APPLIED MATERIALS INC /DE
Form 10-Q
March 09, 2010

**Table of Contents**

**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 January 31, 2010**

**or**

o **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**<br>*(State or other jurisdiction of incorporation or organization)* | **94-1655526**<br>*(I.R.S. Employer Identification No.)* |
| **3050 Bowers Avenue,**<br>**P.O. Box 58039**<br>**Santa Clara, California**<br>*(Address of principal executive offices)* | **95052-8039**<br>*(Zip Code)* |

**(Registrant s telephone number, including area code)**
**(408) 727-5555**

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 o

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

Number of shares outstanding of the issuer s common stock as of January 31, 2010: 1,343,270,238

**TABLE OF CONTENTS**

Table of Contents

## PART I. FINANCIAL INFORMATION

**Item 1.** ***Financial Statements***

### APPLIED MATERIALS, INC.

### CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

| | Three Months Ended January 31, 2010 | Three Months Ended January 25, 2009 |
|---|---|---|
| | (Unaudited) (In thousands, except per share amounts) | |
| Net sales | $ 1,848,902 | $ 1,333,396 |
| Cost of products sold | 1,137,718 | 941,820 |
| Gross margin | 711,184 | 391,576 |
| Operating expenses: | | |
| Research, development and engineering | 269,003 | 229,540 |
| General and administrative | 124,799 | 141,241 |
| Marketing and selling | 97,195 | 84,115 |
| Restructuring and asset impairments | 103,844 | 132,772 |
| Income (loss) from operations | 116,343 | (196,092) |
| Pretax loss of equity-method investment | | 15,808 |
| Impairment of investments | 1,190 | |
| Interest expense | 5,060 | 5,994 |
| Interest income | 8,641 | 15,235 |
| Income (loss) before income taxes | 118,734 | (202,659) |
| Provision (benefit) for income taxes | 35,983 | (69,725) |
| Net income (loss) | $ 82,751 | $ (132,934) |
| Earnings (loss) per share: | | |
| Basic | $ 0.06 | $ (0.10) |
| Diluted | $ 0.06 | $ (0.10) |
| Weighted average number of shares: | | |
| Basic | 1,341,941 | 1,329,223 |
| Diluted | 1,349,567 | 1,329,223 |

See accompanying Notes to Consolidated Condensed Financial Statements.

Table of Contents

**APPLIED MATERIALS, INC.**

**CONSOLIDATED CONDENSED BALANCE SHEETS***

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In thousands) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,399,054 | $ 1,576,381 |
| Short-term investments | 755,122 | 638,349 |
| Accounts receivable, net | 1,267,409 | 1,041,495 |
| Inventories | 1,664,269 | 1,627,457 |
| Deferred income taxes, net | 417,986 | 356,336 |
| Income taxes receivable | 102,711 | 184,760 |
| Other current assets | 242,712 | 264,169 |
| Total current assets | 5,849,263 | 5,688,947 |
| Long-term investments | 1,046,116 | 1,052,165 |
| Property, plant and equipment | 2,964,028 | 2,906,957 |
| Less: accumulated depreciation and amortization | (1,835,359) | (1,816,524) |
| Net property, plant and equipment | 1,128,669 | 1,090,433 |
| Goodwill, net | 1,336,426 | 1,170,932 |
| Purchased technology and other intangible assets, net | 374,000 | 306,416 |
| Deferred income taxes and other assets | 269,364 | 265,350 |
| Total assets | $ 10,003,838 | $ 9,574,243 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 2,400 | $ 1,240 |
| Accounts payable and accrued expenses | 1,252,031 | 1,061,502 |
| Customer deposits and deferred revenue | 993,357 | 864,280 |
| Income taxes payable | 30,160 | 12,435 |
| Total current liabilities | 2,277,948 | 1,939,457 |
| Long-term debt | 210,547 | 200,654 |
| Other liabilities | 367,200 | 339,524 |
| Total liabilities | 2,855,695 | 2,479,635 |
| Stockholders equity: | | |
| Common stock | 13,433 | 13,409 |
| Additional paid-in capital | 5,245,634 | 5,195,437 |

| | | |
|---|---|---|
| Retained earnings | 10,936,149 | 10,934,004 |
| Treasury stock | (9,046,562) | (9,046,562) |
| Accumulated other comprehensive loss | (511) | (1,680) |
| Total stockholders equity | 7,148,143 | 7,094,608 |
| Total liabilities and stockholders equity | $ 10,003,838 | $ 9,574,243 |

* Amounts as of January 31, 2010 are unaudited. Amounts as of October 25, 2009 are derived from the October 25, 2009 audited consolidated financial statements.

See accompanying Notes to Consolidated Condensed Financial Statements.

