

Applied Materials (AMAT)

\$50.50 (As of 05/06/20)

Price Target (6-12 Months): **\$53.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/29/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: A

Summary

Applied Materials is riding on an uptick in demand for semiconductor equipment and solid execution. It is benefiting from increased customer spending in foundry and logic on the back of rising need for specialty nodes in IoT, communications, automotive and sensor solutions. Further, solid momentum in international markets is a positive. Additionally, strong global roll out of 5G mobile technology is acting as a tailwind. Also, strong momentum in conductor etches is aiding the company to gain traction in DRAM and NAND. It remains positive about price elasticity of NAND, which is expected to bolster NAND customer spending. However, softness in semiconductor and display markets on account of slowdown in memory and display customers' spending is a concern. Notably, the stock has underperformed the industry in the past one year.

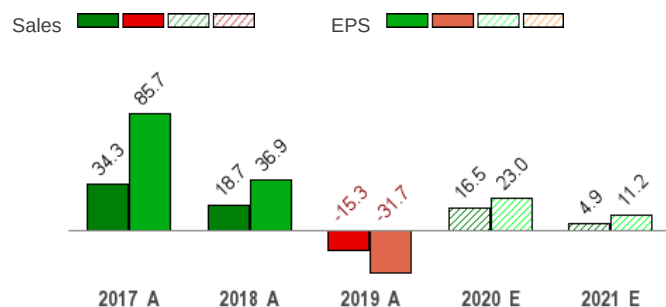
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$69.44 - \$36.64
20 Day Average Volume (sh)	8,386,894
Market Cap	\$46.4 B
YTD Price Change	-17.3%
Beta	1.38
Dividend / Div Yld	\$0.88 / 1.7%
Industry	Semiconductor Equipment - Wafer Fabrication
Zacks Industry Rank	Bottom 36% (161 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	6.5%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-1.4%
Expected Report Date	05/14/2020
Earnings ESP	-1.1%
P/E TTM	15.7
P/E F1	13.5
PEG F1	1.5
P/S TTM	3.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,199 E	4,445 E	4,661 E	4,669 E	17,850 E
2020	4,162 A	4,247 E	4,276 E	4,344 E	17,012 E
2019	3,753 A	3,539 A	3,562 A	3,754 A	14,608 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.91 E	\$1.00 E	\$1.08 E	\$1.09 E	\$4.16 E
2020	\$0.98 A	\$0.92 E	\$1.01 E	\$1.00 E	\$3.74 E
2019	\$0.81 A	\$0.70 A	\$0.74 A	\$0.80 A	\$3.04 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/06/2020. The reports text is as of 05/07/2020.

Overview

Headquartered in Santa Clara, California, Applied Materials is one of the world's largest suppliers of equipment for the fabrication of semiconductor, flat panel liquid crystal displays (LCDs), and solar photovoltaic (PV) cells and modules. The company also offers deployment and support services related to the equipment supplied.

In fiscal year 2019, Applied reported results in three segments—Semiconductor Systems (62% of total 2019 revenue), Applied Global Services (26%) and Display and Adjacent Markets (12%).

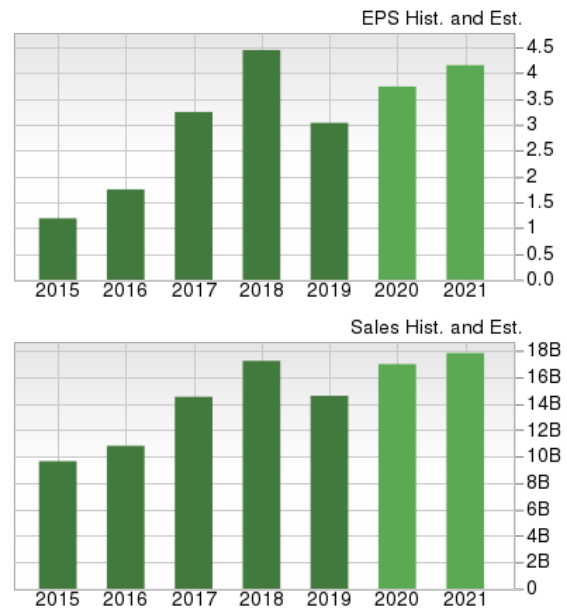
Applied Materials' Silicon segment offers equipment for front-end operations in the semiconductor manufacturing process. Front-end processes involve the deposition or implantation of multiple thin layers of electronically conductive, semiconductive and insulating materials onto and within a silicon wafer with the help of photomasks (reticles) to give multiple copies of integrated circuit devices.

