

## Applied Materials (AMAT)

**\$62.85** (As of 01/20/20)

Price Target (6-12 Months): **\$66.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 01/17/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:C

Value: C

Growth: D

Momentum: A

## Summary

Applied Materials is riding on an uptick in demand for semiconductor equipment. Further, increased customer spending in foundry and logic on the back of rising need for specialty nodes in IoT, communications, automotive and sensor solutions remains a positive. Strong momentum in conductor etches is benefiting the company's position in DRAM and NAND. It remains positive about price elasticity of NAND, which is expected to bolster NAND customer spending. Estimates have been stable lately ahead of the company's Q1 earnings release. The company has positive record of earnings surprises in recent quarters. However, market uncertainties continue to persist. Softness in semiconductor and display markets on account of slowdown in memory and display customers' spending is a concern. The stock has underperformed the industry over a year.

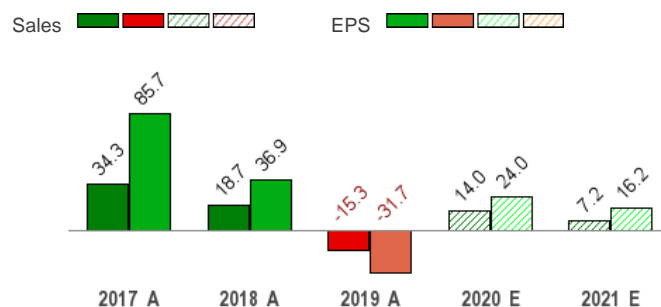
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	\$63.81 - \$33.71
20 Day Average Volume (sh)	5,192,201
Market Cap	\$57.5 B
YTD Price Change	3.0%
Beta	1.66
Dividend / Div Yld	\$0.84 / 1.3%
Industry	<a href="#">Semiconductor Equipment - Wafer Fabrication</a>
Zacks Industry Rank	Top 8% (20 out of 254)

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.3%
Last Sales Surprise	1.9%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/13/2020
Earnings ESP	0.0%
P/E TTM	20.6
P/E F1	16.7
PEG F1	1.9
P/S TTM	3.9

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,212 E	4,413 E	4,588 E	4,469 E	17,857 E
2020	4,100 E	4,136 E	4,160 E	4,262 E	16,650 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	\$1.01 E	\$1.08 E	\$1.15 E	\$1.12 E	\$4.38 E
2020	\$0.92 E	\$0.94 E	\$0.95 E	\$1.00 E	\$3.77 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 01/20/2020. The reports text is as of 01/21/2020.

## 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%).

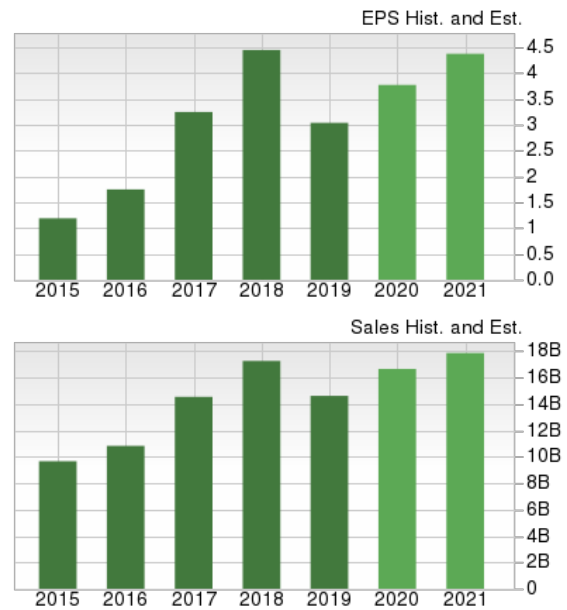
Applied Materials' Silicon segment offers equipment for front-end operations in the semiconductor manufacturing process. Front-end processes involve the deposition or implantation of multiple thin layers of electronically conductive, semiconductive and insulating materials onto and within a silicon wafer 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.



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## 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.
- ▲ 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.

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.

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## 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.
- ▼ 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.

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.

## Last Earnings Report

### Applied Materials Q4 Earnings & Sales Top Estimates

Quarter Ending **10/2019**

Applied Materials Inc. reported fiscal fourth-quarter 2019 non-GAAP earnings of 80 cents per share, which beat the Zacks Consensus Estimate by 4 cents and improved 8.1% sequentially. However, the figure declined 5.9% year over year.