Table of Contents

## APPLIED MATERIALS, INC.

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

| | Three Months Ended January 31, 2010 | Three Months Ended January 25, 2009 |
|---|---|---|
| | (Unaudited) (In thousands) | |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 82,751 | $ (132,934) |
| Adjustments required to reconcile net income (loss) to cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 76,412 | 71,228 |
| Loss on fixed asset retirements | 3,435 | 3,447 |
| Provision for bad debts | 6,000 | 47,526 |
| Restructuring and asset impairments | 103,844 | 132,772 |
| Deferred income taxes | (43,636) | (13,054) |
| Net recognized loss on investments | 5,185 | 5,398 |
| Pretax loss of equity-method investment | | 15,808 |
| Impairment of investments | 1,190 | |
| Equity-based compensation | 33,689 | 33,608 |
| Changes in operating assets and liabilities, net of amounts acquired: | | |
| Accounts receivable | (193,953) | 368,648 |
| Inventories | 25,026 | (144,075) |
| Other current assets | 23,260 | 10,890 |
| Other assets | (9,525) | 1,311 |
| Accounts payable and accrued expenses | 42,290 | (353,672) |
| Customer deposits and deferred revenue | 123,218 | (164,701) |
| Income taxes | 99,864 | (94,337) |
| Other liabilities | (7,177) | 26,920 |
| Cash provided by (used in) operating activities | 371,873 | (185,217) |
| Cash flows from investing activities: | | |
| Capital expenditures | (53,167) | (73,318) |
| Cash paid for acquisition, net of cash acquired | (322,599) | |
| Proceeds from sales and maturities of investments | 183,881 | 541,689 |
| Purchases of investments | (297,683) | (227,348) |
| Cash provided by (used in) investing activities | (489,568) | 241,023 |
| Cash flows from financing activities: | | |
| Debt borrowings | 977 | 510 |
| Proceeds from common stock issuances | 19,855 | 182 |
| Common stock repurchases | | (22,906) |

| | | |
|---|---|---|
| Payment of dividends to stockholders | (80,464) | (79,762) |
| Cash used in financing activities | (59,632) | (101,976) |
| Effect of exchange rate changes on cash and cash equivalents | | 742 |
| Decrease in cash and cash equivalents | (177,327) | (45,428) |
| Cash and cash equivalents beginning of period | 1,576,381 | 1,411,624 |
| Cash and cash equivalents end of period | $ 1,399,054 | $ 1,366,196 |
| Supplemental cash flow information: | | |
| Cash payments (refunds) for income taxes | $ (32,791) | $ 12,064 |
| Cash payments for interest | $ 42 | $ 42 |

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 25, 2009 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 25, 2009 (2009 Form 10-K). Applied s results of operations for the three months ended January 31, 2010 are not necessarily indicative of future operating results.

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.

Applied s fiscal year ends on the last Sunday in October of each year. Fiscal 2010 contains 53 weeks, while fiscal 2009 contained 52 weeks, and the first fiscal quarter of 2010 contained 14 weeks, while the first fiscal quarter of 2009 contained 13 weeks.

***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, Applied recognizes revenue upon shipment 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, revenue is recognized when legal title passes to the customer, which is generally at customer technical acceptance; (4*)* for arrangements initiated prior to fiscal 2010 containing multiple elements, the revenue relating to the undelivered elements is deferred at their estimated relative fair values until delivery of the deferred elements; and (5) for arrangements initiated or materially modified during fiscal 2010 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. The completed contract method is used for SunFab$^{tm}$ thin film lines. Certain SunFab thin film contracts have provisions for additional amounts to become due to Applied if the line achieves certain output criteria subsequent to factory acceptance. Any additional amounts earned under these contracts are recognized upon achievement. Spare parts revenue is generally recognized upon shipment, and services revenue is generally recognized over the period that the services are provided.

In fiscal 2010, Applied elected to early adopt amended accounting standards issued by the Financial Accounting Standards Board (FASB) for multiple deliverable revenue arrangements on a prospective basis for

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

applicable transactions originating or materially modified after October 25, 2009. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The FASB also amended the accounting standards for revenue recognition to exclude software that is contained in a tangible product from the scope of software revenue guidance if the software is essential to the tangible product s functionality. Implementation of this new authoritative guidance had an insignificant impact on reported net sales as compared to net sales under previous guidance, as the new guidance did not change the units of accounting within sales arrangements and the elimination of the residual method for the allocation of arrangement consideration had an inconsequential impact on the amount and timing of reported net sales. Accordingly, Applied does not believe that the effect of adopting these standards will have a material impact on future financial periods.

For fiscal 2010 and future periods, 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, as amended.

***Business Combinations***

Effective in fiscal 2010, Applied adopted revised authoritative guidance on business combinations that covers the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition-related transaction costs, and the recognition of changes in the acquirer s income tax valuation allowance. This authoritative guidance also revised the accounting for both increases and decreases in a parent s controlling ownership interest.

***Equity-Based Compensation***

Applied has adopted stock plans that permit grants to employees of equity-based awards, including stock options, restricted stock and restricted stock units (also referred to as performance shares under the Applied Materials, Inc. Employee Stock Incentive Plan). In addition, the Employee Stock Incentive Plan provides for the automatic grant of restricted stock units to non-employee directors and permits the grant of equity-based awards to consultants. Applied also has two Employee Stock Purchase Plans, one for United States employees and a second for international employees (collectively, ESPP), which enable eligible employees to purchase Applied common stock.

During each of the three months ended January 31, 2010 and January 25, 2009, Applied recognized total equity-based compensation expense related to stock options, ESPP shares, restricted stock units and restricted stock of $34 million. The equity-based compensation expense related to restricted stock units and restricted stock for the three months ended January 31, 2010 and January 25, 2009 was $25 million and $32 million, respectively. During each of the three months ended January 31, 2010 and January 25, 2009, Applied recognized income tax benefits related to equity-based compensation of $9 million. The cost associated with Applied s stock options and restricted stock units, less expected forfeitures, is recognized over the awards service period for the entire award on a straight-

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

line basis. The cost associated with Applied s performance-based equity awards is recognized over the service period for each tranche.

*Stock Options*

The exercise price of each stock option equals the fair market value of Applied common stock on the date of grant. Most options are scheduled to vest over four years and expire no later than seven years from the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. Applied s employee stock options have characteristics significantly different from those of publicly traded options.

There were no stock options granted in the three months ended January 31, 2010 or January 25, 2009.