With over 33,000 systems installed, the Applied Global Services segment goes a long way to ensure customer satisfaction and support. There are primarily three kinds of services offered.

Applied has developed technologies for significantly larger-sized wafers made of materials other than silicon. This has helped it expand its portfolio into equipment for thin film transistor (TFT) LCDs (made from glass) and OLED, which are used in smartphones, TVs and other consumer electronic devices. The company operates this business under the Display segment.

The Energy and Environmental Solutions segment primarily consists of the solar product line. Currently, the company offers equipment for manufacturing both wafer-based crystalline silicon (c-Si) and glass-based thin film used in the solar PV cell fabrication process.

Being a leading producer of specialized equipment, most of the competition comes from other large equipment makers, such as KLAC and LRCX.



Reasons To Buy:

▲ The company's **semiconductor business** continues to be on the growth trajectory with significant design wins. Moreover, the company's AI Design Forum bodes well for its strong focus toward development of new computing materials and designs. In fact, the company's leadership businesses comprising Epi, PVD, Implant, CMP and RTP, boast high market share and unique capabilities. The company is quite optimistic as these businesses deliver important technology that will enable customers to drive major innovations in transistor and interconnect for 10-nanometer (nm) devices. Applied Materials is also well positioned in etch and CVD. The company is positive about the increase in foundry spending and some shifts in customer mix. NAND too is gaining, with its increasing application in cloud computing and building on the existing potential in mobile. The industry's transition to 3D NAND is helping the company to further expand the served available market. In order to maintain Moore's Law and further shrink devices, semiconductor companies have had to innovate on not just the process side but also on materials technology, thus expanding the wafer fab equipment. This is naturally a big positive for an equipment supplier such as Applied because it expands the total wafer fab equipment market thus increasing opportunities. Going forward, the company expects to strengthen its position even further in this area. Furthermore, the emergence of data centers will continue to be a major contributor to the company's top-line growth with the growing demand for DRAM by the cloud service providers.

Ongoing strength in the 3D NAND market, demand for new technologies, 10nm logic processes, innovation strategy, strength in foundry and growth in the Chinese market will drive the business.

▲ Applied Materials is a **global leader in semiconductor equipment sales**. The company is the number one equipment supplier to the global semiconductor industry. AMAT has been the industry leader for over twenty years, and is strongly positioned in the industry.

▲ **Market dynamics appear to be improving.** Being an equipment company offering products for front-end applications, Applied is dependent on wafer starts at new and existing semiconductor facilities. Therefore, in an up cycle, the company would be able to sell its superior quality products and maybe pick up some market share. Through the rest of the cycle however, market share gains if any would be slow. Considering this backdrop and the fab build rate, the company may see a gradual improvement going forward.

The company has been gaining considerable success in **expanding beyond semiconductors**. The company is in a very good position to take advantage of the transition from LCD to OLED technology. Rapid growth in large-format TVs has opened up opportunities to invest in new Gen 10.5 capacity and Applied Materials is currently tracking seven Gen 10.5 projects. Applied is well positioned to take advantage of growth in mobile. Demand for bigger, higher resolution and low-power screens for mobiles will primarily drive the Display segment. The company sees significant opportunities from emerging trends on the semiconductor and display fronts such as artificial intelligence, big data, cloud infrastructure, Internet of Things (IoT), virtual reality and smart vehicles. Further, rising demand for mobile OLEDs and large screen televisions are creating significant growth opportunities for the company. Applied's expanding product line is partly responsible for the increased total available market (TAM), which will spur growth in the following quarters. Continued price declines should also help sales. Since emerging markets are expected to account for most of the growth, we may expect continued demand for the company's equipment, which could improve the efficiency of the manufacturing process.

