit issued by customers during the nine months ended July 30, 2017 or July 31, 2016.

Applied's working capital was \$8.4 billion at July 30, 2017 and \$4.7 billion at October 30, 2016.

Days sales outstanding for the third quarter of fiscal 2017 was 55 days, a decrease compared to day sales outstanding of 60 days for the same period in the prior year. Days sales outstanding varies due to the timing of shipments and payment terms, and the decrease was primarily due to better revenue linearity and increase in factoring of accounts receivable.

Investing Activities

Applied used \$2.0 billion of cash in investing activities during the nine months ended July 30, 2017. Purchases of investments, net of proceeds from sales and maturities of investments, totaled \$1.7 billion and capital expenditures were \$221 million during the nine months ended July 30, 2017.

Applied's investment portfolio consists principally of investment grade money market mutual funds, U.S. Treasury and agency securities, municipal bonds, corporate bonds and mortgage-backed and asset-backed securities, as well as

equity securities. Applied regularly monitors the credit risk in its investment portfolio and takes appropriate measures, which may include the sale of certain securities, to manage such risks prudently in accordance with its investment policies. During the nine months ended July 30, 2017, Applied did not recognize any impairment of its fixed income securities. At July 30, 2017, gross unrealized losses related to Applied's investment portfolio were not material.

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Financing Activities

Applied generated \$1.0 billion of cash from financing activities during the nine months ended July 30, 2017, consisting primarily of net proceeds received from the issuance of senior unsecured notes of \$2.2 billion, excess tax benefits from share-based compensation of \$51 million and proceeds from common stock issuances of \$47 million, partially offset by cash used for repurchases of common stock of \$787 million, cash dividends to stockholders of \$323 million and debt repayments of \$205 million.

In June 2017, March 2017 and December 2016, Applied's Board of Directors declared quarterly cash dividends in the amount of \$0.10 per share. Applied currently anticipates that cash dividends will continue to be paid on a quarterly basis, although the declaration of any future cash dividend is at the discretion of the Board of Directors and will depend on Applied's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination by the Board of Directors that cash dividends are in the best interests of Applied's stockholders.

Applied has credit facilities for unsecured borrowings in various currencies of up to \$1.6 billion, of which \$1.5 billion is comprised of a committed revolving credit agreement with a group of banks that is scheduled to expire in September 2020. This agreement provides for borrowings in United States dollars at interest rates keyed to one of the two rates selected by Applied for each advance and includes financial and other covenants with which Applied was in compliance at July 30, 2017. Remaining credit facilities in the amount of approximately \$72 million are with Japanese banks. Applied's ability to borrow under these facilities is subject to bank approval at the time of the borrowing request, and any advances will be at rates indexed to the banks' prime reference rate denominated in Japanese yen. No amounts were outstanding under any of these facilities at both July 30, 2017 and October 30, 2016, and Applied has not utilized these credit facilities.

In fiscal 2011, Applied established a short-term commercial paper program of up to \$1.5 billion. At July 30, 2017, Applied did not have any commercial paper outstanding, but may issue commercial paper notes under this program from time to time in the future.

In March 2017, Applied issued senior unsecured notes in the aggregate principal amount of \$2.2 billion. Applied had senior unsecured notes in the aggregate principal amount of \$5.4 billion outstanding as of July 30, 2017. The indentures governing these notes include covenants with which Applied was in compliance at July 30, 2017. In May 2017, Applied completed the redemption of the entire outstanding \$200 million in principal amount of senior notes due in October 2017. The redemption price was \$205 million, and after adjusting for the carrying value of the debt issuance costs and discounts, Applied recorded a \$5 million loss on the prepayment of the \$200 million debt, which is included in interest and other income, net in the Consolidated Condensed Statement of Operations for the third quarter of fiscal 2017. See Note 10 of Notes to Consolidated Condensed Financial Statements for additional discussion of long-term debt. Applied may seek to refinance its existing debt and may incur additional indebtedness depending on Applied's capital requirements and the availability of financing.

In the ordinary course of business, Applied provides standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated by either Applied or its subsidiaries. As of July 30, 2017, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately \$67 million. Applied has not recorded any liability in connection with these guarantee agreements beyond that required to appropriately account for the underlying transaction being guaranteed. Applied does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these guarantee agreements.

Applied also has agreements with various banks to facilitate subsidiary banking operations worldwide, including overdraft arrangements, issuance of bank guarantees, and letters of credit. As of July 30, 2017, Applied Materials, Inc. has provided parent guarantees to banks for approximately \$140 million to cover these arrangements.

