APPLIED MATERIALS INC /DE
Form 10-Q
August 23, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 29, 2018
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 incorporation or organization)	(I.R.S. Employer Identification No.)
3050 Bowers Avenue, P.O. Box 58039 Santa Clara, California	95052-8039
(Address of principal executive offices)	(Zip Code)

(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 þ No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes þ 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 þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

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 þ

Number of shares outstanding of the issuer’s common stock as of July 29, 2018: 982,990,521

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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		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(Unaudited)			
Net sales	$4,468	$3,744	$13,239	$10,568
Cost of products sold	2,441	2,044	7,202	5,823
Gross profit	2,027	1,700	6,037	4,745
Operating expenses:				
Research, development and engineering	504	454	1,501	1,308
Marketing and selling	138	117	394	351
General and administrative	128	106	362	316
Total operating expenses	770	677	2,257	1,975
Income from operations	1,257	1,023	3,780	2,770
Interest expense	59	59	174	141
Interest and other income, net	41	14	90	28
Income before income taxes	1,239	978	3,696	2,657
Provision for income taxes	66	53	1,259	205
Net income	$1,173	$925	$2,437	$2,452
Earnings per share:				
Basic	$1.18	$0.86	$2.37	$2.28
Diluted	$1.17	$0.85	$2.35	$2.26
Weighted average number of shares:				
Basic	994	1,071	1,026	1,076
Diluted	1,005	1,083	1,039	1,087

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		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(Unaudited)			
Net income	$1,173	$ 925	$2,437	$2,452
Other comprehensive income (loss), net of tax:				
Change in unrealized net gain on investments	(18)	10	(19)	25
Change in unrealized net loss on derivative instruments	16	1	5	1
Change in defined and postretirement benefit plans	—	(2)	(2)	(12)
Other comprehensive income (loss), net of tax	(2)	9	(16)	14
Comprehensive income	$1,171	$ 934	$2,421	$2,466

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(In millions)

	July 29, 2018	October 29, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$3,374	$ 5,010
Short-term investments	610	2,266
Accounts receivable, net	2,882	2,338
Inventories	3,681	2,930
Other current assets	342	374
Total current assets	10,889	12,918
Long-term investments	1,613	1,143
Property, plant and equipment, net	1,321	1,066
Goodwill	3,368	3,368
Purchased technology and other intangible assets, net	263	412
Deferred income taxes and other assets	429	512
Total assets	$17,883	$ 19,419
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$2,741	$ 2,450
Customer deposits and deferred revenue	1,581	1,665
Total current liabilities	4,322	4,115
Income taxes payable	1,148	392
Long-term debt	5,308	5,304
Other liabilities	280	259
Total liabilities	11,058	10,070
Stockholders’ equity:		
Common stock	10	11
Additional paid-in capital	7,145	7,056
Retained earnings	20,191	18,258
Treasury stock	(20,444)	(15,912)
Accumulated other comprehensive loss	(77)	(64)
Total stockholders’ equity	6,825	9,349
Total liabilities and stockholders’ equity	$17,883	$ 19,419

Amounts as of July 29, 2018 are unaudited. Amounts as of October 29, 2017 are derived from the October 29, 2017 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)

Nine Months Ended July 29, 2018	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Income (Loss)	Total
	(Unaudited)							
Balance as of October 29, 2017	1,060	$ 11	$ 7,056	$ 18,258	917	$ (15,912)	$ (64)	$ 9,349
Adoption of new accounting standards (a)	—	—	—	(3)	—	—	3	—
Net income	—	—	—	2,437	—	—	—	2,437
Other comprehensive loss, net of tax	—	—	—	—	—	—	(16)	(16)
Dividends	—	—	—	(501)	—	—	—	(501)
Share-based compensation	—	—	193	—	—	—	—	193
Issuance under stock plans	7	—	(104)	—	—	—	—	(104)
Common stock repurchases	(84)	(1)	—	—	84	(4,532)	—	(4,533)
Balance as of July 29, 2018	983	$ 10	$ 7,145	$ 20,191	1,001	$ (20,444)	$ (77)	$ 6,825

(a) - Represents the reclassification adjustment related to the early adoption of Accounting Standards Update (ASU) 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. See Note 1.

Nine Months Ended July 30, 2017	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Income (Loss)	Total
	(Unaudited)							
Balance as of 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 tax benefit of $51 and other	8	—	(21)	—	—	—	—	(21)
Common stock repurchases	(20)	—	—	—	20	(787)	—	(787)
Balance as of July 30, 2017	1,066	$ 11	$ 6,950	$ 17,383	909	$ (15,527)	$ (101)	$ 8,716

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 29, 2018	July 30, 2017
	(Unaudited)	
Cash flows from operating activities:		
Net income	$2,437	$2,452
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	337	302
Share-based compensation	193	162
Deferred income taxes	112	6
Other	4	15
Changes in operating assets and liabilities:		
Accounts receivable	(543)	26
Inventories	(751)	(825)
Other current and non-current assets	2	(114)
Accounts payable and accrued expenses	214	272
Customer deposits and deferred revenue	(84)	740
Income taxes payable	764	13
Other liabilities	25	31
Cash provided by operating activities	2,710	3,080
Cash flows from investing activities:		
Capital expenditures	(457)	(221)
Cash paid for acquisitions, net of cash acquired	(5)	(56)
Proceeds from sales and maturities of investments	2,823	1,822
Purchases of investments	(1,661)	(3,542)
Cash provided by (used in) investing activities	700	(1,997)
Cash flows from financing activities:		
Debt borrowings, net of issuance costs	—	2,176
Debt repayments	—	(205)
Proceeds from common stock issuances	56	47
Common stock repurchases	(4,532)	(787)
Tax withholding payments for vested equity awards	(160)	(119)
Payments of dividends to stockholders	(410)	(323)
Cash provided by (used in) financing activities	(5,046)	789
Increase (decrease) in cash and cash equivalents	(1,636)	1,872
Cash and cash equivalents — beginning of period	5,010	3,406
Cash and cash equivalents — end of period	$3,374	$5,278
Supplemental cash flow information:		
Cash payments for income taxes	$281	$168
Cash refunds from income taxes	$51	$17
Cash payments for interest	$143	$110

See accompanying Notes to Consolidated Condensed Financial Statements.

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 29, 2017 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 29, 2017 (2017 Form 10-K). Applied's results of operations for the three and nine months ended July 29, 2018 are not necessarily indicative of future operating results. Applied's fiscal year ends on the last Sunday in October of each year. Fiscal 2018 and 2017 each contain 52 weeks, and the first nine months of fiscal 2018 and 2017 each contained 39 weeks.

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.

Recent Accounting Pronouncements
Accounting Standards Adopted
Inventory Measurement. In July 2015, the Financial Accounting Standard Board (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 adopted this authoritative guidance in the first quarter of fiscal 2018 prospectively to the measurement of inventory after the effective date. The adoption of this guidance did not have a material impact 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 forfeitures, income tax, and classification on the statement of cash flows. Applied adopted this guidance in the first quarter of fiscal 2018. Upon adoption, Applied elected to continue to estimate forfeitures expected to occur to determine the amount of compensation costs to be recognized in each period. The new standard also required recognition of excess tax benefits in the provision for income taxes rather than additional paid-in capital prospectively. In the nine months ended July 29, 2018, Applied recognized an excess tax benefit of $51 million in the Consolidated Condensed Statements of Operations. Additionally, Applied elected to apply the presentation requirements for cash flows related to excess tax benefits and employee taxes paid for withheld shares retrospectively. Adopting this guidance increased cash provided by operating activities by a net $170 million with a corresponding net decrease in cash provided by financing activities for the nine months ended July 30, 2017.
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. In February 2018, the FASB issued authoritative guidance that allows stranded tax effects of the Tax Cuts and Jobs Act (the “Tax Act”) to be reclassified from accumulated other comprehensive income to retained earnings. Applied adopted this guidance at the beginning of the third quarter of fiscal 2018. The stranded income tax effects related to the Tax Act were reclassified from accumulated other comprehensive income to retained earnings in the consolidated statements of stockholders' equity as of July 29, 2018.
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. Applied adopted this guidance in the third quarter of fiscal 2018 on a prospective basis. The impact of the adoption of this guidance will depend on whether the Company makes any future modifications of share-based payment awards.
Accounting Standards Not Yet Adopted
Derivatives and Hedging. In August 2017, the FASB issued authoritative guidance that modifies the recognition and presentation of hedge accounting to better align an entity’s risk management strategies and financial reporting for hedging relationships. The authoritative guidance expands the application of hedge accounting for non-financial and financial risk components and eases certain hedge effectiveness assessment requirements. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2020, with early adoption permitted. Applied is currently evaluating the effect of this new guidance on Applied’s consolidated financial statements.
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, with early adoption permitted. The adoption of this guidance is not expected to have a significant impact on Applied's consolidated financial statements.

Business Combinations. In January 2017, the FASB issued authoritative guidance that clarifies the definition of a business to help companies evaluate whether acquisition or disposal transactions should be accounted for as asset groups or as businesses. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019 on a prospective basis, with early adoption permitted. The impact of the adoption depends on the facts and circumstances of future acquisition or disposal transactions.

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 effects of intercompany asset transfers other than inventory. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2019. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

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.

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.

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, and requires certain additional disclosures. 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. 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. Applied currently anticipates adopting this new guidance using the full retrospective approach, although this continues to be assessed as part of the overall evaluation.

In fiscal 2016, Applied established a project steering committee and cross-functional implementation team that has identified potential differences that would result from applying the requirements of the new standard to Applied's revenue contracts. In addition, the implementation team has identified and is now implementing changes to business processes, systems and controls to support recognition and disclosure under the new standard.

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While the Company's evaluation of the impact of this new guidance is not complete, Applied currently expects that the new standard will have the following impact:

- Revenue related to the sale of equipment and spares will generally continue to be recognized at a point in time upon the transfer of control. Under this new guidance, the point of time at which revenue is recognized for certain of these products is expected to be earlier than under current revenue recognition guidance as there will be fewer constraints related to customer acceptance.
- Revenue related to the sale of services will generally continue to be recognized over time as the services are performed.
- Disclosures related to revenue recognition, including contract balances and revenue disaggregation, will be expanded.

Applied will continue to complete its evaluation of the effect of this new guidance on the Company's financial position, results of operations and its ongoing financial reporting, and its preliminary assessments are subject to change.

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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		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions, except per share amounts)			
Numerator:				
Net income	$1,173	$ 925	$2,437	$2,452
Denominator:				
Weighted average common shares outstanding	994	1,071	1,026	1,076
Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	11	12	13	11
Denominator for diluted earnings per share	1,005	1,083	1,039	1,087
Basic earnings per share	$1.18	$ 0.86	$2.37	$2.28
Diluted earnings per share	$1.17	$ 0.85	$2.35	$2.26
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 and average unamortized fair value are greater than the average market price of Applied common stock, and therefore their inclusion would be anti-dilutive. Prior to the adoption of Accounting Standards Update (ASU) 2016-09 Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting in the first quarter of fiscal 2018, the assumed tax benefits upon the exercise of options and vesting of restricted stock units were also included in this calculation.