Even though the current global economic risks prevail, **spending in China is expected to increase**. The company remains strongly positioned in China where it continues to see strong growth in semiconductor and display. Growing investments from Chinese domestic manufacturers have been the main catalysts. The company is witnessing growth in revenues and orders, both from local manufacturers as well as multinational customers who are expanding their footprint. Applied Materials is well positioned to benefit from this as it was the first in the industry to establish a presence in China more than 30 years ago. It therefore has strong customer relationships and the requisite talent to support the new projects.

Reasons To Sell:

- ▼ Capital equipment sales are typically high-value and AMAT is dependent on a relatively **few high-value product sales to a limited customer base**. Therefore, winning each individual order is very important. Moreover, the company also has to adopt an extremely customer-centric approach, maintaining very good relations with each individual customer. Losing a sale or a customer would have a significant impact on results. In difficult times, the company might also have to write off receivables to accommodate customers, as it has done in the past.
- ▼ The company has a **high fixed cost structure**. Therefore, margins suffer a lot when sales fall. On the other hand, the structure is necessary to support an increase in demand. Additionally, Applied Materials has to spend a considerable amount of money on R&D to maintain its edge in innovation and recover margins that are high enough to continue this spend.
- ▼ Applied Materials' balance sheet **remains leveraged**. As of Jan 31, 2020, the company's net debt amounted to \$1.4 billion compared with \$1.7 billion reported in the previous quarter. However, the company had a current debt of only \$600 million at the end of Jan 31, 2020, which should not be a matter of concern. Also, the debt to total capital was 35.25% (less than the industry average of 36.5%) as of Jan 31, 2020, which is reasonable. Moreover, management boosts shareholder value through regular share repurchases and dividends. The company has a consistently growing dividend stream. The dividend yield of the company is currently 1.77%.

Applied's high fixed cost structure, customer concentration, slowing smartphone market, weak chip demand, uncertain global economy and exposure to unpredictable industrial changes are concerns.

Growth depends on the company's ability to innovate. Applied Materials is **vulnerable to intense competition and changing technology, commercialization methods, industry standards and seller and buyer needs**. These call for frequent changes in product and service offerings, which in turn require heavy investments, putting pressure on its earning capacity.

Last Earnings Report

Applied Materials Q1 Earnings & Sales Top Estimates

Applied Materials Inc. reported fiscal first-quarter 2020 non-GAAP earnings of 98 cents per share, which beat the Zacks Consensus Estimate by 6 cents. Moreover, the figure improved 22.5% sequentially and 21% year over year.

Net sales of \$4.16 billion surpassed the Zacks Consensus Estimate of \$4.12 billion. In addition, the figure improved 10.9% from the prior quarter and 10.9% from the year-ago period.

The company witnessed solid momentum in key geographies, namely Taiwan and China. Additionally, strong global roll out of 5G mobile technology led to higher demand for semiconductor equipment, which drove fiscal first-quarter results.

Let's delve deeper into the numbers.

Segments in Detail

The Semiconductor Systems Group generated \$2.8 billion sales in the reported quarter (contributing 68% to its net sales), reflecting an increase of 24.1% year over year.

Applied Global Services reported sales of \$997 million (24% of net sales), which increased 3.6% from the prior-year quarter.

Sales from the Display and Adjacent Markets came in at \$332 million (8% of net sales), down 34.5% from the year-ago level.

Revenues by Geography

United States, Europe, Japan, Korea, Taiwan, Southeast Asia and China generated sales of \$441 million, \$153 million, \$351 million, \$508 million, \$1.36 billion, \$72 million and \$1.27 billion, contributing 10%, 4%, 8%, 12%, 33%, 2% and 31% to net sales, respectively.