Others

During the nine months ended July 30, 2017, Applied did not record a bad debt provision. While Applied believes that its allowance for doubtful accounts at July 30, 2017 is adequate, it will continue to closely monitor customer liquidity and economic conditions.

As of July 30, 2017, approximately \$5.0 billion of cash, cash equivalents and marketable securities held by foreign subsidiaries may be subject to U.S. income tax if repatriated for U.S. operations. Applied intends to indefinitely reinvest approximately \$4.0 billion of these funds outside of the U.S. and does not plan to repatriate these funds. Applied would need to accrue and pay U.S. income tax if these funds were repatriated. For the remaining cash, cash equivalents and marketable securities held by foreign subsidiaries, U.S. income tax has been provided for in the financial statements.

Although cash requirements will fluctuate based on the timing and extent of factors such as those discussed above, Applied's management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy Applied's liquidity requirements for the next 12 months. For further details regarding Applied's operating, investing and financing activities, see the Consolidated Condensed Statements of Cash Flows in this report.

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Critical Accounting Policies and Estimates

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. Note 1 of Notes to Consolidated Financial Statements in Applied's Annual Report on Form 10-K and Note 1 of Notes to Consolidated Condensed Financial Statements in this report describe the significant accounting policies used in the preparation of the consolidated financial statements. Certain of these significant accounting policies are considered to be critical accounting policies.

A critical accounting policy is defined as one that is both material to the presentation of Applied's consolidated financial statements and that requires management to make difficult, subjective or complex judgments that could have a material effect on Applied's financial condition or results of operations. Specifically, these policies have the following attributes: (1) Applied is required to make assumptions about matters that are highly uncertain at the time of the estimate; and (2) different estimates Applied could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on Applied's financial condition or results of operations. Estimates and assumptions about future events and their effects cannot be determined with certainty. Applied bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as Applied's operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties include those discussed in Part II, Item 1A, "Risk Factors." Based on a critical assessment of its accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that Applied's consolidated financial statements are fairly stated in accordance with accounting principles generally accepted in the United States of America, and provide a meaningful presentation of Applied's financial condition and results of operations.

Management believes that the following are critical accounting policies and estimates:

Revenue Recognition

Applied recognizes revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; sales price is fixed or determinable; and collectability is probable. Each sale arrangement may contain commercial terms that differ from other arrangements. In addition, Applied frequently enters into contracts that contain multiple deliverables. Judgment is required to properly identify the accounting units of the multiple deliverable transactions and to determine the manner in which revenue should be allocated among the accounting units. Moreover, judgment is used in interpreting the commercial terms and determining when all criteria of revenue recognition have been met in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the estimated sales price between the units of accounting will not affect the amount of total revenue recognized for a particular sales arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could have a material effect on Applied's financial condition and results of operations.

Warranty Costs

Applied provides for the estimated cost of warranty when revenue is recognized. Estimated warranty costs are determined by analyzing specific product, current and historical configuration statistics and regional warranty support costs. Applied's warranty obligation is affected by product and component failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. As Applied's customer engineers and process support engineers are highly trained and deployed globally, labor availability is a significant factor in determining labor costs. The quantity and availability of critical replacement parts is another significant factor in estimating warranty costs. Unforeseen component failures or exceptional component performance can also result in changes to warranty costs. If actual warranty costs differ substantially from Applied's estimates, revisions to the estimated warranty liability would be required, which could have a material adverse effect on Applied's business, financial condition and results of operations.

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Allowance for Doubtful Accounts

Applied maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. This allowance is based on historical experience, credit evaluations, specific customer collection history and any customer-specific issues Applied has identified. Changes in circumstances, such as an unexpected material adverse change in a major customer's ability to meet its financial obligation to Applied or its payment trends, may require Applied to further adjust its estimates of the recoverability of amounts due to Applied, which could have a material adverse effect on Applied's business, financial condition and results of operations.

Inventory Valuation

Inventories are generally stated at the lower of cost or market, with cost determined on a first-in, first-out basis. The carrying value of inventory is reduced for estimated obsolescence by the difference between its cost and the estimated market value based upon assumptions about future demand. Applied evaluates the inventory carrying value for potential excess and obsolete inventory exposures by analyzing historical and anticipated demand. In addition, inventories are evaluated for potential obsolescence due to the effect of known and anticipated engineering change orders and new products. If actual demand were to be substantially lower than estimated, additional adjustments for excess or obsolete inventory may be required, which could have a material adverse effect on Applied's business, financial condition and results of operations.