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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 29, 2018	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$1,364	$ —	$ —	$ 1,364
Cash equivalents:				
Money market funds	1,596	—	—	1,596
Non-U.S. government securities*	2	—	—	2
Municipal securities	119	—	—	119
Commercial paper, corporate bonds and medium-term notes	292	—	—	292
Asset-backed and mortgage-backed securities	1	—	—	1
Total Cash equivalents	2,010	—	—	2,010
Total Cash and Cash equivalents	$3,374	$ —	$ —	$ 3,374
Short-term and long-term investments:				
U.S. Treasury and agency securities	$336	$ —	$ 2	$ 334
Non-U.S. government securities*	10	—	—	10
Municipal securities	417	—	2	415
Commercial paper, corporate bonds and medium-term notes	722	—	3	719
Asset-backed and mortgage-backed securities	586	—	4	582
Total fixed income securities	2,071	—	11	2,060
Publicly traded equity securities	20	61	—	81
Equity investments in privately-held companies	82	—	—	82
Total short-term and long-term investments	$2,173	$ 61	$ 11	$ 2,223
Total Cash, Cash equivalents and Investments	$5,547	$ 61	$ 11	$ 5,597

* Includes agency debt securities guaranteed by Canada.

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APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

October 29, 2017	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$1,346	$ —	$ —	$ 1,346
Cash equivalents:				
Money market funds	2,658	—	—	2,658
U.S. Treasury and agency securities	15	—	—	15
Non-U.S. government securities*	55	—	—	55
Municipal securities	341	—	—	341
Commercial paper, corporate bonds and medium-term notes	595	—	—	595
Total Cash equivalents	3,664	—	—	3,664
Total Cash and Cash equivalents	$5,010	$ —	$ —	$ 5,010
Short-term and long-term investments:				
U.S. Treasury and agency securities	$667	$ —	$ 1	$ 666
Non-U.S. government securities*	161	—	—	161
Municipal securities	1,007	—	—	1,007
Commercial paper, corporate bonds and medium-term notes	1,024	1	1	1,024
Asset-backed and mortgage-backed securities	379	—	1	378
Total fixed income securities	3,238	1	3	3,236
Publicly traded equity securities	22	78	1	99
Equity investments in privately-held companies	74	—	—	74
Total short-term and long-term investments	$3,334	$ 79	$ 4	$ 3,409
Total Cash, Cash equivalents and Investments	$8,344	$ 79	$ 4	$ 8,419

* 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 as of July 29, 2018:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$556	$ 555
Due after one through five years	929	923
No single maturity date**	688	745
	$2,173	$ 2,223

** 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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Gains and Losses on Investments

During the three and nine months ended July 29, 2018, gross realized gains on investments were $13 million and $14 million, respectively, and the gross realized losses on investments for these periods were not material. During the three and nine months ended July 30, 2017, gross realized gains and losses on investments were not material.

As of July 29, 2018 and October 29, 2017, 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 as of July 29, 2018 and July 30, 2017 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 29, 2018 or July 30, 2017.

Impairment charges on equity investments in privately-held companies during the three and nine months ended July 29, 2018 and July 30, 2017 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 29, 2018, 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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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 29, 2018			October 29, 2017		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(In millions)					
Assets:						
Money market funds	$1,596	$—	$1,596	$2,658	$—	$2,658
U.S. Treasury and agency securities	303	31	334	192	489	681
Non-U.S. government securities	—	12	12	—	216	216
Municipal securities	—	534	534	—	1,348	1,348
Commercial paper, corporate bonds and medium-term notes	—	1,011	1,011	—	1,619	1,619
Asset-backed and mortgage-backed securities	—	583	583	—	378	378
Publicly traded equity securities	81	—	81	99	—	99
Total	$1,980	$2,171	$4,151	$2,949	$4,050	$6,999

There were no transfers between Level 1 and Level 2 fair value measurements during the three and nine months ended July 29, 2018 or July 30, 2017. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of July 29, 2018 or October 29, 2017.

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. As of July 29, 2018, equity investments in privately-held companies totaled $82 million, of which $65 million of these investments were accounted for under the cost method of accounting and $17 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. As of October 29, 2017, equity investments in privately-held companies totaled $74 million, of which $65 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. Impairment charges on equity investments in privately-held companies during the three and nine months ended July 29, 2018 and July 30, 2017 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. As of July 29, 2018 the aggregate principal amount of long-term debt was $5.4 billion and the estimated fair value was $5.6 billion. As of October 29, 2017, the aggregate principal amount of long-term debt was $5.4 billion and the estimated fair value was $5.8 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.

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 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 accumulated other comprehensive loss (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 as of July 29, 2018 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 29, 2018 and July 30, 2017.

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 as of July 29, 2018 and October 29, 2017 were not material.

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

		Three Months Ended					
		July 29, 2018			July 30, 2017		
		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)	Gain or (Loss)	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss)	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	AOCI	$11	$ —	$ —	$6	$ —	$ —
Foreign exchange contracts	Cost of products sold	—	(3)	7	—	1	—
Foreign exchange contracts	General and administrative	—	(6)	(2)	—	3	(1)
Interest rate contracts	Interest expense	—	(1)	—	—	(1)	—
Total		$11	$ (10)	$ 5	$6	$ 3	$ (1)

		Nine Months Ended					
		July 29, 2018			July 30, 2017		
		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)	Gain or (Loss)	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss)	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	AOCI	$(5)	$ —	$ —	$24	$ —	$ —
Foreign exchange contracts	Cost of products sold	—	(7)	13	—	7	(3)
Foreign exchange contracts	General and administrative	—	(2)	(5)	—	3	(2)
Interest rate contracts	Interest expense	—	(3)	—	(14)	(2)	—
Total		$(5)	$ (12)	$ 8	$10	$ 8	$ (5)

		Amount of Gain or (Loss) Recognized in Income			
		Three Months Ended		Nine Months Ended	
	Location of Gain or (Loss) Recognized in Income	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
		(In millions)			
Derivatives Not Designated as Hedging Instruments					
Foreign exchange contracts	General and administrative	$ 2	$ 9	$ (8)	$ 34
Total		$ 2	$ 9	$ (8)	$ 34

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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 29, 2018.

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 $271 million and $1 billion of accounts receivable during the three and nine months ended July 29, 2018, respectively. Applied sold $211 million and $360 million of accounts receivable during the three and nine months ended July 30, 2017, respectively. Applied did not discount letters of credit issued by customers or discount promissory notes during the three and nine months ended July 29, 2018 and July 30, 2017. 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 $34 million as of July 29, 2018 and October 29, 2017. 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 29, 2018, 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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Note 7 Balance Sheet Detail

	July 29, 2018	October 29, 2017
	(In millions)	
Inventories		
Customer service spares	$829	$ 595
Raw materials	978	603
Work-in-process	603	468
Finished goods	1,271	1,264
	$3,681	$ 2,930

Included in finished goods inventory are $129 million as of July 29, 2018, and $331 million as of October 29, 2017, 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 $342 million and $281 million of evaluation inventory as of July 29, 2018 and October 29, 2017, respectively.

	July 29, 2018	October 29, 2017
	(In millions)	
Other Current Assets		
Prepaid income taxes and income taxes receivable	$53	$ 57
Prepaid expenses and other	289	317
	$342	$ 374

	Useful Life	July 29, 2018	October 29, 2017
	(In years)	(In millions)	
Property, Plant and Equipment, Net			
Land and improvements		$221	$ 160
Buildings and improvements	3-30	1,419	1,315
Demonstration and manufacturing equipment	3-5	1,261	1,129
Furniture, fixtures and other equipment	3-5	625	572
Construction in progress		198	135
Gross property, plant and equipment		3,724	3,311
Accumulated depreciation		(2,403)	(2,245)
		$1,321	$ 1,066

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	July 29, 2018	October 29, 2017
	(In millions)	
Accounts Payable and Accrued Expenses		
Accounts payable	$1,094	$ 945
Compensation and employee benefits	625	666
Warranty	220	199
Dividends payable	197	106
Income taxes payable	121	112
Other accrued taxes	64	70
Interest payable	59	38
Other	361	314
	$2,741	$ 2,450

	July 29, 2018	October 29, 2017
	(In millions)	
Customer Deposits and Deferred Revenue		
Customer deposits	$410	$ 381
Deferred revenue	1,171	1,284
	$1,581	$ 1,665

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 29, 2018	October 29, 2017
	(In millions)	
Other Liabilities		
Defined and postretirement benefit plans	$159	$ 160
Other	121	99
	$280	$ 259

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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 were not presented because they were not material to Applied's consolidated results of operations. The acquired businesses were 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 29, 2018, Applied's reporting units include Semiconductor Product 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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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 as of July 29, 2018 and October 29, 2017 were as follows:

	July 29, 2018	October 29, 2017
	(In millions)	
Semiconductor Systems	$2,151	$ 2,151
Applied Global Services	1,018	1,018
Display and Adjacent Markets	199	199
Carrying amount	$3,368	$ 3,368

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

	July 29, 2018	October 29, 2017
	(In millions)	
Purchased technology, net	$154	$ 288
Intangible assets - finite-lived, net	109	124
Total	$263	$ 412

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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Details of finite-lived intangible assets were as follows:

	July 29, 2018			October 29, 2017		
	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	33	44	77
Display and Adjacent Markets	163	38	201	163	38	201
Corporate and Other	—	9	9	—	9	9
Gross carrying amount	$1,645	$ 343	$1,988	$1,645	$ 343	$1,988
Accumulated amortization:						
Semiconductor Systems	$(1,334)	$ (145)	$(1,479)	$(1,210)	$ (131)	$(1,341)
Applied Global Services	(29)	(44)	(73)	(28)	(44)	(72)
Display and Adjacent Markets	(128)	(36)	(164)	(119)	(35)	(154)
Corporate and Other	—	(9)	(9)	—	(9)	(9)
Accumulated amortization	$(1,491)	$ (234)	$(1,725)	$(1,357)	$ (219)	$(1,576)
Carrying amount	$154	$ 109	$263	$288	$ 124	$412

Details of amortization expense by segment were as follows:

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions)			
Semiconductor Systems	$47	$ 46	$138	$ 138
Applied Global Services	—	—	1	1
Display and Adjacent Markets	3	3	10	4
Total	$50	$ 49	$149	$ 143

Amortization expense was charged to the following categories:

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions)			
Cost of products sold	$44	$ 44	$134	$ 128
Research, development and engineering	1	—	1	1
Marketing and selling	5	5	14	14
Total	$50	$ 49	$149	$ 143

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As of July 29, 2018, future estimated amortization expense is expected to be as follows:

	Amortization Expense (In millions)
2018 (remaining 3 months)	$ 49
2019	57
2020	52
2021	40
2022	65
Total	$ 263

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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 2021. 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 as of both July 29, 2018 and October 29, 2017, 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. As of July 29, 2018, Applied did not have any commercial paper outstanding.

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 29, 2018 and October 29, 2017 was as follows:

	Principal Amount			
	July 29, 2018	October 29, 2017	Effective Interest Rate	Interest Pay Dates
	(In millions)			
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	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	1,000	4.361%	April 1, October 1
	5,350	5,350		
Total unamortized discount	(11)	(12)		
Total unamortized debt issuance costs	(31)	(34)		
Total long-term debt	5,308	5,304		
Total debt	$5,308	$ 5,304		

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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 on Investments, Net	Unrealized Gain (Loss) on Derivative Instruments Qualifying as Cash Flow Hedges	Defined and Postretirement Benefit Plans	Cumulative Translation Adjustments	Total
	(in millions)				
Balance as of October 29, 2017	$53	$ (11)	$ (120)	$ 14	$(64)
Adoption of new accounting standards (a)	5	(2)	—	—	3
Other comprehensive loss before reclassifications	(7)	(4)	—	—	(11)
Amounts reclassified out of AOCI	(12)	9	(2)	—	(5)
Other comprehensive loss, net of tax	(19)	5	(2)	—	(16)
Balance as of July 29, 2018	$39	$ (8)	$ (122)	$ 14	$(77)

(a) - Represents the reclassification adjustment related to the early adoption of Accounting Standards Update (ASU) 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. See Note 1.