On a year-over-year basis, we note that sales in all the countries declined except Taiwan and China, which witnessed growth of 108.1% and 31.4%, respectively.

Operating Results

Non-GAAP gross margin was 44.9%, expanding 30 basis points (bps) from the year-ago quarter.

Operating expenses were \$816 million, 7.8% higher than the year-ago quarter. As a percentage of sales, research, development and engineering, and marketing and selling expenses decreased, while general and administrative costs increased.

Non-GAAP operating margin of 25.7% in the reported quarter expanded 110 bps from the prior-year period.

Balance Sheet & Cash Flow

At the end of the fiscal first quarter, cash and cash equivalent balance was \$3.42 billion compared with \$3.13 billion at the end of fiscal fourth quarter.

Inventories were \$3.47 billion, flat with the prior quarter. Accounts receivables increased to \$2.68 billion from \$2.53 billion in the fiscal fourth quarter.

The company returned \$200 million and \$192 million through stock repurchases and cash dividends, respectively.

Notably, Applied Materials generated cash flow of \$987 million, up from \$826 million in the fiscal fourth quarter.

Guidance

For second-quarter fiscal 2020, Applied Materials expects net sales to be \$4.34 (+/- \$200 million). The Zacks Consensus Estimate for the same is pegged at \$4.19 billion.

Non-GAAP EPS is expected in the range of 98 cents to \$1.10. The corresponding Zacks Consensus Estimate is pegged at 96 cents per share.

Bottom Line

Management believes that demand for foundry logic is expected to remain strong in the near term, thanks to rising need for specialty nodes in automotive, power, 5G rollout, IoT, communications and image sensor markets.

Also, ongoing inventory correction in DRAM is a tailwind for the near term. The company expects more clients to upgrade their equipment ahead of the 5G rollout in key markets, which will help it expand top-line growth.

The company's expanding etch footprint bodes well for the semiconductor portfolio. Moreover, its strengthening momentum in conductor etch is aiding it to gain traction in DRAM and NAND. Additionally, the company remains confident about its relentless focus on research and development activities to develop new products.

Quarter Ending **01/2020**

Report Date	Feb 12, 2020
Sales Surprise	1.01%
EPS Surprise	6.52%
Quarterly EPS	0.98
Annual EPS (TTM)	3.22

Recent News

On **Dec 5, 2020**, Applied Materials' Board of Directors approved a quarterly dividend of 21 cents per share for the shareholders of the record as of Feb 19, 2020 which will be paid on Mar 11, 2020.

Valuation

Applied Materials shares are down 17.3% in the year-to-date period but up 21.4% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 9.7% and 2.7% in the Zacks Computer & Technology sector in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is up 32.6% and the sector is up 8.3%

The S&P 500 index is down 10.9% in the year-to-date period and 0.6% in the past year.

The stock is currently trading at 12.83X forward 12-month earnings, which compares to 20.69X for the Zacks sub-industry, 22.82X for the Zacks sector and 20.63X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.56X and as low as 7.38X, with a 5-year median of 13.44X. Our Neutral recommendation indicates that the stock will perform inline with the market. Our \$53 price target reflects 13.6X forward 12-month earnings.

The table below shows summary valuation data for AMAT

Valuation Multiples - AMAT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	12.83	20.69	22.82	20.63
	5-Year High	18.56	22.46	22.82	20.63
	5-Year Low	7.38	12.36	16.71	15.19
	5-Year Median	13.44	17.19	19.23	17.44
P/S F12M	Current	2.88	6.13	3.35	3.21
	5-Year High	4.14	6.45	3.59	3.44
	5-Year Low	1.69	3.63	2.32	2.54
	5-Year Median	2.67	4.83	3.09	3.01
EV/EBITDA TTM	Current	12.73	25.1	10.89	10.45
	5-Year High	15.71	30.6	12.85	12.87
	5-Year Low	4.6	9.4	7.56	8.27
	5-Year Median	10.9	19.76	10.62	10.78