Goodwill and Intangible Assets

Applied reviews goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also annually reviews goodwill and intangibles with indefinite lives for impairment. Intangible assets, such as purchased technology, are generally recorded in connection with a business acquisition. The value assigned to intangible assets is usually based on estimates and judgments regarding expectations for the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from the estimates, Applied may be required to record an impairment charge to reduce the carrying value of the reporting unit to its estimated fair value.

To test goodwill for impairment, Applied first performs a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, Applied then performs the two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. Under the two-step goodwill impairment test, Applied would in the first step compare the estimated fair value of each reporting unit to its carrying value. If the carrying value of a reporting unit exceeds its estimated fair value, Applied would then perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If Applied determines that the carrying value of a reporting unit's goodwill exceeds its implied fair value, Applied would record an impairment charge equal to the difference.

Applied determines the fair value of each reporting unit based on a weighting of an income and a market approach. Applied bases the fair value estimates on assumptions that it believes to be reasonable but that are unpredictable and inherently uncertain. Under the income approach, Applied estimates the fair value based on discounted cash flow method.

The estimates used in the impairment testing are consistent with the discrete forecasts that Applied uses to manage its business, and considers any significant developments during the period. Under the discounted cash flow method, cash flows beyond the discrete forecasts are estimated using a terminal growth rate, which considers the long-term earnings growth rate specific to the reporting units. The estimated future cash flows are discounted to present value using each reporting unit's weighted average cost of capital. The weighted average cost of capital measures a reporting unit's cost of debt and equity financing weighted by the percentage of debt and equity in a reporting unit's target capital structure. In addition, the weighted average cost of capital is derived using both known and estimated market metrics, and is adjusted to reflect both the timing and risks associated with the estimated cash flows. The tax rate used in the discounted cash flow method is the median tax rate of comparable companies and reflects Applied's current international structure, which is consistent with the market participant perspective. Under the market approach, Applied uses the guideline company method which applies market multiples to forecasted revenues and earnings before interest, taxes, depreciation and amortization. Applied uses market multiples that are consistent with comparable publicly-traded companies and considers each reporting unit's size, growth and profitability relative to its

comparable companies.

Management uses significant judgment when assessing goodwill for potential impairment, especially in emerging markets. Indicators of potential impairment include, but are not limited to, challenging economic conditions, an unfavorable industry or economic environment or other severe decline in market conditions. Such conditions could have the effect of changing one of the critical assumptions or estimates used for the fair value calculation, resulting in an unexpected goodwill impairment charge, which could have a material adverse effect on Applied's business, financial condition and results of operations.

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Income Taxes

Applied's provision for income taxes and effective tax rate are affected by the geographical composition of pre-tax income which includes jurisdictions with differing tax rates, conditional reduced tax rates and other income tax incentives. It is also affected by events that are not consistent from period to period, such as changes to income tax laws and the resolution of prior years' income tax filings.

Applied recognizes a current tax liability for the estimated amount of income tax payable on tax returns for the current fiscal year. Deferred tax assets and liabilities are recognized for the estimated future tax effects of temporary differences between the book and tax bases of assets and liabilities. Deferred tax assets are also recognized for net operating loss and tax credit carryforwards. Deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

Applied recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized from such positions are estimated based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Any changes in judgment related to uncertain tax positions are recognized in Applied's provision for income taxes in the quarter in which such change occurs. Interest and penalties related to uncertain tax positions are recognized in Applied's provision for income taxes.

The calculation of Applied's provision for income taxes and effective tax rate involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with Applied's expectations could have an adverse material impact on Applied's results of operations and financial condition.

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Non-GAAP Adjusted Financial Results

Management uses non-GAAP adjusted financial measures to evaluate the Company's operating and financial performance and for planning purposes, and as performance measures in its executive compensation program. Applied believes these measures enhance an overall understanding of our performance and investors' ability to review the Company's business from the same perspective as the Company's management and facilitate comparisons of this period's results with prior periods on a consistent basis by excluding items that we do not believe are indicative of our ongoing operating performance.

The non-GAAP adjusted financial measures presented below are adjusted to exclude the impact of certain costs, expenses, gains and losses, including certain items related to mergers and acquisitions; restructuring charges and any associated adjustments; impairments of assets, or investments; gain or loss on sale of strategic investments; certain other discrete adjustments and income tax items. Reconciliations of these non-GAAP measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are provided in the financial tables presented below. There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles, may be different from non-GAAP financial measures used by other companies, and may exclude certain items that may have a material impact upon our reported financial results. The presentation of this additional information is not meant to be considered in isolation or as a substitute for the directly comparable financial measures prepared in accordance with GAAP.