	Unrealized Gain on Investments, Net	Unrealized Gain (Loss) on Derivative Instruments Qualifying as Cash Flow Hedges	Defined and Postretirement Benefit Plans	Cumulative Translation Adjustments	Total
	(in millions)				
Balance as of October 30, 2016	$30	$ (18)	$ (141)	$ 14	$(115)
Other comprehensive income 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 as of July 30, 2017	$55	$ (17)	$ (153)	$ 14	$(101)

The tax effects on net income of amounts reclassified from AOCI for the three and nine months ended July 29, 2018 and July 30, 2017 were not material.
Stock Repurchase Program

In September 2017, the Board of Directors approved a common stock repurchase program authorizing up to $3.0 billion in repurchases. In February 2018, the Board of Directors approved a new common stock repurchase program authorizing up to an additional $6.0 billion in repurchases. As of July 29, 2018, $5.1 billion 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 29, 2018 and July 30, 2017:

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(in millions, except per share amount)			
Shares of common stock repurchased	25	9	84	20
Cost of stock repurchased	$1,250	$375	$4,532	$787
Average price paid per share	$49.31	$44.34	$53.72	$39.48

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 2018, February 2018 and December 2017, Applied's Board of Directors declared quarterly cash dividends in the amount of $0.20, $0.20 and $0.10 per share, respectively. Dividends paid during the nine months ended July 29, 2018 and July 30, 2017 totaled $410 million and $323 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 29, 2018 and July 30, 2017, 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 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions)			
Cost of products sold	$22	$ 18	$65	$ 51
Research, development and engineering	24	20	72	61
Marketing and selling	7	7	23	21
General and administrative	11	10	33	29
Total share-based compensation	$64	$ 55	$193	$ 162

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.

As of July 29, 2018, Applied had $399 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. As of July 29, 2018, there were 81 million shares available for grants of share-based awards under the Employee Stock Incentive Plan, and an additional 19 million shares available for issuance under the ESPP.

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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 29, 2018 is presented below:

	Shares	Weighted Average Grant Date Fair Value
	(In millions, except per share amounts)	
Outstanding as of October 29, 2017	22	$ 23.96
Granted	6	$ 51.63
Vested	(8)	$ 22.03
Canceled	(1)	$ 29.63
Outstanding as of July 29, 2018	19	$ 32.45

As of July 29, 2018, 1 million additional performance-based awards could be earned based upon achievement of certain levels of specified performance goals.

During the first quarter of fiscal 2018, 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 adjusted operating profit and vest ratably over three years. Other awards require the achievement of targeted levels of adjusted 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 applicable 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.

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 1 million shares during the nine months ended July 29, 2018 and 2 million shares during the nine months ended July 30, 2017. 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 29, 2018	July 30, 2017
ESPP:		
Dividend yield	1.40%	1.09%
Expected volatility	35.5%	24.9%
Risk-free interest rate	1.83%	0.78%
Expected life (in years)	0.5	0.5

Weighted average estimated fair value	$14.26	$8.08

Note 12 Income Taxes

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act. The Tax Act includes a reduction to the U.S. federal corporate tax rate from 35.0 percent to 21.0 percent and requires a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries payable over eight years. U.S. deferred tax assets and liabilities were subject to remeasurement due to the reduction of the U.S. federal corporate tax rate. Applied has a blended U.S. federal corporate tax rate of 23.4 percent for fiscal 2018 based on the number of days before and after the effective date of the Tax Act.

The U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (SAB 118), which provides guidance on accounting for the income tax effects of the Tax Act. SAB 118 provides a measurement period for companies to complete this accounting. Pursuant to this guidance, provisional adjustments were recorded when reasonable estimates could be determined. No adjustments were recorded when reasonable estimates could not be determined. These provisional estimates will be revised as information becomes available and as guidance is issued by the Internal Revenue Service. The accounting for the income tax effects of the Tax Act will be completed during the measurement period, which will not extend beyond one year from the Tax Act enactment date.

The transition tax is a tax on previously untaxed accumulated earnings and profits (“E&P”) of foreign subsidiaries. To determine the amount of the transition tax, the amount of post-1986 E&P of foreign subsidiaries, as well as the amount of foreign income taxes paid on such earnings, must be calculated. Additional information is being gathered to more precisely compute the transition tax.

The Tax Act also includes provisions that do not affect Applied in fiscal 2018, including a provision designed to tax global intangible low-taxed income (“GILTI”). Due to the complexity of the GILTI tax rules, this provision and related tax accounting will continue to be evaluated. An accounting policy choice is allowed to either treat taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the “period cost method”) or factor such amounts into the measurement of deferred taxes (the “deferred method”). The calculation of the deferred balance with respect to the new GILTI tax provisions will depend, in part, on analyzing global income to determine whether future U.S. inclusions in taxable income are expected related to GILTI and, if so, what the impact is expected to be. An accounting policy choice has not yet been made.

Applied’s effective tax rates for the third quarter of fiscal 2018 and 2017 were 5.3 percent and 5.4 percent, respectively. The third quarter of fiscal 2018 included tax benefits from the resolution of tax liabilities for uncertain tax positions, the lower U.S. federal corporate tax rate, and changes in the geographical composition of income. The third quarter of the prior fiscal year included tax benefits from the recognition of previously unrecognized foreign tax credits.

Applied’s effective tax rates for the first nine months fiscal 2018 and 2017 were 34.1 percent and 7.7 percent, respectively. The first nine months of fiscal 2018 included tax expense of $1.1 billion for the transition tax and remeasurement of deferred tax assets partially offset by tax benefits from the lower U.S. federal corporate tax rate, changes in the geographical composition of income, adoption of authoritative guidance for share-based compensation, and the resolution of tax liabilities for uncertain tax positions. The first nine months of the prior fiscal year included tax benefits from the recognition of previously unrecognized foreign tax credits.

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Note 13 Warranty, Guarantees and Contingencies
Warranty
Changes in the warranty reserves are presented below:

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions)			
Beginning balance	$218	$ 182	$199	$ 153
Warranties issued	48	41	147	123
Change in reserves related to preexisting warranty	1	1	—	3
Consumption of reserves	(47)	(32)	(126)	(87)
Ending balance	$220	$ 192	$220	$ 192

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.
Guarantees
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 29, 2018, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately $62 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 29, 2018, Applied has provided parent guarantees to banks for approximately $150 million to cover these arrangements.

Legal 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.

Note 14 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 29, 2018 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), equipment 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.

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 29, 2018:				
Semiconductor Systems	$2,748	$ 930	$8,594	$ 2,996
Applied Global Services	954	281	2,777	813
Display and Adjacent Markets	741	214	1,796	477
Corporate and Other	25	(168)	72	(506)
Total	$4,468	$ 1,257	$13,239	$ 3,780
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

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

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
	(In millions)			
Unallocated net sales	$25	$16	$72	$73
Unallocated cost of products sold and expenses	(129)	(116)	(385)	(388)
Share-based compensation	(64)	(55)	(193)	(162)
Total	$(168)	$(155)	$(506)	$(477)

The following customers accounted for at least 10 percent of Applied’s net sales for the nine months ended July 29, 2018, and sales to these customers included products and services from multiple reportable segments.

	Percentage of Net Sales
Samsung Electronics Co., Ltd.	15 %
Taiwan Semiconductor Manufacturing Company Limited	12 %
Intel Corporation	11 %

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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 29, 2018 should be read in conjunction with the financial statements for the fiscal year ended October 29, 2017 contained in the Company's Form 10-K filed December 15, 2017.

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, customer demand and spending, end-use demand, market and industry trends and outlooks, 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, 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," "potent "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 semiconductor, display, and related industries. Applied's customers include manufacturers of semiconductor wafers and chips, liquid crystal and organic light-emitting diode (OLED) 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. 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.

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 14 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 customer spending on capital equipment and services to support key technology transitions or to increase production volume in response to worldwide demand for semiconductors and displays. While certain existing technologies may be adapted to new requirements, some applications create the need for an entirely different technological approach. The timing of customer investment in manufacturing equipment is also affected by the timing of next generation production schedules, and the timing of capacity expansion to meet end market demand. 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 table presents certain significant measurements for the periods indicated:

	Three Months Ended			Nine Months Ended		
	July 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions, except per share amounts and percentages)					
Net sales	$4,468	$3,744	$ 724	$13,239	$10,568	$2,671
Gross margin	45.4 %	45.4 %	—%	45.6 %	44.9 %	0.7 points
Operating income	$1,257	$1,023	$ 234	$3,780	$2,770	$1,010
Operating margin	28.1 %	27.3 %	0.8 points	28.6 %	26.2 %	2.4 points
Net income	$1,173	$925	$ 248	$2,437	$2,452	$(15)
Earnings per diluted share	$1.17	$0.85	$ 0.32	$2.35	$2.26	$0.09

Fiscal 2018 and 2017 each contains 52 weeks, and the first nine months of fiscal 2018 and 2017 each contained 39 weeks.

Investment in semiconductor and display manufacturing equipment and services continued to be a strong driver of revenue during the first nine months of fiscal 2018. Semiconductor equipment customers continued to make investments in new capacity and overall semiconductor systems revenue increased as compared to the same period in the prior year. Logic and dynamic random-access memory (DRAM) demand increased, and NAND demand remained strong reflecting increasing memory requirements in smartphones and servers. Foundry customers' spending decreased compared to the prior year and Applied continues to see these customers optimize existing capacity and re-prioritize their capital spending plans. Display equipment spending reflected continued investment in new technology and manufacturing equipment. Customers continue to invest in a new generation of equipment for producing larger LCD TVs and in new equipment for mobile devices.

The three and nine months ended July 29, 2018 included a one-time expense related to the enactment of recent U.S. tax legislation that reduced diluted earnings per share by $0.01 and $1.05, respectively.

Results of Operations

Net Sales

Net sales for the periods indicated were as follows:

	Three Months Ended					Nine Months Ended				
	July 29, 2018		July 30, 2017		Change	July 29, 2018		July 30, 2017		Change
	(In millions, except percentages)									
Semiconductor Systems	$2,748	62 %	$2,532	68 %	9 %	$8,594	65 %	$7,086	67 %	21 %
Applied Global Services	954	21 %	786	21 %	21 %	2,777	21 %	2,186	21 %	27 %
Display and Adjacent Markets	741	17 %	410	11 %	81 %	1,796	14 %	1,223	11 %	47 %
Corporate and Other	25	— %	16	— %	56 %	72	— %	73	1 %	(1)%
Total	$4,468	100%	$3,744	100%	19 %	$13,239	100%	$10,568	100%	25 %

For the three and nine months ended July 29, 2018 compared to the same periods in the prior year, net sales increased primarily due to increased customer investments in all segments. The Semiconductor Systems segment's relative share of total net sales 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 29, 2018		July 30, 2017		Change	July 29, 2018		July 30, 2017		Change
	(In millions, except percentages)									
Korea	$588	13 %	$1,265	34 %	(54)%	$3,066	23 %	$2,877	27 %	7 %
Taiwan	641	14 %	607	16 %	6 %	2,124	16 %	2,573	24 %	(17)%
China	1,725	39 %	774	21 %	123 %	3,782	29 %	2,149	20 %	76 %
Japan	700	16 %	444	12 %	58 %	1,684	13 %	1,011	10 %	67 %
Southeast Asia	173	4 %	104	2 %	66 %	601	4 %	310	3 %	94 %
Asia Pacific	3,827	86 %	3,194	85 %	20 %	11,257	85 %	8,920	84 %	26 %
United States	401	9 %	359	10 %	12 %	1,166	9 %	1,059	10 %	10 %
Europe	240	5 %	191	5 %	26 %	816	6 %	589	6 %	39 %
Total	$4,468	100%	$3,744	100%	19 %	$13,239	100%	$10,568	100%	25 %

The changes in net sales in all regions in the three and nine months ended July 29, 2018 compared to the same periods in the prior year primarily reflected changes in semiconductor equipment spending and customer mix, and increased spending in semiconductor spares and services. The increase in net sales to customers in China for the three and nine months ended July 29, 2018 compared to the same periods in the prior year, also reflected increased investments in display manufacturing equipment. The decrease in net sales to customers in Taiwan for the nine months ended July 29, 2018 compared to the same periods in the prior year primarily reflected decreased investments in semiconductor equipment. The decrease in net sales to customers in Korea for the three months ended July 29, 2018 compared to the same period in the prior year primarily reflected decrease in investments in semiconductor and display manufacturing equipment.