*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 at the end of each 6-month purchase period. No shares were issued under the ESPP during the three months ended January 31, 2010 or January 25, 2009. Compensation expense associated with the ESPP is calculated using the fair value of the employees purchase rights under the Black-Scholes model.

*Restricted Stock Units and Restricted Stock*

Restricted stock units are converted into shares of Applied common stock upon vesting on a one-for-one basis. Restricted stock units typically vest over three to four years. Vesting of restricted stock units usually is subject to the grantee s continued service with Applied. The compensation expense related to these awards is determined using the fair market value of Applied common stock on the date of the grant, and the compensation expense is recognized over the vesting period. Restricted stock has the same rights of other issued and outstanding shares of Applied common stock except these shares have no rights to dividends and are held in escrow until the grantee s performance goals are achieved. At January 31, 2010, Applied had $225 million total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock unit grants, which will be recognized over a weighted average period of 1.5 years. There were 9,508,000 and 214,000 restricted stock units granted in the three months ended January 31, 2010 and January 25, 2009, respectively.

Beginning in fiscal 2007, Applied initiated a performance-based equity award program for named executive officers and other key employees. These awards vest only if specific performance goals set by the Human Resources and Compensation Committee of Applied s Board of Directors (the Committee) are achieved and if the grantee remains employed by Applied through the applicable vesting date. The performance goals require the achievement of targeted relative annual operating profit margin levels as compared to Applied s peer companies in at least one of the four fiscal years beginning with the fiscal year of the grant. The fair value of the performance-based restricted stock units and restricted stock is estimated using the fair market value of Applied common stock on the date of the grant and assumes that the performance goals will be achieved. If achieved, the award vests over a specified remaining service period. If the performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. The expected cost of each award is reflected over the service period and is reduced for estimated forfeitures. The Committee approved the grant of 1,775,000 performance-based restricted stock units and 50,000 performance-based shares of restricted stock under this program in the three months ended January 31, 2010. There were no performance-based awards granted in the three months ended January 25, 2009. As of January 31, 2010, 70% of the performance goals associated with the performance-based awards granted in fiscal 2008 were achieved. The performance goals associated with the remaining 30% may still be achieved during fiscal 2010 and fiscal 2011.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

## Note 2 Treasury Stock

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. No shares of treasury stock were reissued during the three months ended January 31, 2010 or January 25, 2009.

## Note 3 Earnings (Loss) Per Share

Basic earnings (loss) 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 ESPP shares) outstanding during the period. Applied s net income (loss) has not been adjusted for any period presented for purposes of computing basic or diluted earnings (loss) per share due to the Company s non-complex capital structure. For purposes of computing diluted earnings per share, weighted average potential common shares do not include stock options with an exercise price greater than the average fair market value of Applied common stock for the period as the effect would be anti-dilutive. Accordingly, options to purchase 46,441,000 shares of common stock were excluded from the computation for the three months ended January 31, 2010. Potential common shares have not been included in the calculation of diluted net loss per share for the three months ended January 25, 2009 as the effect would be anti-dilutive. As such, the numerator and the denominator used in computing both basic and diluted net loss per share for the three months ended January 25, 2009 are the same. The number of potential common shares that were excluded from the computation of diluted earnings per share was 74,745,000 for the three months ended January 25, 2009.

## Note 4 Investments

***Summary of Investments***

The following tables summarizes Applied s investments by security type:

| January 31, 2010 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | | (In thousands) | | |
| U.S. Treasury and agency securities | $ 710,523 | $ 8,534 | $ 107 | $ 718,950 |
| Obligations of states and political subdivisions | 444,885 | 7,757 | 23 | 452,619 |
| U.S. commercial paper, corporate bonds and medium-term notes | 396,606 | 7,104 | 42 | 403,668 |
| Other debt securities* | 136,064 | 1,629 | 663 | 137,030 |

| | | | | |
|---|---|---|---|---|
| Total fixed income securities | 1,688,078 | 25,024 | 835 | 1,712,267 |
| Publicly traded equity securities | 10,569 | 10,420 | | 20,989 |
| Equity investments in privately-held companies | 67,982 | | | 67,982 |
| Total | $ 1,766,629 | $ 35,444 | $ 835 | $ 1,801,238 |

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

| October 25, 2009 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | | (In thousands) | | |
| U.S. Treasury and agency securities | $ 653,627 | $ 8,013 | $ 170 | $ 661,470 |
| Obligations of states and political subdivisions | 419,640 | 7,597 | | 427,237 |
| U.S. commercial paper, corporate bonds and medium-term notes | 382,550 | 5,676 | 281 | 387,945 |
| Other debt securities* | 103,193 | 1,430 | 391 | 104,232 |
| Total fixed income securities | 1,559,010 | 22,716 | 842 | 1,580,884 |
| Publicly traded equity securities | 9,572 | 9,439 | | 19,011 |
| Equity investments in privately-held companies | 90,619 | | | 90,619 |
| Total | $ 1,659,201 | $ 32,155 | $ 842 | $ 1,690,514 |

* Other debt securities consist primarily of investment grade asset-backed and mortgage-backed securities.

Included in cash and cash equivalents are investments in money market funds totaling $0.9 billion at January 31, 2010 and $1.2 billion at October 25, 2009.