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The following tables present a reconciliation of the GAAP and non-GAAP adjusted consolidated results:

APPLIED MATERIALS, INC.

UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

(In millions, except percentages)	Three Months Ended		Nine Months Ended	
	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016
Non-GAAP Adjusted Gross Profit				
Reported gross profit - GAAP basis	\$1,700	\$1,192	\$4,745	\$3,112
Certain items associated with acquisitions ¹	44	42	127	125
Inventory reversals related to restructuring ²	—	(1)	—	(2)
Non-GAAP adjusted gross profit	\$1,744	\$1,233	\$4,872	\$3,235
Non-GAAP adjusted gross margin	46.6 %	43.7 %	46.1 %	43.0 %
Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	\$1,023	\$596	\$2,770	\$1,375
Certain items associated with acquisitions ¹	49	47	142	141
Acquisition integration costs	1	2	3	2
Reversals related to restructuring, net ²	—	(1)	—	(3)
Other gains, losses or charges, net	—	—	(3)	—
Non-GAAP adjusted operating income	\$1,073	\$644	\$2,912	\$1,515
Non-GAAP adjusted operating margin	28.7 %	22.8 %	27.6 %	20.1 %
Non-GAAP Adjusted Net Income				
Reported net income - GAAP basis	\$925	\$505	\$2,452	\$1,111
Certain items associated with acquisitions ¹	49	47	142	141
Acquisition integration costs	1	2	3	2
Reversals related to restructuring, net ²	—	(1)	—	(3)
Impairment (gain on sale) of strategic investments, net	(1)	—	4	(3)
Loss on early extinguishment of debt	5	—	5	5
Other gains, losses or charges, net	—	—	(3)	—
Reinstatement of federal R&D tax credit, resolution of prior years' income tax filings and other tax items ³	(46)	1	(68)	(12)
Income tax effect of non-GAAP adjustments ⁴	(6)	(4)	(15)	(13)
Non-GAAP adjusted net income	\$927	\$550	\$2,520	\$1,228

¹ These items are incremental charges attributable to completed acquisitions, consisting of amortization of purchased intangible assets.

² Results for the three and nine months ended July 31, 2016 included favorable adjustments associated with the cost reductions in the solar business.

³ Results for the three and nine months ended July 30, 2017 included the recognition of previously unrecognized foreign tax credits.

⁴ These amounts represent non-GAAP adjustments above multiplied by the effective tax rate within the jurisdictions that the adjustments affect.

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APPLIED MATERIALS, INC.

UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

	Three Months Ended July 30, 2017		Nine Months Ended July 30, 2017	
(In millions, except per share amounts)	July 31, 2016		July 31, 2016	
Non-GAAP Adjusted Earnings Per Diluted Share				
Reported earnings per diluted share - GAAP basis	\$0.85	\$ 0.46	\$2.26	\$ 0.99
Certain items associated with acquisitions	0.04	0.04	0.12	0.11
Reinstatement of federal R&D tax credit, resolution of prior years' income tax filings and other tax items	(0.04)	—	(0.06)	(0.01)
Other gains, losses or charges, net	0.01	—	—	—
Non-GAAP adjusted earnings per diluted share	\$0.86	\$ 0.50	2.32	1.09
Weighted average number of diluted shares	1,083	1,093	1,087	1,123

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The following table presents a reconciliation of the GAAP and non-GAAP adjusted segment results:

APPLIED MATERIALS, INC.

UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

	Three Months		Nine Months	
	Ended		Ended	
(In millions, except percentages)	July 30, 2017	July 31, 2016	July 30, 2017	July 31, 2016
Semiconductor Systems Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	\$874	\$511	\$2,372	\$1,140
Certain items associated with acquisitions ¹	46	45	138	138
Non-GAAP adjusted operating income	\$920	\$556	\$2,510	\$1,278
Non-GAAP adjusted operating margin	36.3 %	31.1 %	35.4 %	26.9 %
AGS Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	\$213	\$175	\$585	\$489
Certain items associated with acquisitions ¹	1	1	1	1
Acquisition integration costs	1	—	3	—
Non-GAAP adjusted operating income	\$215	\$176	\$589	\$490
Non-GAAP adjusted operating margin	27.4 %	26.8 %	26.9 %	25.8 %
Display and Adjacent Markets Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	91	63	290	142
Certain items associated with acquisitions ¹	2	—	2	—
Non-GAAP adjusted operating income	\$93	\$63	\$292	\$142
Non-GAAP adjusted operating margin	22.7 %	20.1 %		