Gross Margin

Gross margins for the periods indicated were as follows:

	Three Months Ended			Nine Months Ended		
	July 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
Gross margin	45.4%	45.4 %	—%	45.6%	44.9 %	0.7 points

While gross margin in the three months ended July 29, 2018 remained flat compared to the same period in the prior year, gross margin in the first nine months of fiscal 2018 increased compared to the same periods in the prior year primarily due to the increase in net sales and materials cost savings.

Gross margin during the three months ended July 29, 2018 and July 30, 2017 included $22 million and $18 million of share-based compensation expense, respectively. Gross margin during the nine months ended July 29, 2018 and July 30, 2017 included $65 million and $51 million of share-based compensation expense, respectively.

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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 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions)					
Research, development and engineering	$504	$ 454	$ 50	$1,501	$1,308	$ 193

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.

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 three and nine months ended July 29, 2018 compared to the same periods in the prior year primarily due to additional headcount and increased research and development 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 29, 2018 and July 30, 2017 included $24 million and $20 million of share-based compensation expense, respectively. RD&E expenses during the nine months ended July 29, 2018 and July 30, 2017 included $72 million and $61 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 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions)					
Marketing and selling	$138	$ 117	$ 21	$394	$ 351	$ 43

Marketing and selling expenses increased in the three and nine months ended July 29, 2018 compared to the same periods in fiscal 2017 primarily due to additional headcount.

Marketing and selling expenses during the three months ended July 29, 2018 and July 30, 2017 each included $7 million of share-based compensation expense. Marketing and selling expenses during the nine months ended July 29, 2018 and July 30, 2017 included $23 million and $21 million of share-based compensation expense, respectively.

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General and Administrative

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

	Three Months Ended			Nine Months Ended		
	July 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions)					
General and administrative	$128	$ 106	$ 22	$362	$ 316	$ 46

G&A expenses in the three and nine months ended July 29, 2018 increased compared to the same periods in the prior year primarily due to additional headcount.

G&A expenses during the three months ended July 29, 2018 and July 30, 2017 included $11 million and $10 million of share-based compensation expense, respectively. G&A expenses during the nine months ended July 29, 2018 and July 30, 2017 included $33 million and $29 million of share-based compensation expense, respectively.

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 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions)					
Interest expense	$59	$ 59	$ —	$174	$ 141	$ 33
Interest and other income, net	$41	$ 14	$ 27	$90	$ 28	$ 62

Interest expenses incurred were primarily associated with the senior unsecured notes issued in June 2011, September 2015 and March 2017. Interest expense in the nine months ended July 29, 2018 increased compared to the same periods in fiscal 2017 primarily due to the issuance of senior unsecured notes in March 2017.

Interest and other income, net in the three and nine months ended July 29, 2018 increased compared to the same periods in fiscal 2017 primarily driven by realized gains on sales of securities and higher interest income from 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 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions, except percentages)					
Provision for income taxes	$66	$ 53	$ 13	$1,259	$205	$1,054
Effective tax rate	5.3 %	5.4 %	(0.1) points	34.1 %	7.7 %	26.4 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.

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act includes a reduction to the U.S. federal corporate tax rate from 35.0 percent to 21.0 percent and requires a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries payable over eight years. U.S. deferred tax assets and liabilities were subject to remeasurement due to the reduction of the U.S. federal corporate tax rate. Applied has a blended U.S. federal corporate tax rate of 23.4 percent for fiscal 2018 based on the number of days before and after the effective date of the Tax Act.

The U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (SAB 118), which provides guidance on accounting for the income tax effects of the Tax Act. SAB 118 provides a measurement period for companies to complete this accounting. Pursuant to SAB 118, provisional adjustments were recorded when reasonable estimates could be determined. These provisional estimates will be revised as information becomes available and as guidance is issued by the Internal Revenue Service. The accounting for the income tax effects of the Tax Act will be completed during the measurement period, which will not extend beyond one year from the Tax Act enactment date.

The effective tax rate for the third quarter of fiscal 2018 was relatively flat compared to the same period in the prior fiscal year. The third quarter of fiscal 2018 included tax benefits from the resolution of tax liabilities for uncertain tax positions, the lower U.S. federal corporate tax rate, and changes in the geographical composition of income. The third quarter of the prior fiscal year included tax benefits from the recognition of previously unrecognized foreign tax credits.

The effective tax rate for the first nine months of fiscal 2018 was higher than the same period in the prior fiscal year. The first nine months of fiscal 2018 included tax expense of $1.1 billion for the transition tax and remeasurement of deferred tax assets partially offset by tax benefits from the lower U.S. federal corporate tax rate, changes in the geographical composition of income, adoption of authoritative guidance for share-based compensation and the resolution of tax liabilities for uncertain tax positions. The first nine months of the prior fiscal year included tax benefits from the recognition of previously unrecognized foreign tax credits.

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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 14 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 is comprised primarily of capital equipment used to fabricate semiconductor chips. Semiconductor industry spending on capital equipment is driven by demand for advanced electronic products, including smartphones and other mobile devices, servers, personal computers, automotive devices, storage, and other products, and the nature and timing of technological advances in fabrication processes, and as a result is subject to variable industry conditions. Development efforts are focused on solving customers' key technical challenges in transistor, interconnect, patterning and packaging performance as devices scale to advanced technology nodes.

Investment in semiconductor manufacturing equipment continued to be a strong driver of revenue during the first nine months of fiscal 2018. Semiconductor equipment customers continued to make investments in new capacity and overall semiconductor systems revenue increased as compared to the same period in the prior year. Demand for logic, DRAM, and NAND increased during the first nine months of fiscal 2018, although NAND demand decreased slightly in the three months ended July 29, 2018 compared to the same period in the prior year. Foundry customers' spending decreased compared to the prior year and Applied continues to see these customers optimize existing capacity and re-prioritize their capital spending plans.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended			Nine Months Ended		
	July 29, 2018	July 30, 2017	Change	July 29, 2018	July 30, 2017	Change
	(In millions, except percentages and ratios)					
Net sales	$2,748	$2,532	$216 9 %	$8,594	$7,086	$1,508 21 %
Operating income	$930	$874	$56 6 %	$2,996	$2,372	$624 26 %
Operating margin	33.8 %	34.5 %	(0.7) points	34.9 %	33.5 %	1.4 points

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

	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Foundry	28 %	39 %	25 %	43 %
Dynamic random-access memory (DRAM)	24 %	15 %	26 %	17 %
Flash memory	36 %	38 %	37 %	32 %
Logic and other	12 %	8 %	12 %	8 %
	100 %	100 %	100 %	100 %

Net sales for the three and nine months ended July 29, 2018 increased compared to the same periods in the prior year primarily due to higher spending from memory and logic customers, offset by lower spending from foundry customers. Operating margin for the three months ended July 29, 2018 slightly decreased, despite a slight increase in net sales, primarily due an increase in RD&E expenses. Operating income and operating margin for the nine months ended July 29, 2018 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. Five customers each accounted for at least 10 percent of this segment's net sales, and together they accounted for approximately 59 percent of this segment's total net sales, in the three months ended July 29, 2018.

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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 29, 2018		July 30, 2017		Change	July 29, 2018		July 30, 2017		Change
	(In millions, except percentages)									
Korea	$424	15%	$997	39%	(57)%	$2,494	29%	$2,254	32%	11 %
Taiwan	$459	17%	$444	18%	3 %	$1,511	18%	$2,096	30%	(28)%
China	$903	33%	$454	18%	99 %	$1,904	22%	$1,118	16%	70 %

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.

Demand for Applied Global Services' service solutions are driven by Applied's large and growing installed base of manufacturing systems, and customers' needs to shorten ramp times, improve device performance and yield, and optimize factory output and operating costs. Industry conditions that affect Applied Global Services' sales of spares and services are primarily characterized by increases in semiconductor manufacturers' wafer starts and continued strong utilization rates, growth of the installed base of equipment, growing service intensity of newer tools, and the company's ability to sell more comprehensive service agreements.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended				Nine Months Ended			
	July 29, 2018	July 30, 2017	Change		July 29, 2018	July 30, 2017	Change	
	(In millions, except percentages and ratios)							
Net sales	$954	$786	$168	21 %	$2,777	$2,186	$591	27 %
Operating income	$281	$213	$68	32 %	$813	$585	$228	39 %
Operating margin	29.5 %	27.1 %		2.4 points	29.3 %	26.8 %		2.5 points

Net sales for the three and nine months ended July 29, 2018 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 three and nine months ended July 29, 2018 compared to the same periods in the prior year increased due to higher net sales. In the three months ended July 29, 2018, two customers each accounted for more than 10 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 and OLED displays, and other display technologies for TVs, personal computers, electronic tablets, smart phones, and other consumer-oriented devices, equipment upgrades and flexible coating systems. The segment is focused on expanding its presence through technologically-differentiated equipment for manufacturing large-scale LCD TVs, OLEDs, 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.

The market environment for Applied's Display and Adjacent Markets segment in the first nine months of fiscal 2018 was characterized by increased demand for manufacturing equipment for TV and mobile devices. Uneven demand 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 29, 2018	July 30, 2017	Change		July 29, 2018	July 30, 2017	Change	
	(In millions, except percentages and ratios)							
Net sales	$741	$410	$331	81 %	$1,796	$1,223	$573	47 %
Operating income	$214	$91	$123	135 %	$477	$290	$187	64 %
Operating margin	28.9 %	22.2 %		6.7 points	26.6 %	23.7 %		2.9 points

Net sales for the three and nine months ended July 29, 2018 increased compared to the same periods in the prior year primarily due to higher customer investments in TV display and mobile device manufacturing equipment. Operating income and operating margin for the three and nine months ended July 29, 2018 increased compared to the same period in the prior year, reflecting higher net sales and favorable product mix, partially offset by higher RD&E spending. In the three months ended July 29, 2018, three customers each accounted for at least 10 percent of this segment’s net sales, and together they accounted for approximately 72 percent of this segment’s total net sales.

The following region 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 29, 2018		July 30, 2017		Change	July 29, 2018		July 30, 2017		Change
	(In millions, except percentages)									
China	$635	86%	$198	48%	221%	$1,342	75%	$700	57%	92%
Korea	$29	4%	$168	41%	(83)%	$196	11%	$376	31%	(48)%

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Financial Condition, Liquidity and Capital Resources

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

	July 29, 2018	October 29, 2017
	(In millions)	
Cash and cash equivalents	$3,374	$ 5,010
Short-term investments	610	2,266
Long-term investments	1,613	1,143
Total cash, cash-equivalents and investments	$5,597	$ 8,419

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 29, 2018	July 30, 2017
	(In millions)	
Cash provided by operating activities	$2,710	$3,080
Cash provided by (used in) investing activities	$700	$(1,997)
Cash provided by (used in) financing activities	$(5,046)	$789

Operating Activities

Cash from operating activities for the nine months ended July 29, 2018 was $2.7 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 decreased in the first nine months of fiscal 2018 compared to the same period in the prior year primarily due to an increase in accounts receivable and lower deferred revenue, partially offset by an increase in income taxes payable.