***Maturities of Investments***

The following table summarizes the contractual maturities of Applied s investments at January 31, 2010:

| | Cost | Estimated Fair Value |
|---|---|---|
| | (In thousands) | |
| Due in one year or less | $ 730,222 | $ 734,133 |
| Due after one through five years | 813,518 | 832,159 |
| Due after five years | 8,274 | 8,945 |
| No single maturity date** | 214,615 | 226,001 |
| | $ 1,766,629 | $ 1,801,238 |

**

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

***Gains and Losses on Investments***

Applied manages its cash equivalents and investments, excluding strategic investments, as a single portfolio of highly marketable securities that is intended to be available to meet Applied s current cash requirements.

For the three months ended January 31, 2010, gross realized gains on sales of investments were $0.3 million and gross realized losses were $0.6 million. For the three months ended January 25, 2009, gross realized gains on sales of investments were $3.3 million and gross realized losses were $5.8 million.

At January 31, 2010, Applied had a gross unrealized loss of $0.8 million due to a decrease in the fair value of certain fixed income securities. 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 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.

Table of Contents

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Generally, the contractual terms of investments in marketable securities do not permit settlement at prices less than the amortized cost of the investments. Applied has determined that the gross unrealized losses on its marketable securities at January 31, 2010, are temporary in nature and therefore it did not recognize any impairment of its marketable securities for the three months ended January 31, 2010. At January 31, 2010, Applied determined that certain of its equity investments in privately-held companies were other-than-temporarily impaired and, accordingly, recognized an impairment in the amount of $1.2 million in the first quarter of fiscal 2010.

The following table provides the fair market value of Applied s investments with unrealized losses that are not deemed to be other-than-temporarily impaired as of January 31, 2010.

| | In Loss Position for Less Than 12 Months | | In Loss Position for 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| | (In thousands) | | | | | |
| U.S. Treasury and agency securities | $ 103,422 | $ 107 | $ | $ | $ 103,422 | $ 107 |
| Obligations of states and political subdivisions | 5,529 | 23 | | | 5,529 | 23 |
| U.S. commercial paper, corporate bonds and medium-term notes | 70,537 | 27 | 946 | 15 | 71,483 | 42 |
| Other debt securities | 24,769 | 392 | 2,828 | 271 | 27,597 | 663 |
| Total | $ 204,257 | $ 549 | $ 3,774 | $ 286 | $ 208,031 | $ 835 |

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 5 Fair Value Measurements**

Effective October 27, 2008, Applied adopted authoritative guidance for fair value measurements and the fair value option for financial assets and liabilities. This authoritative guidance defines fair value, establishes a framework for measuring fair value and enhances disclosure requirements for fair value measurements. Fair value is defined under this authoritative guidance as the exchange price that would be received for an asset, or paid to transfer a liability (an exit price), in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

On October 26, 2009, Applied adopted the newly issued accounting standard for fair value measurements of all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. Applied s financial assets are measured and recorded at fair value, except for equity investments held 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 indicates 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 when an event or circumstance indicates that an other-than-temporary decline in value may have occurred.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

***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 Observable 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 are comprised primarily of debt securities that are classified as available-for-sale and recorded at their fair value. 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 January 31, 2010, a substantial majority of Applied s available-for-sale, short-term and long-term investments were recognized at fair value that was determined based upon observable inputs.

Table of Contents

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

Financial assets and liabilities (excluding cash balances) measured at fair value on a recurring basis are summarized below as of January 31, 2010 and October 25, 2009:

| | January 31, 2010 | | | | October 25, 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 (In thousands) | Level 3 | Total | Level 1 | Level 2 (In thousands) | Level 3 | Total |
| **Assets:** | | | | | | | | |
| Money market funds | $ 860,499 | $ | $ | $ 860,499 | $ 1,235,254 | $ | $ | $ 1,235,254 |
| U.S. Treasury and agency securities | 134,403 | 584,547 | | 718,950 | 145,166 | 516,304 | | 661,470 |
| Obligations of states and political subdivisions | | 452,619 | | 452,619 | | 427,237 | | 427,237 |
| U.S. commercial paper, corporate bonds and medium-term notes | | 403,668 | | 403,668 | | 387,945 | | 387,945 |
| Other debt securities | | 137,030 | | 137,030 | | 104,232 | | 104,232 |
| Publicly traded equity securities | 20,989 | | | 20,989 | 19,011 | | | 19,011 |
| Foreign exchange derivative assets | | 1,241 | | 1,241 | | 2,173 | | 2,173 |
| **Total** | $ 1,015,891 | $ 1,579,105 | $ | $ 2,594,996 | $ 1,399,431 | $ 1,437,891 | $ | $ 2,837,322 |
| **Liabilities:** | | | | | | | | |
| Foreign exchange derivative | $ | $ (2,842) | $ | $ (2,842) | $ | $ (1,678) | $ | $ (1,678) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| liabilities | | | | | | | | |
| **Total** | $ | $ (2,842) | $ | $ (2,842) | $ | $ (1,678) | $ | $ (1,678) |

The following table presents the activity in Level 3 instruments during the periods indicated below:

| | **Three Months Ended** | |
|---|---|---|
| | **January 31, 2010** | **January 25, 2009** |
| | **Level 3** | **Level 3** |
| | **(In thousands)** | **(In thousands)** |
| Balance, beginning of period | $ | $ 13,100 |
| Total realized and unrealized losses: | | |
| Included in earnings | | (2,334) |
| Included in other comprehensive loss | | (1,516) |
| Purchases, sales, and maturities | | (6,143) |
| Transfers out of Level 3, net | | (100) |
| Balance, end of period | $ | $ 3,007 |

*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. Equity investments

Table of Contents

APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

in privately-held companies totaled $68 million at January 31, 2010, of which $52 million of investments were accounted for under the cost method of accounting and $16 million of investments had been measured at fair value on a non-recurring basis during the three months ended January 31, 2010 due to an other-than-temporary decline in value. During the three months ended January 25, 2009, Applied did not record any other-than-temporary impairments on those assets required to be measured at fair value on a non-recurring basis.