Net sales of \$3.75 billion surpassed the Zacks Consensus Estimate by 1.9% and were within management's guided range of \$3.535-\$3.835 billion. The figure improved 5.3% from the fiscal third quarter but marginally decreased 0.1% from the year-ago period.

The company witnessed solid momentum in key geographies namely United States, China and Taiwan. Additionally, strong investments by foundry logic customers and acceleration of the 5G roadmap drove fiscal fourth-quarter results.

Following strong fiscal fourth-quarter results, its shares were up 4% in after-hours trading. Encouragingly, the company provided strong guidance for first-quarter fiscal 2020.

**Let's delve deeper into the numbers.**

### Segments in Detail

The Semiconductor Systems Group generated \$2.3 billion sales in the reported quarter (contributing 61% to its net sales), reflecting an increase of 2.5% year over year.

Applied Global Services reported sales of \$977 million (26% of net sales), which increased 0.1% from the prior-year quarter.

Sales from the Display and Adjacent Markets came in at \$457 million (13% of net sales), down 12.1% from the year-ago level.

### Revenues by Geography

United States, Europe, Japan, Korea, Taiwan, Southeast Asia and China generated sales of \$412 million, \$147 million, \$471 million, \$471 million, \$919 million, \$135 million and \$1.20 billion, contributing 11%, 4%, 13%, 13%, 24%, 3% and 32% to net sales, respectively.

We note that sales in United States, Taiwan and China were up 17.7%, 55.5% and 5.5% year over year, respectively. However, Applied Materials' sales in Europe, Japan, Korea and Southeast Asia declined 39%, 33.8%, 11.5% and 31.5%, respectively.

### Operating Results

Non-GAAP gross margin was 43.8%, contracting 150 basis points (bps) from the year-ago quarter.

Applied Materials' adjusted operating expenses, as a percentage of net sales, contracted 10 bps on a year-over-year basis to 20.5%.

Further, non-GAAP operating margin of 23.7% in the reported quarter contracted 140 bps from the prior-year quarter.

### Balance Sheet & Cash Flow

At the end of the fiscal fourth quarter, cash and cash equivalent balance was \$3.13 billion compared with \$3.01 billion at the end of fiscal third quarter.

Inventories were \$3.47 billion compared with \$3.54 billion in the fiscal third quarter. Accounts receivables increased to \$2.53 billion from \$2.37 billion in the fiscal third quarter.

The company returned \$500 million and \$194 million through stock repurchases and cash dividends, respectively.

Notably, Applied Materials generated cash flow of \$826 million, up from \$787 million in the fiscal third quarter.

### Guidance

For first-quarter fiscal 2020, Applied Materials expects net sales to be approximately \$4.10 (+/- \$150 million).

Non-GAAP EPS is expected in the range of 87-95 cents.

### Bottom Line

Management remains optimistic about the price elasticity of NAND, which is expected to bolster NAND customer spending in the near term. The demand for foundry logic is improving, thanks to rising need for specialty nodes in automotive, power, 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 to 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.

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## 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.

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## Valuation

Applied Materials shares are up 23.8% in the six-month period and 82.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 32.7% and 16.5% in the six-month period, respectively. Over the past year, the Zacks sub-industry is up 95% and the sector is up 35.3%.

The S&P 500 index is up 12.2% in the six-month period and 25.6% in the past year.

The stock is currently trading at 16.08X forward 12-month earnings, which compares to 22.76X for the Zacks sub-industry, 23.12X for the Zacks sector and 19.19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.19X and as low as 7.38X, with a 5-year median of 13.58X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$66 price target reflects 16.88X 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	16.08	22.76	23.12	19.19
	5-Year High	19.19	22.76	23.12	19.34
	5-Year Low	7.38	12.36	16.87	15.17
	5-Year Median	13.58	17.24	19.24	17.44
P/S F12M	Current	3.4	6.86	3.74	3.57
	5-Year High	4.14	6.86	3.74	3.57
	5-Year Low	1.69	3.63	2.3	2.54
	5-Year Median	2.69	4.8	3.01	3
EV/EBITDA TTM	Current	15.39	28.73	12.71	12.38
	5-Year High	15.39	28.73	12.71	12.86
	5-Year Low	4.8	9.68	7.68	8.48
	5-Year Median	10.98	19.7	10.52	10.67