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 $1.0 billion and $360 million of accounts receivable during the nine months ended July 29, 2018 and July 30, 2017, respectively. Applied did not discount promissory notes or utilize programs to discount letters of credit issued by customers during the nine months ended July 29, 2018 or July 30, 2017.

Applied's working capital was $6.6 billion as of July 29, 2018 and $8.8 billion as of October 29, 2017.

Days sales outstanding for the three months ended July 29, 2018 was 59 days, an increase compared to day sales outstanding of 55 days for the same period in the prior year. Days sales outstanding varies due to the timing of shipments and payment terms, and the increase was primarily due to better revenue linearity for the same period in the prior year.

Investing Activities

Applied generated $700 million of cash from investing activities during the nine months ended July 29, 2018. Proceeds from sales and maturities of investments, net of purchases of investments, totaled $1.2 billion and were partially offset by capital expenditures of $457 million during the nine months ended July 29, 2018.

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 29, 2018, Applied did not recognize any impairment of its fixed income securities. As of July 29, 2018, gross unrealized losses related to Applied’s investment portfolio were not material.

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Financing Activities

Applied used $5.0 billion of cash in financing activities during the nine months ended July 29, 2018, consisting primarily of repurchases of common stock of $4.5 billion, tax withholding payments for vested equity awards of $160 million and cash dividends to stockholders of $410 million.

In June 2018, February 2018 and December 2017, Applied's Board of Directors declared quarterly cash dividends in the amount of $0.20, $0.20 and $0.10 per share, 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.

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 2021. 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 as of July 29, 2018. 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 as of both July 29, 2018 and October 29, 2017, 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. As of July 29, 2018, 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 29, 2018. The indentures governing these notes include covenants with which Applied was in compliance as of July 29, 2018. 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 29, 2018, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately $62 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 29, 2018, Applied has provided parent guarantees to banks for approximately $150 million to cover these arrangements.

Others

During the nine months ended July 29, 2018, Applied did not record a bad debt provision. While Applied believes that its allowance for doubtful accounts as of July 29, 2018 is adequate, it will continue to closely monitor customer liquidity and economic conditions.

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act. The Tax Act requires a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries payable over eight years, with eight percent due in each of the first five years starting with fiscal 2018. For the nine months ended July 29, 2018, Applied realized tax expense of $1.1 billion associated with the Tax Act, primarily due to the transition tax. The transition tax eliminated the requirement that cash, cash equivalents and marketable securities held by certain foreign subsidiaries be subject to U.S income taxes if repatriated for U.S. operations. Accordingly, cash, cash equivalents and marketable securities held by all foreign subsidiaries may be repatriated for U.S. operation without being subject to U.S. income taxes.

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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.

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 net realizable value, 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 net realizable 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; tax effect of share-based compensation; certain income tax items and other discrete adjustments. Additionally, the three and nine months ended July 29, 2018 non-GAAP results exclude estimated discrete income tax expense items associated with recent U.S. tax legislation. 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

	Three Months Ended		Nine Months Ended	
(In millions, except percentages)	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Non-GAAP Adjusted Gross Profit				
Reported gross profit - GAAP basis	$2,027	$1,700	$6,037	$4,745
Certain items associated with acquisitions[1]	45	44	134	127
Non-GAAP adjusted gross profit	$2,072	$1,744	$6,171	$4,872
Non-GAAP adjusted gross margin	46.4 %	46.6 %	46.6 %	46.1 %
Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	$1,257	$1,023	$3,780	$2,770
Certain items associated with acquisitions[1]	49	49	147	142
Acquisition integration costs	—	1	2	3
Other gains, losses or charges, net	—	—	—	(3)
Non-GAAP adjusted operating income	$1,306	$1,073	$3,929	$2,912
Non-GAAP adjusted operating margin	29.2 %	28.7 %	29.7 %	27.6 %
Non-GAAP Adjusted Net Income				
Reported net income - GAAP basis	$1,173	$925	$2,437	$2,452
Certain items associated with acquisitions[1]	49	49	147	142
Acquisition integration costs	—	1	2	3
Impairment (gain on sale) of strategic investments, net	(14)	(1)	(10)	4
Loss on early extinguishment of debt	—	5	—	5
Other gains, losses or charges, net	—	—	—	(3)
Income tax effect of share-based compensation[2]	13	—	(13)	—
Income tax effect of changes in applicable U.S. tax laws[3]	12	—	1,089	—
Resolution of prior years' income tax filings and other tax items	(29)	(46)	(32)	(68)
Income tax effect of non-GAAP adjustments[4]	1	(6)	(7)	(15)
Non-GAAP adjusted net income	$1,205	$927	$3,613	$2,520

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

2 Applied adopted the accounting standard related to share-based compensation (ASU 2016-09) in the first quarter of fiscal 2018, which resulted in $51 million tax benefit on a GAAP basis for the nine months ended July 29, 2018; this benefit is being recognized ratably over the fiscal year on a non-GAAP basis.

3 Charges to income tax provision related to a one-time transition tax and a decrease in U.S. deferred tax assets as a result of the recent U.S. tax legislation.

4 Adjustment to provision for income taxes related to non-GAAP adjustments reflected in income before income taxes.

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APPLIED MATERIALS, INC.
UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

(In millions, except per share amounts)	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Non-GAAP Adjusted Earnings Per Diluted Share				
Reported earnings per diluted share - GAAP basis	$1.17	$0.85	$2.35	$2.26
Certain items associated with acquisitions	0.05	0.04	0.13	0.12
Impairment (gain on sale) of strategic investments, net	(0.01)	—	(0.01)	—
Income tax effect of share-based compensation	0.01	—	(0.01)	—
Income tax effect of changes in applicable U.S. tax laws	0.01	—	1.05	—
Resolution of prior years' income tax filings and other tax items	(0.03)	(0.04)	(0.03)	(0.06)
Other gains, losses or charges, net	—	0.01	—	—
Non-GAAP adjusted earnings per diluted share	$1.20	$0.86	$3.48	$2.32
Weighted average number of diluted shares	1,005	1,083	1,039	1,087

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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

(In millions, except percentages)	Three Months Ended		Nine Months Ended	
	July 29, 2018	July 30, 2017	July 29, 2018	July 30, 2017
Semiconductor Systems Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	$930	$874	$2,996	$2,372
Certain items associated with acquisitions[1]	45	46	137	138
Non-GAAP adjusted operating income	$975	$920	$3,133	$2,510
Non-GAAP adjusted operating margin	35.5 %	36.3 %	36.5 %	35.4 %
AGS Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	$281	$213	$813	$585
Certain items associated with acquisitions[1]	—	1	—	1
Acquisition integration costs	—	1	1	3
Non-GAAP adjusted operating income	$281	$215	$814	$589
Non-GAAP adjusted operating margin	29.5 %	27.4 %	29.3 %	26.9 %
Display and Adjacent Markets Non-GAAP Adjusted Operating Income				
Reported operating income - GAAP basis	$214	$91	$477	$290
Certain items associated with acquisitions[1]	4	2	10	2
Acquisition integration costs	—	—	1	—
Non-GAAP adjusted operating income	$218	$93	$488	$292
Non-GAAP adjusted operating margin	29.4 %	22.7 %	27.2 %	23.9 %

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

Note: The reconciliation of GAAP and non-GAAP adjusted segment results above does not include certain revenues, costs of products sold and operating expenses that are reported within corporate and other and included in consolidated operating income.

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Item 3: Quantitative and Qualitative Disclosures About Market Risk

Applied is exposed to interest rate risk related to its investment portfolio and debt issuances. Applied's investment portfolio includes fixed-income securities with a fair value of approximately $2.1 billion as of July 29, 2018. These securities are subject to interest rate risk and will decline in value if interest rates increase. Based on Applied's investment portfolio as of July 29, 2018, an immediate 100 basis point increase in interest rates would result in a decrease in the fair value of the portfolio of approximately $26 million. While an increase in interest rates reduces the fair value of the investment portfolio, Applied will not realize the losses in the consolidated statement of operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary. As of July 29, 2018, the carrying amount of long-term debt issued by Applied was $5.3 billion with an estimated fair value of $5.6 billion. A hypothetical decrease in interest rates of 100 basis points would result in an increase in the fair value of Applied's long-term debt issuances of approximately $531 million as of July 29, 2018.

Certain operations of Applied are conducted in foreign currencies, such as Japanese yen, euro, Israeli shekel and Taiwanese dollar. Applied enters into currency forward exchange and option contracts to hedge a portion of, but not all, existing and anticipated foreign currency denominated transactions generally expected to occur within the next 24 months. Gains and losses on these contracts are generally recognized in income at the time that the related transactions being hedged are recognized. Because the effect of movements in currency exchange rates on currency forward exchange and option contracts generally offsets the related effect on the underlying items being hedged, these financial instruments are not expected to subject Applied to risks that would otherwise result from changes in currency exchange rates. Applied does not use derivative financial instruments for trading or speculative purposes.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this report, management of Applied conducted an evaluation, under the supervision and with the participation of Applied's Chief Executive Officer and Chief Financial Officer, of the effectiveness of Applied's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, Applied's Chief Executive Officer and Chief Financial Officer concluded that Applied's disclosure controls and procedures were effective as of the end of the period covered by this report in ensuring that information required to be disclosed was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that information required to be disclosed by Applied in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

During the third quarter of fiscal 2018, Applied implemented a new enterprise resource planning (ERP) system for certain of its business units, subsidiaries and locations. The ERP system replaces a legacy manufacturing system, automates and streamlines the consolidation process and enhances reporting capabilities. Throughout the implementation, Applied evaluated the impact of the ERP system on its internal control over financial reporting and made changes to controls where necessary to maintain the effectiveness of internal control over financial reporting in all material respects.

Other than the ERP implementation, there were no changes in the internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act, that materially affected, or are reasonably likely to materially affect, Applied's internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings
The information set forth under “Legal Matters” in Note 13 in Notes to Consolidated Condensed Financial Statements is incorporated herein by reference.

Item 1A: Risk Factors
The risk factors set forth below include any material changes to, and supersede the description of, the risk factors disclosed in Part I, Item 1A of Applied’s 2017 Form 10-K. These factors could materially and adversely affect Applied’s business, financial condition or results of operations and cause reputational harm, and should be carefully considered in evaluating the Company and its business, in addition to other information presented elsewhere in this report.
The industries that Applied serves can be volatile and difficult to predict.
As a supplier to the global semiconductor and display and related industries, Applied is subject to variable industry conditions, as demand for manufacturing equipment and services can change depending on several factors, including the nature and timing of technology inflections and advances in fabrication processes, the timing and requirements of new and emerging technologies and market drivers, production capacity relative to demand for chips and display technologies, end-user demand, customers’ capacity utilization, production volumes, access to affordable capital, consumer buying patterns and general economic conditions. Applied’s industries historically have been cyclical, and are subject to volatility and sudden changes in customer requirements for new manufacturing capacity and advanced technology. These changes can affect the timing and amounts of customer investments in technology and manufacturing equipment, and can have a significant impact on Applied’s net sales, operating expenses, gross margins and net income. The amount and mix of capital equipment spending between different products and technologies can have a significant impact on the Company’s results of operations.
To meet rapidly changing demand in the industries it serves, Applied must accurately forecast demand and effectively manage its resources and production capacity across its businesses, and may incur unexpected or additional costs to align its business operations. During periods of increasing demand for its products, Applied must have sufficient manufacturing capacity and inventory to meet customer demand; effectively manage its supply chain; attract, retain and motivate a sufficient number of qualified employees; and continue to control costs. During periods of decreasing demand, Applied must reduce costs and align its cost structure with prevailing market conditions; effectively manage its supply chain; and motivate and retain key employees. If Applied does not effectively manage these challenges during periods of changing demand, its business performance and results of operations may be adversely impacted. Even with effective allocation of resources and management of costs, during periods of decreasing demand, Applied’s gross margins and earnings may be adversely impacted.
Applied is exposed to risks associated with an uncertain global economy.
Uncertain global economic and business conditions, along with uncertainties and volatility in the financial markets, national debt and fiscal concerns in various regions, pose challenges to the industries in which Applied operates. Markets for semiconductors and displays depend largely on business and consumer spending and demand for electronic products. Economic uncertainty and related factors exacerbate negative trends in business and consumer spending and may cause certain Applied customers to push out, cancel, or refrain from purchasing for equipment or services, which may have an adverse impact on Applied’s revenues, results of operations and financial condition. Uncertain market conditions, difficulties in obtaining capital, or reduced profitability may also cause some customers to scale back operations, exit businesses, merge with other manufacturers, or file for bankruptcy protection and potentially cease operations, which can also result in lower sales, additional inventory or bad debt expense for Applied. Economic and industry uncertainty may similarly affect suppliers, which could impair their ability to deliver parts and negatively affect Applied’s ability to manage operations and deliver its products. These conditions may also lead to consolidation or strategic alliances among other equipment manufacturers, which could adversely affect Applied’s ability to compete effectively.