The following table presents the balance of equity securities at January 31, 2010 that had been measured at fair value on a non-recurring basis, using the process described above, and the impairment charges recorded during the three months then ended:

| | Level 1 | Level 2 | Level 3 | Total Impairment For the Three Months Ended January 31, 2010 |
|---|---|---|---|---|
| | | | (In thousands) | |
| Equity investments in privately-held companies measured at fair value on a non-recurring basis during the three months ended January 31, 2010 | $ | $ | $ 15,881 | $ 1,190 |

*Other*

The carrying amounts of Applied s financial instruments, including cash and cash equivalents, accounts receivable, notes payable, and accounts payable and accrued expenses, approximate fair value due to the short maturities of these financial instruments. At January 31, 2010, the carrying amount of long-term debt was $213 million and the estimated fair value was $240 million. At October 25, 2009, the carrying amount of long-term debt was $202 million and the estimated fair value was $216 million. 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.

## Note 6 Derivative Instruments and Hedging Activities

***Derivative Financial Instruments***

Derivative instruments and hedging activities, including foreign currency exchange 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 accounts payable and accrued expenses.

Applied conducts business in a number of foreign countries, with certain transactions denominated in local currencies, such as Japanese yen, euro, Israeli shekel and Swiss francs. 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. Applied does not use derivative financial instruments for trading or speculative purposes.

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. Hedges related to anticipated transactions are designated and documented at the inception of the hedge as cash flow hedges and 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 accumulated other comprehensive income or loss (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 derivative instruments included in AOCI at January 31, 2010 is expected to be reclassified into earnings within 12 months.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

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 promptly 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 general and administrative expenses. 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 months ended January 31, 2010 and January 25, 2009.

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 promptly in earnings to offset the changes in the fair value of the assets or liabilities being hedged.

Fair values of derivative instruments were as follows:

| | January 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Asset Derivatives | | | Liability Derivatives | | |
| | Balance Sheet Location | | Fair Value | Balance Sheet Location | | Fair Value |
| | (In thousands) | | | | | |
| **Derivatives Designated as Hedging Instruments** | | | | | | |
| Foreign exchange contracts | Other current assets | $ | 717 | Accounts payable and accrued expenses | $ | 1,967 |
| **Derivatives Not Designated as Hedging Instruments** | | | | | | |
| Foreign exchange contracts | Other current assets | $ | 524 | Accounts payable and accrued expenses | $ | 875 |
| Total derivatives | | $ | 1,241 | | $ | 2,842 |

| | October 25, 2009 | |
|---|---|---|
| | Asset Derivatives | Liability Derivatives |

| | Balance Sheet Location | | Fair Value | Balance Sheet Location | | Fair Value |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| **Derivatives Designated as Hedging Instruments** | | | | | | |
| Foreign exchange contracts | Other current assets | $ | 1,811 | Accounts payable and accrued expenses | $ | 1,225 |
| **Derivatives Not Designated as Hedging Instruments** | | | | | | |
| Foreign exchange contracts | Other current assets | $ | 362 | Accounts payable and accrued expenses | $ | 453 |
| Total derivatives | | $ | 2,173 | | $ | 1,678 |

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

The effect of derivative instruments on the Consolidated Condensed Statement of Operations for the three months ended January 31, 2010 was as follows:

| | Three Months Ended January 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Effective Portion | | | Ineffective Portion and Amount Excluded from Effectiveness Testing | |
| | Gain or (Loss) Recognized in AOCI | Location of Gain or (Loss) Reclassified from AOCI into Income | Gain or (Loss) Reclassified from AOCI into Income | Location of Gain or (Loss) Recognized in Income | Gain or (Loss) Recognized in Income |
| | (In thousands) | | | | |
| **Derivatives in Cash Flow Hedging Relationships** | | | | | |
| Foreign exchange contracts | $ (2,835) | Cost of products sold | $ (1,757) | Cost of products sold | $ (304) |
| Foreign exchange contracts | | General and administrative | 1,037 | General and administrative | (566) |
| Foreign exchange contracts | | Research, development and engineering | (82) | Research, development and engineering | |
| Total | $ (2,835) | | $ (802) | | $ (870) |

| | Location of Gain or (Loss) Recognized in Income | Three Months Ended January 31, 2010 Amount of Gain or (Loss) Recognized in Income |
|---|---|---|
| **Derivatives Not Designated as Hedging Instruments** | | |
| Foreign exchange contracts | General and administrative | $ (10,460) |

| | | |
|---|---|---|
| Total | $ | (10,460) |

The effect of derivative instruments on the Consolidated Condensed Statement of Operations for the three months ended January 25, 2009 was as follows:

| | Three Months Ended January 25, 2009 | | | | |
|---|---|---|---|---|---|
| | Effective Portion | | | Ineffective Portion and Amount Excluded from Effectiveness Testing | |
| | Gain or (Loss) Recognized in AOCI | Location of Gain or (Loss) Reclassified from AOCI into Income | Gain or (Loss) Reclassified from AOCI into Income | Location of Gain or (Loss) Recognized in Income | Gain or (Loss) Recognized in Income |
| | | | (In thousands) | | |
| **Derivatives in Cash Flow Hedging Relationships** | | | | | |
| Foreign exchange contracts | $ (11,523) | Cost of products sold | $ (11,510) | Cost of products sold | $ (2,220) |
| Foreign exchange contracts | | General and administrative | (6,215) | General and administrative | (1,501) |
| Foreign exchange contracts | | Research, development and engineering | (81) | Research, development and engineering | |
| Total | $ (11,523) | | $ (17,806) | | $ (3,721) |

15

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

| | Location of Gain or (Loss) Recognized in Income | Three Months Ended January 25, 2009 Amount of Gain or (Loss) Recognized in Income | |
|---|---|---|---|
| **Derivatives Not Designated as Hedging Instruments** | | | |
| Foreign exchange contracts | General and administrative | $ | (29,656) |
| Total | | $ | (29,656) |

*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 liability position was immaterial as of January 31, 2010.