As of 05/06/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (161 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Analog Devices Inc (ADI)	Neutral	3
Advanced Energy Industries Inc (AEIS)	Neutral	4
Amkor Technology Inc (AMKR)	Neutral	3
ASML Holding NV (ASML)	Neutral	3
KLA Corporation (KLAC)	Neutral	3
Lam Research Corporation (LRCX)	Neutral	3
TE Connectivity Ltd (TEL)	Neutral	3
Veeco Instruments Inc (VECO)	Neutral	3

Industry Comparison Industry: Semiconductor Equipment - Wafer Fabrication				Industry Peers		
	AMAT	X Industry	S&P 500	ASML	KLAC	LRCX
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	F	A	B
Market Cap	46.37 B	40.94 B	19.11 B	122.54 B	25.68 B	35.50 B
# of Analysts	10	6	14	3	7	9
Dividend Yield	1.66%	1.26%	2.2%	0.85%	2.08%	1.88%
Value Score	B	-	-	F	C	B
Cash/Price	0.09	0.13	0.06	0.04	0.07	0.16
EV/EBITDA	12.18	18.28	11.69	33.70	16.59	12.72
PEG Ratio	1.52	1.24	2.48	1.76	1.47	1.24
Price/Book (P/B)	5.36	6.58	2.58	8.87	11.05	7.80
Price/Cash Flow (P/CF)	14.41	17.05	10.40	35.98	16.71	13.87
P/E (F1)	13.71	20.76	18.81	40.02	16.80	15.89
Price/Sales (P/S)	3.09	3.39	1.97	9.17	4.58	3.69
Earnings Yield	7.41%	5.10%	4.99%	2.50%	5.95%	6.29%
Debt/Equity	0.54	0.50	0.75	0.31	1.48	1.11
Cash Flow (\$/share)	3.51	5.81	7.01	8.11	9.80	17.63
Growth Score	C	-	-	F	B	C
Hist. EPS Growth (3-5 yrs)	35.63%	26.99%	10.87%	22.72%	29.49%	31.25%
Proj. EPS Growth (F1/F0)	23.13%	6.69%	-9.86%	5.85%	15.26%	5.77%
Curr. Cash Flow Growth	-35.58%	-30.45%	5.88%	-4.32%	18.14%	-25.33%
Hist. Cash Flow Growth (3-5 yrs)	13.90%	14.24%	8.55%	14.58%	18.07%	23.38%
Current Ratio	2.36	2.78	1.25	2.72	2.61	4.47
Debt/Capital	35.25%	33.44%	44.23%	23.60%	59.70%	52.58%
Net Margin	18.83%	20.32%	10.87%	21.83%	18.26%	21.81%
Return on Equity	36.15%	28.82%	16.36%	21.49%	57.76%	47.79%
Sales/Assets	0.79	0.74	0.55	0.55	0.62	0.78
Proj. Sales Growth (F1/F0)	16.45%	10.08%	-2.18%	0.98%	26.02%	3.71%
Momentum Score	A	-	-	A	A	A
Daily Price Chg	3.38%	2.30%	-1.27%	1.23%	5.26%	0.72%
1 Week Price Chg	-9.37%	-6.88%	0.53%	-4.38%	-8.88%	-11.87%
4 Week Price Chg	-1.87%	1.46%	0.68%	4.78%	7.51%	-8.32%
12 Week Price Chg	-22.75%	-22.97%	-22.30%	-8.05%	-6.91%	-26.91%
52 Week Price Chg	21.45%	21.96%	-11.55%	44.91%	43.00%	22.46%
20 Day Average Volume	8,386,894	1,564,889	2,470,143	804,590	1,337,944	2,325,188
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.14%	0.16%	0.00%
(F1) EPS Est 4 week change	-1.40%	-0.90%	-6.52%	0.64%	-1.29%	-0.41%
(F1) EPS Est 12 week change	-1.66%	-12.57%	-14.84%	-16.62%	-4.40%	-8.53%
(Q1) EPS Est Mthly Chg	-1.78%	-4.84%	-12.48%	46.51%	-1.71%	-9.33%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	C
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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