As of 01/17/2020

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## Industry Analysis Zacks Industry Rank: Top 8% (20 out of 254)



## Top Peers

Advanced Energy Industries, Inc. (AEIS)	Outperform
ASML Holding N.V. (ASML)	Neutral
Lam Research Corporation (LRCX)	Neutral

Industry Comparison Industry: Semiconductor Equipment - Wafer Fabrication				Industry Peers		
	AMAT Neutral	X Industry	S&P 500	ASML Neutral	KLAC Neutral	LRCX Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>D</b>	<b>C</b>	<b>D</b>
Market Cap	57.53 B	51.11 B	24.65 B	126.36 B	28.20 B	44.68 B
# of Analysts	10	7	13	3	6	9
Dividend Yield	1.34%	1.00%	1.73%	0.66%	1.90%	1.49%
<b>Value Score</b>	<b>C</b>	-	-	<b>D</b>	<b>D</b>	<b>C</b>
Cash/Price	0.06	0.10	0.04	0.02	0.06	0.13
EV/EBITDA	15.15	15.60	14.11	31.89	17.91	15.52
PEG Ratio	1.87	2.03	2.08	2.31	1.53	1.49
Price/Book (P/B)	7.07	8.02	3.39	9.41	10.52	8.97
Price/Cash Flow (P/CF)	17.93	17.70	13.81	35.51	18.23	17.47
P/E (F1)	16.84	21.28	19.19	32.00	18.09	20.26
Price/Sales (P/S)	3.94	4.70	2.69	10.20	5.77	4.71
Earnings Yield	6.00%	4.71%	5.21%	3.13%	5.53%	4.94%
Debt/Equity	0.57	0.61	0.72	0.26	1.18	0.76
Cash Flow (\$/share)	3.51	6.53	6.94	8.45	9.80	17.63
<b>Growth Score</b>	<b>D</b>	-	-	<b>F</b>	<b>C</b>	<b>D</b>
Hist. EPS Growth (3-5 yrs)	39.24%	29.14%	10.56%	21.26%	30.74%	37.02%
Proj. EPS Growth (F1/F0)	24.14%	30.92%	7.57%	36.09%	16.76%	4.48%
Curr. Cash Flow Growth	-35.58%	-13.09%	14.73%	19.24%	18.14%	-25.33%
Hist. Cash Flow Growth (3-5 yrs)	13.90%	18.35%	9.00%	16.21%	18.07%	23.38%
Current Ratio	2.30	2.60	1.24	2.72	2.24	3.59
Debt/Capital	36.46%	37.70%	42.99%	20.80%	54.22%	43.21%
Net Margin	18.52%	20.34%	11.14%	22.15%	23.03%	22.38%
Return on Equity	35.13%	27.78%	17.16%	20.42%	54.53%	43.11%
Sales/Assets	0.77	0.68	0.55	0.54	0.59	0.79
Proj. Sales Growth (F1/F0)	13.98%	13.26%	4.16%	12.54%	24.97%	2.48%
<b>Momentum Score</b>	<b>A</b>	-	-	<b>A</b>	<b>A</b>	<b>C</b>
Daily Price Chg	-0.57%	-0.29%	0.27%	-0.35%	-1.21%	0.67%
1 Week Price Chg	0.42%	-0.36%	0.39%	-0.59%	-3.39%	-0.12%
4 Week Price Chg	3.59%	4.30%	2.95%	2.82%	1.86%	5.02%
12 Week Price Chg	14.13%	15.05%	7.76%	13.24%	5.92%	15.96%
52 Week Price Chg	81.96%	86.21%	22.29%	90.45%	92.35%	117.27%
20 Day Average Volume	5,192,201	793,746	1,536,375	416,391	881,107	1,171,100
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.13%	0.00%	0.43%	0.00%	0.00%
(F1) EPS Est 12 week change	14.71%	7.53%	-0.40%	1.74%	3.96%	12.36%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-0.04%

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## 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.

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### 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	C
Growth Score	D
Momentum Score	A
VGM Score	C

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.

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