Entering into foreign exchange 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 7 Accounts Receivable, Net**

Applied has agreements with various financial institutions to sell accounts receivable and discount promissory notes from selected customers. Applied also discounts letters of credit through various financial institutions. Under these agreements, Applied discounted letters of credit in the amounts of $27 million and $13 million for the three months ended January 31, 2010 and January 25, 2009, respectively. For the three months ended January 31, 2010 and January 25, 2009, Applied factored accounts receivable and discounted promissory notes totaling $26 million and $4 million, respectively. 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 $73 million at January 31, 2010 and $67 million at October 25, 2009.

Applied sells principally to manufacturers within the semiconductor, display and solar industries. As a result of challenging economic and industry conditions, certain of these manufacturers may experience difficulties in meeting their obligations in a timely manner. While Applied believes that its allowance for doubtful accounts is adequate and represents Applied s best estimate at January 31, 2010, Applied will continue to closely monitor customer liquidity and other economic conditions, which may result in changes to Applied s estimates regarding collectability.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

## Note 8 Inventories

Inventories are stated at the lower of cost or market, with cost determined on a FIFO basis. Components of inventories were as follows:

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In thousands) | |
| Customer service spares | $ 258,158 | $ 263,688 |
| Raw materials | 373,754 | 351,824 |
| Work-in-process | 648,084 | 667,484 |
| Finished goods | 384,273 | 344,461 |
| | $ 1,664,269 | $ 1,627,457 |

Included in finished goods inventory is $140 million at January 31, 2010, and $133 million at October 25, 2009, of newly-introduced systems at customer locations where the sales transaction did not meet Applied s revenue recognition criteria, which are set forth in Note 1.

Applied adjusts inventory carrying value for estimated obsolescence equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Applied fully reserves for inventories and noncancelable purchase orders for inventory deemed obsolete. Applied performs periodic reviews of inventory items to identify excess inventories on hand by comparing on-hand balances to anticipated usage using recent historical activity as well as anticipated or forecasted demand. If estimates of customer demand diminish further or market conditions become less favorable than those projected by Applied, additional inventory adjustments may be required.

## Note 9 Goodwill, Purchased Technology and Other Intangible Assets

### *Goodwill and Purchased Intangible Assets*

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. For goodwill, Applied performs a two-step impairment test. In the first step, Applied compares the estimated fair value of each reporting unit to its carrying value. Applied s reporting units are consistent with the reportable segments identified in Note 18, based on the manner in which Applied operates its business and the nature of those operations. Applied determines the fair value of each of its reporting units based on a weighting of income and market approaches. Under the income approach, Applied calculates the fair value of a reporting unit based on the present value of estimated future cash flows. Under the market approach, Applied estimates the fair value based on market multiples of revenue or earnings for comparable companies. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Applied would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s goodwill. Applied would then allocate the fair value of the reporting unit to all of the assets and liabilities of that unit, as if Applied had acquired the reporting unit in a business combination, with the fair value of the reporting unit being the purchase price. The excess of the purchase price over the carrying amounts assigned to assets and liabilities representing the implied fair value of goodwill. If Applied determined that the carrying value of a reporting unit s goodwill exceeded its implied fair value, Applied would record an impairment loss equal to the difference.

Applied conducted these impairment tests in the fourth quarter of fiscal 2009, and the results of these tests indicated that Applied s goodwill and purchased intangible assets with indefinite useful lives were not impaired.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

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 cost of the acquisition 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 a reporting unit 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.

Details of indefinite-lived intangible assets were as follows:

| | January 31, 2010 | | | October 25, 2009 | | |
|---|---|---|---|---|---|---|
| | Goodwill | Other Intangible Assets | Total | Goodwill | Other Intangible Assets | Total |
| | (In thousands) | | | | | |
| Gross carrying amount | $ 1,382,296 | $ 17,400 | $ 1,399,696 | $ 1,216,802 | $ 17,860 | $ 1,234,662 |
| Accumulated amortization | (45,870) | | (45,870) | (45,870) | | (45,870) |
| | $ 1,336,426 | $ 17,400 | $ 1,353,826 | $ 1,170,932 | $ 17,860 | $ 1,188,792 |

From October 25, 2009 to January 31, 2010, goodwill increased by $158 million due to the acquisition of Semitool, Inc. (Semitool) and by $7 million due to an asset purchase from Advent Solar, Inc. (Advent Solar) (see Note 19). Other intangible assets that are not subject to amortization consist primarily of a trade name. As of January 31, 2010, indefinite-lived intangible assets by reportable segment were: Energy and Environmental Solutions, $661 million; Silicon, $382 million; Applied Global Services, $195 million; and Display, $116 million.