Uncertain economic and industry conditions also make it more challenging for Applied to forecast its operating results, make business decisions, and identify and prioritize the risks that may affect its businesses, sources and uses of cash, financial condition and results of operations. If Applied does not appropriately manage its business operations in response to changing economic and industry conditions, it could have a significant negative impact on its business performance and financial condition. Applied may be required to implement additional cost reduction efforts, including restructuring activities, which may adversely affect Applied’s ability to capitalize on opportunities. Even during periods of economic uncertainty or lower revenues, Applied must continue to invest in research and development and maintain a global business infrastructure to compete effectively and support its customers, which can have a negative impact on its operating margins and earnings.

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Applied maintains an investment portfolio that is subject to general credit, liquidity, market and interest rate risks. The risks to Applied's investment portfolio may be exacerbated if financial market conditions deteriorate and, as a result, the value and liquidity of the investment portfolio, as well as returns on pension assets, could be negatively impacted and lead to impairment charges. Applied also maintains cash balances in various bank accounts globally in order to fund normal operations. If any of these financial institutions becomes insolvent, it could limit Applied's ability to access cash in the affected accounts, which could affect its ability to manage its operations.

Applied is exposed to the risks of operating a global business.

Applied has product development, engineering, manufacturing, sales and other operations distributed throughout many countries, and some of its business activities are concentrated in certain geographic areas. Moreover, in the three months ended July 29, 2018, approximately 91 percent of Applied's net sales were to customers in regions outside the United States. As a result of the global nature of its operations, Applied's business performance and results of operations may be adversely affected by a number of factors, including:

- uncertain global economic and political business conditions and demands;
- political and social attitudes, laws, rules, regulations and policies within countries that favor domestic companies over non-domestic companies, including customer- or government-supported efforts to promote the development and growth of local competitors;
- global trade issues and changes in and uncertainties with respect to trade policies, including the ability to obtain required import and export licenses, trade sanctions, tariffs, and international trade disputes;
- customer- or government-supported efforts to influence Applied to conduct more of its operations and sourcing in a particular country, such as Korea and China;
- variations among, and changes in, local, regional, national or international laws and regulations, including contract, intellectual property, cybersecurity, data privacy, labor, tax, and import/export laws, and the interpretation and application of such laws and regulations;
- ineffective or inadequate legal protection of intellectual property rights in certain countries;
- positions taken by governmental agencies regarding possible national commercial and/or security issues posed by international business operations;
- fluctuating raw material, commodity, energy and shipping costs or shipping delays;
- geographically diverse operations and projects, and our ability to maintain appropriate business processes, procedures and internal controls, and comply with environmental, health and safety, anti-corruption and other regulatory requirements;
- supply chain interruptions, and service interruptions from utilities, transportation, data hosting or telecommunications providers;
- a diverse workforce with different experience levels, languages, cultures, customs, business practices and worker expectations, and differing employment practices and labor issues;
- variations in the ability to develop relationships with local customers, suppliers and governments;
- fluctuations in interest rates and currency exchange rates, including the relative strength or weakness of the U.S. dollar against the Japanese yen, euro, Taiwanese dollar, Israeli shekel, Chinese yuan or Singapore dollar;
- the need to provide sufficient levels of technical support in different locations around the world;
- performance of third party providers of outsourced functions, including certain engineering, software development, manufacturing, information technology and other activities;
- political instability, natural disasters, pandemics, social unrest, terrorism or acts of war in locations where Applied has operations, suppliers or sales, or that may influence the value chain of the industries that Applied serves;
- challenges in hiring and integration of an increasing number of workers in new countries;
- the increasing need for a mobile workforce to work in or travel to different regions; and
- uncertainties with respect to economic growth rates in various countries, including for the manufacture and sale of semiconductors and displays in the developing economies of certain countries.

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Increases in tariffs, additional taxes or trade barriers may increase our manufacturing costs, decrease margins, reduce the competitiveness of our products, or inhibit our ability to sell products or purchase necessary equipment and supplies, which could have a material adverse effect on our business, results of operations, or financial condition. In addition, government authorities may impose conditions that require the use of local suppliers or partnerships with local companies, require the license or other transfer of intellectual property, or engage in other efforts to promote local businesses and local competitors, which could have a significant adverse impact on Applied's business. Many of these challenges are present in China and Korea, markets that represent significant long-term growth opportunities for Applied businesses.

Applied is exposed to risks as a result of ongoing changes in the various industries in which it operates.

The global semiconductor, display and related industries in which Applied operates are characterized by ongoing changes affecting some or all of these industries that impact demand for and the profitability of Applied's products, including:

- the nature, timing and degree of visibility of changes in end demand for electronic products, including those related to fluctuations in consumer buying patterns tied to seasonality or the introduction of new products, and the effects of these changes on customers' businesses and on demand for Applied's products;
- increasing capital requirements for building and operating new fabrication plants and customers' ability to raise the necessary capital;
- trade, regulatory or tax policies impacting the timing of customers' investment in new or expanded fabrication plants;
- differences in growth rates among the semiconductor, display and other industries in which Applied operates;
- the increasing importance of establishing, improving and maintaining strong relationships with customers;
- the increasing cost and complexity for customers to move from product design to volume manufacturing, which may slow the adoption rate of new manufacturing technology;
- the need for customers to continually reduce the total cost of manufacturing system ownership;
- the heightened importance to customers of system reliability and productivity and the effect on demand for fabrication systems as a result of their increasing productivity, device yield and reliability;
- manufacturers' ability to reconfigure and re-use fabrication systems which can reduce demand for new equipment;
- the increasing importance of, and difficulties in, developing products with sufficient differentiation to influence customers' purchasing decisions;
- requirements for shorter cycle times for the development, manufacture and installation of manufacturing equipment;
- price and performance trends for semiconductor devices and displays, and the corresponding effect on demand for such products;
- the increasing importance of the availability of spare parts to maximize the time that customers' systems are available for production;
- the increasing role for and complexity of software in Applied products; and
- the increasing focus on reducing energy usage and improving the environmental impact and sustainability associated with manufacturing operations.

Applied is exposed to risks as a result of ongoing changes specific to the semiconductor industry.

The largest proportion of Applied's consolidated net sales and profitability is derived from sales of manufacturing equipment in the Semiconductor Systems segment to the global semiconductor industry. In addition, a majority of the revenues of Applied Global Services is from sales to semiconductor manufacturers. The semiconductor industry is characterized by ongoing changes particular to this industry that impact demand for and the profitability of Applied's semiconductor equipment and service products, including:

- the increasing frequency and complexity of technology transitions and inflections, and Applied's ability to timely and effectively anticipate and adapt to these changes;
- the increasing cost of research and development due to many factors, including shrinking geometries, the use of new materials, new and more complex device structures, more applications and process steps, increasing chip design costs, and the increasing cost and complexity of integrated manufacturing processes;
- the need to reduce product development time, despite the increasing difficulty of technical challenges;
-

the growing number of types and varieties of semiconductors and number of applications across multiple substrate sizes;

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- the increasing cost and complexity for semiconductor manufacturers to move more technically advanced capability and smaller geometries to volume manufacturing, and the resulting impact on the rates of technology transition and investment in capital equipment;
- challenges in generating organic growth given semiconductor manufacturers' levels of capital expenditures and the allocation of capital investment to market segments that Applied does not serve, such as lithography, or segments where Applied's products have lower relative market presence;
- the importance of increasing market positions in segments with growing demand;
- semiconductor manufacturer's ability to reconfigure and re-use equipment, and the resulting effect on their need to purchase new equipment and services;
- shorter cycle times between order placements by customers and product shipment require greater reliance on forecasting of customer investment, which may lead to inventory write-offs and manufacturing inefficiencies that decrease gross margin;
- competitive factors that make it difficult to enhance position, including challenges in securing development-tool-of-record (DTOR) and production-tool-of-record (PTOR) positions with customers;
- consolidation in the semiconductor industry, including among semiconductor manufacturers and among manufacturing equipment suppliers;
- shifts in sourcing strategies by computer and electronics companies that impact the equipment requirements of Applied's foundry customers;
- the concentration of new wafer starts in Korea and Taiwan, where Applied's service penetration and service-revenue-per-wafer-start have been lower than in other regions;
- investment in semiconductor manufacturing capabilities in China, which may be affected by changes in economic conditions and governmental policies in China; and
- the increasing fragmentation of semiconductor markets, leading certain markets to become too small to support the cost of a new fabrication plant, while others require less technologically advanced products.

If Applied does not accurately forecast, and allocate appropriate resources and investment towards addressing, key technology changes and inflections, successfully develop and commercialize products to meet demand for new technologies, and effectively address industry trends, its business and results of operations may be adversely impacted.

Applied is exposed to risks as a result of ongoing changes specific to the display industry.

The global display industry historically has experienced considerable volatility in capital equipment investment levels, due in part to the limited number of display manufacturers, the concentrated nature of end-use applications, production capacity relative to end-use demand, and panel manufacturer profitability. Industry growth depends primarily on consumer demand for increasingly larger and more advanced TVs, and on demand for advanced smartphones and mobile device displays, which demand is highly sensitive to cost and improvements in technologies and features. The display industry is characterized by ongoing changes particular to this industry that impact demand for and the profitability of Applied's display products and services, including:

- the importance of new types of display technologies, such as organic light-emitting diode (OLED), low temperature polysilicon (LTPS), flexible displays and metal oxide, and new touch panel films;
- the increasing cost of research and development, and complexity of technology transitions and inflections, and Applied's ability to timely and effectively anticipate and adapt to these changes;
- the timing and extent of an expansion of manufacturing facilities in China, which may be affected by changes in economic conditions and governmental policies in China;
- the importance of increasing market positions in products and technologies with growing demand;
- the rate of transition to larger substrate sizes for TVs and to new display technologies for TVs and mobile applications, and the resulting effect on capital intensity in the industry and on Applied's product differentiation, gross margin and return on investment; and
- the variability in demand for display manufacturing equipment, concentration of display manufacturer customers and their ability to successfully commercialize new products and technologies, and uncertainty with respect to future display technology end-use applications and growth drivers.

If Applied does not successfully develop and commercialize products to meet demand for new and emerging display technologies, or if industry demand for display manufacturing equipment and technologies slows, Applied's business and its results of operations may be adversely impacted.