***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 environment, technological advances, and changes in cost structure.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Details of amortized intangible assets were as follows:

| | January 31, 2010 | | | October 25, 2009 | | |
|---|---|---|---|---|---|---|
| | Purchased Technology | Other Intangible Assets | Total | Purchased Technology | Other Intangible Assets | Total |
| | (In thousands) | | | | | |
| Gross carrying amount | $ 618,442 | $ 351,843 | $ 970,285 | $ 554,920 | $ 329,629 | $ 884,549 |
| Accumulated amortization | (403,012) | (210,673) | (613,685) | (400,093) | (195,900) | (595,993) |
| | $ 215,430 | $ 141,170 | $ 356,600 | $ 154,827 | $ 133,729 | $ 288,556 |

From October 25, 2009 to January 31, 2010, the change in gross carrying amount of the amortized intangible assets was approximately $86 million, primarily due to the acquisition of Semitool (see Note 19). Aggregate amortization expense was $25 million and $22 million for the three months ended January 31, 2010 and January 25, 2009, respectively. As of January 31, 2010, future estimated amortization expense is expected to be $51 million for the remainder of fiscal 2010, $62 million for fiscal 2011, $59 million for fiscal 2012, $53 million for fiscal 2013, $49 million for fiscal 2014, and $83 million thereafter. As of January 31, 2010, amortized intangible assets by reportable segment were: Energy and Environmental Solutions, $196 million; Silicon, $99 million; Applied Global Services, $35 million; and Display, $27 million.

**Note 10 Accounts Payable and Accrued Expenses**

Components of accounts payable and accrued expenses were as follows:

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In thousands) | |
| Accounts payable | $ 466,924 | $ 477,148 |
| Compensation and employee benefits | 198,919 | 134,949 |
| Warranty | 137,430 | 117,537 |
| Dividends payable | 80,596 | 80,455 |
| Other accrued taxes | 53,665 | 36,954 |
| Restructuring reserve | 106,598 | 31,581 |
| Other | 207,899 | 182,878 |
| | $ 1,252,031 | $ 1,061,502 |

**Note 11 Customer Deposits and Deferred Revenue**

Details of customer deposits and deferred revenue were as follows:

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In thousands) | |
| Customer deposits | $ 603,489 | $ 564,412 |
| Deferred revenue | 389,868 | 299,868 |
| | $ 993,357 | $ 864,280 |

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

## Note 12 Warranty, Guarantees and Contingencies

***Warranty***

Changes in the warranty reserves during the three months ended January 31, 2010 and January 25, 2009 were as follows:

| | Three Months Ended | |
|---|---|---|
| | January 31, 2010 | January 25, 2009 |
| | (In thousands) | |
| Beginning balance | $ 117,537 | $ 142,846 |
| Provisions for warranty | 34,476 | 23,546 |
| Consumption of reserves | (14,583) | (22,669) |
| Ending balance | $ 137,430 | $ 143,723 |

Applied products are generally sold with a 12-month warranty 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***

During the ordinary course of business, Applied provides standby letters of credit or other guarantee instruments to certain parties as required for certain transactions initiated by either Applied or its subsidiaries. As of January 31, 2010, the maximum potential amount of future payments that Applied could be required to make under these guarantee arrangements was $54 million. Applied has not recorded any liability in connection with these guarantee arrangements beyond that required to 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 arrangements.

Applied also has agreements with various global banks to facilitate subsidiary banking operations world-wide, including overdraft arrangements, bank guarantees and letters of credit. As of January 31, 2010, Applied Materials, Inc. has provided parent guarantees to banks for approximately $176 million to cover these arrangements.

***Legal matters***

*Semitool Shareholder Litigation*

On November 17, 2009, Applied announced that it was making a tender offer to acquire all of the outstanding shares of Semitool in accordance with an Agreement and Plan of Merger entered into with Semitool. Following this announcement, three lawsuits were filed by Semitool shareholders in the District Court of the Eleventh Judicial District Court for the State of Montana, County of Flathead, against Semitool, Semitool s directors, Applied and Applied s acquisition subsidiary. The actions seek certification of a class of all holders of Semitool common stock, except the defendants and their affiliates. The complaints allege that Semitool s directors breached their fiduciary duties by, among other things, failing to maximize shareholder value and failing to disclose material information, and that Applied aided and abetted such alleged breaches. The actions sought injunctive relief enjoining the defendants from consummating the transaction, as well as damages and attorneys fees.

On December 14, 2009, all parties in these cases reached an agreement in principle to settle the matters and the plaintiffs withdrew their motion to enjoin consummation of the transaction. Without admitting any wrongdoing or fault, Semitool disclosed certain additional information in its Schedule 14D-9 filed with the Securities and

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Exchange Commission on December 14, 2009. Following the tender of shares representing over 95% of the outstanding shares of Semitool common stock, the merger of Semitool into Applied s acquisition subsidiary was completed on December 21, 2009. Pursuant to a memorandum of understanding between the parties, plaintiffs may conduct reasonable discovery to confirm the fairness and reasonableness of the settlement and defendants will not object to an application by plaintiffs counsel for an award of attorneys fees and expenses up to $200,000. A class of Semitool s public shareholders will be certified solely for purposes of settlement, which, if approved by the Court, will result in a complete and final discharge of all claims on behalf of the class.

*Jusung*

Applied has been engaged in a number of lawsuits and patent and administrative proceedings in Taiwan and South Korea since 2003 with Jusung Engineering Co., Ltd. (Jusung Engineering) and/or Jusung Pacific Co., Ltd. (Jusung Pacific, referred to together with Jusung Engineering as Jusung) involving technology used in manufacturing LCDs. Applied believes that it has meritorious claims and defenses against Jusung that it intends to pursue vigorously.