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The industries in which Applied operates are highly competitive and subject to rapid technological and market changes.

Applied operates in a highly competitive environment in which innovation is critical, and its future success depends on many factors, including the development of new technologies and effective commercialization and customer acceptance of its equipment, services and related products, and its ability to increase its position in its current markets, expand into adjacent and new markets, and optimize operational performance. The development, introduction and support of a broadening set of products in a geographically diverse and competitive environment, and that may require greater collaboration with customers and other industry participants, have grown more complex and expensive over time. Furthermore, new or improved products may entail higher costs and lower profits. To compete successfully, Applied must:

- identify and address technology inflections, market changes, new applications, customer requirements and end-use demand;
- develop new products and disruptive technologies, improve and develop new applications for existing products, and adapt products for use by customers in different applications and markets with varying technical requirements;
- differentiate its products from those of competitors, meet customers' performance specifications, appropriately price products, and achieve market acceptance;
- maintain operating flexibility to enable responses to changing markets, applications, customers and customer requirements;
- enhance its worldwide operations across its businesses to reduce cycle time, enable continuous quality improvement, reduce costs, and enhance design for manufacturability and serviceability;
- focus on product development and sales and marketing strategies that address customers' high value problems and strengthen customer relationships;
- effectively allocate resources between its existing products and markets, the development of new products, and expanding into new and adjacent markets;
- improve the productivity of capital invested in R&D activities;
- accurately forecast demand, work with suppliers and meet production schedules for its products;
- improve its manufacturing processes and achieve cost efficiencies across product offerings;
- adapt to changes in value offered by companies in different parts of the supply chain;
- qualify products for evaluation and volume manufacturing with its customers; and
- implement changes in its design engineering methodology to reduce material costs and cycle time, increase commonality of platforms and types of parts used in different systems, and improve product life cycle management.

If Applied does not successfully anticipate technology inflections, develop and commercialize new products and technologies, and respond to changes in customer requirements and market trends, its business performance and results of operations may be adversely impacted.

Applied is exposed to risks associated with a highly concentrated customer base.

Applied's customer base is highly concentrated, and has become increasingly concentrated as a result of continued consolidation. Applied's customer base is also geographically concentrated. A relatively limited number of manufacturers account for a substantial portion of Applied's business. As a result, the actions of even a single customer can expose Applied's business and results of operations to greater volatility. The mix and type of customers, and sales to any single customer, including as a result of changes in government policy, may vary significantly from quarter to quarter and from year to year, and have a significant impact on Applied's net sales, gross margins and net income. Applied's products are configured to customer specifications, and changing, rescheduling or canceling orders may result in significant, non-recoverable costs. If customers do not place orders, or they substantially reduce, delay or cancel orders, Applied may not be able to replace the business, which may have a significant adverse impact on its results of operations and financial condition. The concentration of Applied's customer base increases its risks related to the financial condition of its customers, and the deterioration in financial condition of a single customer or the failure of a single customer to perform its obligations could have a material adverse effect on Applied's results of operations and cash flow. To the extent its customers experience liquidity constraints, Applied may incur additional bad debt expense, which may have a significant impact on its results of operations. Major customers may also seek pricing, payment, intellectual property-related, or other commercial terms that are less favorable to Applied, which may have a negative impact on Applied's business, revenue and gross margins.

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Applied is exposed to risks associated with business combinations, acquisitions and strategic investments.

Applied engages in acquisitions of or investments in companies, technologies or products in existing, related or new markets for Applied. Business combinations, acquisitions and investments involve numerous risks to Applied's business, financial condition and operating results, including but not limited to:

- diversion of management's attention and disruption of ongoing businesses;
- contractual restrictions on the conduct of Applied's business during the pendency of a proposed transaction;
- inability to complete proposed transactions due to the failure to obtain regulatory or other approvals, litigation or other disputes, and any ensuing obligation to pay a termination fee;
- the failure to realize expected returns from acquired businesses;
- requirements imposed by government regulators in connection with their review of a transaction, which may include, among other things, divestitures and restrictions on the conduct of Applied's existing business or the acquired business;
- ineffective integration of operations, systems, technologies, products or employees, which can impact the ability to realize anticipated synergies or other benefits;
- failure to commercialize technologies from acquired businesses or developed through strategic investments;
- dependence on unfamiliar supply chains or relatively small supply partners;
- inability to capitalize on characteristics of new markets that may be significantly different from Applied's existing markets and where competitors may have stronger market positions and customer relationships;
- failure to retain and motivate key employees of acquired businesses;
- the potential impact of the announcement or consummation of a proposed transaction on relationships with third parties;
- potential changes in Applied's credit rating, which could adversely impact the Company's access to and cost of capital;
- reductions in cash balances or increases in debt obligations to finance activities associated with a transaction, which reduce the availability of cash flow for general corporate or other purposes, including share repurchases and dividends;
- exposure to new operational risks, rules, regulations, worker expectations, customs and practices to the extent acquired businesses are located in regions where Applied has not historically conducted business;
- challenges associated with managing new, more diverse and more widespread operations, projects and people;
- inability to obtain and protect intellectual property rights in key technologies;
- inadequacy or ineffectiveness of an acquired company's internal financial controls, disclosure controls and procedures, cybersecurity, privacy policies and procedures, or environmental, health and safety, anti-corruption, human resource, or other policies or practices;
- impairment of acquired intangible assets and goodwill as a result of changing business conditions, technological advancements or worse-than-expected performance of the segment;
- the risk of litigation or claims associated with a proposed or completed transaction;
- unknown, underestimated or undisclosed commitments or liabilities; and
- the inappropriate scale of acquired entities' critical resources or facilities for business needs.

Applied also makes strategic investments in other companies, including companies formed as joint ventures, which may decline in value or not meet desired objectives. The success of these investments depends on various factors over which Applied may have limited or no control and, particularly with respect to joint ventures, requires ongoing and effective cooperation with strategic partners. The risks to Applied's strategic investment portfolio may be exacerbated by unfavorable financial market and macroeconomic conditions and, as a result, the value of the investment portfolio could be negatively impacted and lead to impairment charges.

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Applied's indebtedness and debt covenants could adversely affect its financial condition and business.

Applied has $5.4 billion in aggregate principal amount of senior unsecured notes outstanding. Under the indenture governing the senior unsecured notes, it may be required to offer to repurchase the notes at a price equal to 101% of the principal amount, plus accrued and unpaid interest, upon a change of control of Applied and a contemporaneous downgrade of the notes below investment grade. Applied also has in place a $1.5 billion committed revolving credit agreement. While no amounts were outstanding under this credit agreement as of July 29, 2018, Applied may borrow amounts in the future under the agreement. Applied may also enter into new financing arrangements. Applied's ability to satisfy its debt obligations is dependent upon the results of its business operations and subject to other risks discussed in this section. Significant changes in Applied's credit rating or changes in the interest rate environment could have a material adverse consequence on Applied's access to and cost of capital for future financings, and financial condition. If Applied fails to satisfy its debt obligations, or comply with financial and other debt covenants, it may be in default and any borrowings may become immediately due and payable, and such default may also constitute a default under other of Applied's obligations. There can be no assurance that Applied would have sufficient financial resources or be able to arrange financing to repay any borrowings at such time.

Applied is exposed to risks associated with expanding into new and related markets and industries.

As part of its growth strategy, Applied must successfully expand into related or new markets and industries, either with its existing products or with new products developed internally, or those developed in collaboration with third parties, or obtained through acquisitions. Applied's ability to successfully expand its business into new and related markets and industries may be adversely affected by a number of factors, including:

- the need to devote additional resources to develop new products for, and operate in, new markets;
- the need to develop new sales and technical marketing strategies, cultivate relationships with new customers and meet different customer service requirements;
- differing rates of profitability and growth among multiple businesses;
- Applied's ability to anticipate demand, capitalize on opportunities, and avoid or minimize risks;
- the complexity of managing multiple businesses with variations in production planning, execution, supply chain management and logistics;
- the adoption of new business models, business processes and systems;
- the complexity of entering into and effectively managing strategic alliances or partnering opportunities;
- new materials, processes and technologies;
- the need to attract, motivate and retain employees with skills and expertise in these new areas;
- new and more diverse customers and suppliers, including some with limited operating histories, uncertain or limited funding, evolving business models or locations in regions where Applied does not have, or has limited, operations;
- new or different competitors with potentially more financial or other resources, industry experience and established customer relationships;
- entry into new industries and countries, with differing levels of government involvement, laws and regulations, and business, employment and safety practices;
- third parties' intellectual property rights; and
- the need to comply with, or work to establish, industry standards and practices.

In addition, Applied from time to time receives funding from United States and other government agencies for certain strategic development programs to increase its research and development resources and address new market opportunities. As a condition to this government funding, Applied may be subject to certain record-keeping, audit, intellectual property rights-sharing and/or other obligations.

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Manufacturing interruptions or delays, or the failure to accurately forecast customer demand, could affect Applied's ability to meet customer demand, lead to higher costs, or result in excess or obsolete inventory.

Applied's business depends on its timely supply of equipment, services and related products that meet the rapidly changing technical and volume requirements of its customers, which depends in part on the timely delivery of parts, including components and subassemblies, from suppliers, including contract manufacturers. The inability to timely obtain sufficient quantities of parts can have an adverse impact on Applied's manufacturing operations and ability to meet customer demand for equipment, spares and services. Some key parts are subject to long lead-times or obtainable only from a single supplier or limited group of suppliers, and some sourcing or subassembly is provided by suppliers located in countries other than the countries where Applied conducts its manufacturing. Variable industry conditions and the volatility of demand for manufacturing equipment increase capital, technical, operational and other risks for Applied and for companies throughout its supply chain. These conditions may cause some suppliers to scale back operations, exit businesses, merge with other companies, or file for bankruptcy protection and possibly cease operations. Applied may also experience significant interruptions of its manufacturing operations, delays in its ability to deliver products or services, increased costs or customer order cancellations as a result of:

- the failure or inability to accurately forecast demand and obtain sufficient quantities of quality parts on a cost-effective basis;
- volatility in the availability and cost of materials;
- difficulties or delays in obtaining required import or export approvals;
- shipment delays due to transportation interruptions or capacity constraints;
- information technology or infrastructure failures, including those of a third party supplier or service provider; and
- natural disasters or other events beyond Applied's control (such as earthquakes, floods or storms, regional economic downturns, pandemics, social unrest, political instability, terrorism, or acts of war), particularly where it conducts manufacturing.

If a supplier fails to meet Applied's requirements concerning quality, cost, protection of intellectual property, socially-responsible business practices, or other performance factors, Applied may transfer its business to alternative sources, which could entail manufacturing delays, additional costs, or other difficulties. If Applied is unable to meet its customers' demand for a prolonged period due to its inability to obtain certain parts or components, it could affect its ability to manage its operations, and have an adverse impact on Applied's business, results of operations and customer relationships. In addition, if Applied needs to rapidly increase its business and manufacturing capacity to meet increases in demand or expedited shipment schedules, this may exacerbate any interruptions in Applied's manufacturing operations and supply chain and the associated effect on Applied's working capital. Moreover, if actual demand for Applied's products is different than expected, Applied may purchase more/fewer parts than necessary or incur costs for canceling, postponing or expediting delivery of parts. If Applied purchases inventory in anticipation of customer demand that does not materialize, or if customers reduce or delay orders, Applied may incur excess inventory charges.

The ability to attract, retain and motivate key employees is vital to Applied's success.

Applied's success, competitiveness and ability to execute on its global strategies and maintain a culture of innovation depend in large part on its ability to attract, retain and motivate employees with key skills and experience. Achieving this objective may be difficult due to many factors, including fluctuations in global economic and industry conditions, management changes, Applied's organizational structure, increasing global competition for talent, the availability of qualified employees, cost reduction activities (including workforce reductions and unpaid shutdowns), availability of career development opportunities, the ability to obtain necessary authorizations for workers to provide services outside their home countries, and the attractiveness of Applied's compensation and benefit programs, including its share-based programs. The loss or retirement of employees present particular challenges to the extent they involve the departure of knowledgeable and experienced employees and the resulting need to identify and train existing or new workers to perform necessary functions, which may result in unexpected costs, reduced productivity, and/or difficulties with respect to internal processes and controls.

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Applied is exposed to various risks related to protection and enforcement of intellectual property rights.

Applied’s success depends in significant part on the protection of its patents, trade secrets, copyrights and other intellectual property rights. Infringement of Applied’s rights by a third party, such as the unauthorized manufacture or sale of equipment or spare parts, could result in uncompensated lost market and revenue opportunities for Applied. Policing any unauthorized use of intellectual property is difficult and costly and Applied cannot be certain that the measures it has implemented will prevent misuse. Applied’s ability to enforce its intellectual property rights is subject to litigation risks, as well as uncertainty as to the protection and enforceability of those rights in some countries. If Applied seeks to enforce its intellectual property rights, it may be subject to claims that those rights are invalid or unenforceable, and others may seek counterclaims against Applied, which could have a negative impact on its business. If Applied is unable to enforce and protect intellectual property rights, or if they are circumvented, invalidated, rendered obsolete by the rapid pace of technological change, it could have an adverse impact on its competitive position and business. In addition, changes in intellectual property laws or their interpretation, such as recent changes in U.S. patent laws, may impact Applied’s ability to protect and assert its intellectual property rights, increase costs and uncertainties in the prosecution of patent applications and enforcement or defense of issued patents, and diminish the value of Applied’s intellectual property.

Third parties may also assert claims against Applied and its products. Claims that Applied’s products infringe the rights of others, whether or not meritorious, can be expensive and time-consuming to defend and resolve, and may divert the efforts and attention of management and personnel. The inability to obtain rights to use third party intellectual property on commercially reasonable terms could have an adverse impact on Applied’s business. In addition, Applied may face claims based on the theft or unauthorized use or disclosure of third-party trade secrets and other confidential business information. Any such incidents and claims could severely harm Applied’s business and reputation, result in significant expenses, harm its competitive position, and prevent Applied from selling certain products, all of which could have a significant adverse impact on Applied’s business and results of operations.

Applied is exposed to risks related to cybersecurity threats and incidents.

In the conduct of its business, Applied collects, uses, transmits and stores data on information technology systems, including systems owned and maintained by Applied or third party providers. These data include confidential information and intellectual property belonging to Applied or its customers or other business partners, as well as personally-identifiable information of individuals. All information systems are subject to disruption, breach or failure. Applied has experienced, and expects to continue to be subject to, cybersecurity threats and incidents ranging from employee error or misuse to individual attempts to gain unauthorized access to these information systems, to sophisticated and targeted measures known as advanced persistent threats, none of which have been material to the Company to date. Applied devotes significant resources to network security, data encryption and other measures to protect its systems and data from unauthorized access or misuse. However, depending on their nature and scope, cybersecurity incidents could result in business disruption; the misappropriation of intellectual property, and corruption or loss of confidential information and critical data (Applied’s and that of third parties); reputational damage; litigation with third parties; diminution in the value of Applied’s investment in research, development and engineering; data privacy issues; and increased cybersecurity protection and remediation costs. Compliance with, and changes to, laws and regulations concerning privacy and information security could result in significant expense, and any failure to comply could result in proceedings against Applied by regulatory authorities or other third parties.

Applied is exposed to various risks related to legal proceedings.

Applied from time to time is, and in the future may be involved in legal proceedings or claims regarding patent infringement, intellectual property rights, antitrust, environmental regulations, securities, contracts, product performance, product liability, unfair competition, misappropriation of trade secrets, employment, workplace safety, and other matters. Applied also on occasion receives notification from customers who believe that Applied owes them indemnification or other obligations related to claims made against such customers by third parties.

Legal proceedings and claims, whether with or without merit, and associated internal investigations, may be time-consuming and expensive to prosecute, defend or conduct; divert management’s attention and other Applied resources; inhibit Applied’s ability to sell its products; result in adverse judgments for damages, injunctive relief, penalties and fines; and negatively affect Applied’s business. There can be no assurance regarding the outcome of current or future legal proceedings, claims or investigations.

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The failure to successfully implement enterprise resource planning and other information systems changes could adversely impact Applied's business and results of operations.

Applied periodically implements new or enhanced enterprise resource planning and related information systems in order to better manage its business operations, align its global organizations and enable future growth. Implementation of new business processes and information systems requires the commitment of significant personnel, training and financial resources, and entails risks to Applied's business operations. If Applied does not successfully implement enterprise resource planning and related information systems improvements, or if there are delays or difficulties in implementing these systems, Applied may not realize anticipated productivity improvements or cost efficiencies, and may experience interruptions in service and operational difficulties, such as its ability to track orders, timely manufacture and ship products, project inventory requirements, effectively manage its supply chain and allocate human resources, aggregate financial data and report operating results, and otherwise effectively manage its business, all of which could result in quality issues, reputational harm, lost market and revenue opportunities, and otherwise adversely affect Applied's business, financial condition and results of operations.

Applied may incur impairment charges to goodwill or long-lived assets.

Applied has a significant amount of goodwill and other acquired intangible assets related to acquisitions. 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 more frequently when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The review compares the fair value for each of Applied's reporting units to its associated carrying value, including goodwill. Factors that could lead to impairment of goodwill and intangible assets include adverse industry or economic trends, reduced estimates of future cash flows, declines in the market price of Applied common stock, changes in Applied's strategies or product portfolio, and restructuring activities. Applied's valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. Applied may be required to record future charges to earnings during the period in which an impairment of goodwill or intangible assets is determined to exist.

Applied is exposed to risks associated with operating in jurisdictions with complex and changing tax laws.

Applied is subject to income taxes in the United States and foreign jurisdictions. Significant judgment is required to determine and estimate worldwide tax liabilities. Applied's provision for income taxes and effective tax rates could be affected by numerous factors, including changes in applicable tax laws, interpretations of applicable tax laws, amount and composition of pre-tax income in jurisdictions with differing tax rates, and valuation of deferred tax assets. An increase in Applied's provision for income taxes and effective tax rate could have a material adverse impact on Applied's results of operations and financial condition.

On December 22, 2017, the U.S. government enacted tax legislation referred to as the Tax Cuts and Jobs Act. The U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (SAB 118), which provides guidance on accounting for income tax effects of the Tax Act. SAB 118 provides a measurement period for companies to complete this accounting. Pursuant to SAB 118, provisional adjustments were recorded when reasonable estimates could be determined. No adjustments were recorded when reasonable estimates could not be determined. These provisional estimates will be revised as information becomes available and guidance is issued by the Internal Revenue Service, and changes in Applied's provision for income taxes and effective tax rates could have a material impact on Applied's results of operations and financial condition.

Consistent with the international nature of its business, Applied conducts certain manufacturing, supply chain, and other operations in Asia, bringing these activities closer to customers and reducing operating costs. In certain foreign jurisdictions, conditional reduced income tax rates have been granted to Applied. To obtain the benefit of these tax incentives, Applied must meet requirements relating to various activities. Applied's ability to realize benefits from these incentives could be materially affected if, among other things, applicable requirements are not met or Applied incurs net losses in these jurisdictions.

In addition, Applied is subject to examination by the Internal Revenue Service and other tax authorities, and from time to time amends previously filed tax returns. Applied regularly assesses the likelihood of favorable or unfavorable outcomes resulting from these examinations and amendments to determine the adequacy of its provision for income taxes, which requires estimates and judgments. Although Applied believes its tax estimates are reasonable, there can be no assurance that the tax authorities will agree with such estimates. Applied may have to engage in litigation to achieve the results reflected in the estimates, which may be time-consuming and expensive. There can be no assurance that Applied will be successful or that any final determination will not be materially different from the treatment reflected in Applied's historical income tax provisions and effective tax rates.

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Applied is subject to risks associated with environmental and safety regulations.

Applied is subject to environmental and safety regulations in connection with its global business operations, including but not limited to: regulations related to the development, manufacture and use of its products; handling, discharge, recycling and disposal of hazardous materials used in its products or in producing its products; the operation of its facilities; and the use of its real property. The failure or inability to comply with existing or future environmental and safety regulations could result in: significant remediation or other legal liabilities; the imposition of penalties and fines; restrictions on the development, manufacture, sale or use of certain of its products; limitations on the operation of its facilities or ability to use its real property; and a decrease in the value of its real property. Applied could be required to alter its manufacturing and operations and incur substantial expense in order to comply with environmental and safety regulations. Any failure to comply with environmental and safety regulations could subject Applied to significant costs and liabilities that could adversely affect Applied’s business, financial condition and results of operations.

Applied is exposed to various risks related to the global regulatory environment.

As a public company with global operations, Applied is subject to the laws of the United States and multiple foreign jurisdictions and the rules and regulations of various governing bodies, which may differ among jurisdictions, including those related to financial and other disclosures, corporate governance, intellectual property, tax, trade, antitrust, employment, immigration and travel regulations, privacy, and anti-corruption. Changing, inconsistent or conflicting laws, rules and regulations, and ambiguities in their interpretation and application create uncertainty and challenges, and compliance with laws, rules and regulations may be onerous and expensive, divert management time and attention from revenue-generating activities, and otherwise adversely impact Applied’s business operations. Violations of law, rules and regulations could result in fines, criminal sanctions, restrictions on Applied’s business, and damage to its reputation, and could have an adverse impact on its business operations, financial condition and results of operations.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

The following table provides information as of July 29, 2018 with respect to the shares of common stock repurchased by Applied during the three months ended July 29, 2018.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Aggregate Price Paid	Total Number of Shares Purchased as Part of Publicly Announced Program*	Maximum Dollar Value of Shares That May Yet be Purchased Under the Program*
	(In millions, except per share amounts)				
Month #1 (April 30, 2018 to May 27, 2018)	10.7	$ 51.62	$ 554	10.7	$ 5,774
Month #2 (May 28, 2018 to June 24, 2018)	5.2	$ 50.09	257	5.2	$ 5,517
Month #3 (June 25, 2018 to July 29, 2018)	9.5	$ 46.28	439	9.5	$ 5,078
Total	25.4	$ 49.31	$ 1,250	25.4	

* In September 2017, the Board of Directors approved a common stock repurchase program authorizing up to $3.0 billion in repurchases. In February 2018, the Board of Directors approved a new common stock repurchase program authorizing up to an additional $6.0 billion in repurchases.

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Item 6. Exhibits

Exhibits are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K:

Exhibit No.	Description	Incorporated by Reference Form	File No.	Exhibit No.	Filing Date
10.1	Form of Restricted Stock Unit Agreement for use under the amended and restated Applied Materials, Inc. Employee Stock Incentive Plan†				
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†				
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†				
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002‡				
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002‡				
101.INS	XBRL Instance Document‡				
101.SCH	XBRL Taxonomy Extension Schema Document‡				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document‡				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document‡				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document‡				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document‡				

† Filed herewith.

‡ Furnished herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

APPLIED MATERIALS, INC.

By: /s/ DANIEL J. DURN
Daniel J. Durn
Senior Vice President,
Chief Financial Officer
(Principal Financial Officer)
August 23, 2018

By: /s/ CHARLES W. READ
Charles W. Read
Corporate Vice President,
Corporate Controller
and Chief Accounting Officer
(Principal Accounting Officer)
August 23, 2018