In 2004, Applied filed a complaint for patent infringement against Jusung in the Hsinchu District Court in Taiwan seeking damages and a permanent injunction for infringement of a patent related to chemical vapor deposition (CVD) equipment, and this case remains pending. Jusung Pacific unsuccessfully sought invalidation of Applied s CVD patent in the Taiwanese Intellectual Property Office (TIPO). Jusung Pacific s initial appeal of the TIPO s decision was denied, and it has filed a further appeal to the Taipei High Supreme Administrative Court.

In 2006, Applied filed an action in the TIPO challenging the validity of a patent owned by Jusung Engineering related to severability of the transfer chamber on a CVD tool. Jusung Engineering filed a lawsuit against Applied and AKT America in Hsinchu District Court in Taiwan alleging infringement of the same patent. The TIPO granted Applied s request for invalidation and revoked Jusung Engineering s patent. In March 2009, the Hsinchu District Court dismissed Jusung Engineering s lawsuit, and in April 2009, the Ministry of Economic Affairs overruled Jusung Engineering s administrative appeal of the decision revoking its patent. Jusung appealed both decisions. On January 7, 2010, the Taiwan Intellectual Property Court granted Jusung s appeal of the decision revoking its patent and remanded the matter to the TIPO for reconsideration of validity. In November 2009, Applied filed an action in China with the Patent Reexamination Board of the State Intellectual Property Office seeking to invalidate this patent.

In 2006, Jusung Engineering filed a complaint of private prosecution in the Taipei District Court of Taiwan alleging that Applied s outside counsel received from the Court and used a copy of an expert report that Jusung had filed in the ongoing patent infringement lawsuits that Jusung had intended to remain confidential. The complaint names as defendants Applied s outside counsel in Taiwan, as well as Michael R. Splinter, Applied s President and Chief Executive Officer, as the statutory representative of Applied. The Taipei District Court dismissed the private prosecution complaint, and the matter was transferred to the Taipei District Attorney s Office. The Taipei District Attorney s Office has issued three successive rulings not to prosecute, each of which Jusung Engineering has appealed to the Taiwan High Court District Attorney. In each instance, the Taiwan High Court District Attorney has returned the matter to the Taipei District Attorney s Office for further consideration, where it remains pending.

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 or these claims and proceedings cannot be predicted with certainty, Applied does not believe that any of these proceedings or other claims will have a material adverse effect on its consolidated financial condition or results of operations.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

## Note 13 Restructuring and Asset Impairments

On November 11, 2009, Applied announced a restructuring program to reduce its global workforce as of October 25, 2009 by approximately 1,300 to 1,500 positions, or 10 to 12 percent, over a period of 18 months. During the first quarter of fiscal 2010, Applied recorded restructuring charges of $104 million associated with this program.

Changes in restructuring reserves related to the program described above for the three months ended January 31, 2010 were as follows:

| | Severance (In thousands) |
|---|---|
| Provision for restructuring reserves | $ 103,780 |
| Consumption of reserves | (16,688) |
| Balance, January 31, 2010 | $ 87,092 |

Changes in restructuring reserves for the three months ended January 31, 2010 related to other restructuring plans and facilities realignment programs initiated in prior periods were as follows:

| | Severance | Facilities | Total |
|---|---|---|---|
| | | (In thousands) | |
| Balance, October 25, 2009 | $ 26,353 | $ 5,228 | $ 31,581 |
| Provision for restructuring reserves | | 64 | 64 |
| Consumption of reserves | (11,915) | (227) | (12,142) |
| Foreign currency changes | | 3 | 3 |
| Balance, January 31, 2010 | $ 14,438 | $ 5,068 | $ 19,506 |

## Note 14 Stockholders Equity

***Comprehensive Income***

Components of comprehensive income (loss), on an after-tax basis where applicable, were as follows:

| | Three Months Ended | |
|---|---|---|
| | January 31, | January 25, |

| | 2010 | 2009 |
|---|---|---|
| | (In thousands) | |
| Net income (loss) | $ 82,751 | $ (132,934) |
| Pension liability adjustment | 74 | 112 |
| Change in unrealized net gain on investments | 2,121 | 16,474 |
| Change in unrealized net loss on derivative instruments qualifying as cash flow hedges | (1,299) | (210) |
| Foreign currency translation adjustments | 273 | (1,310) |
| Comprehensive income (loss) | $ 83,920 | $ (117,868) |

22

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Components of accumulated other comprehensive loss, on an after-tax basis where applicable, were as follows:

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In thousands) | |
| Pension liability | $ (32,090) | $ (32,164) |
| Retiree medical benefits | 15 | 15 |
| Unrealized gain on investments net | 22,093 | 19,972 |
| Unrealized gain (loss) on derivative instruments qualifying as cash flow hedges | (989) | 310 |
| Cumulative translation adjustments | 10,460 | 10,187 |
| | $ (511) | $ (1,680) |

***Stock Repurchase Program***

On September 15, 2006, Applied s Board of Directors approved a stock repurchase program for up to $5.0 billion in repurchases over the three years ending in September 2009. Under this authorization, Applied implemented a systematic stock repurchase program and also made supplemental repurchases of its common stock from time to time in the open market, depending on market conditions, stock price and other factors, for a total of $2.7 billion. In November 2008, Applied announced that it was suspending stock repurchases in light of uncertain global economic and market conditions. During the three months ended January 25, 2009, prior to such suspension, Applied repurchased 1,942,000 shares of its common stock at an average price of $11.80 per share for a total cash outlay of $23 million.

***Dividends***

In December 2009, Applied s Board of Directors declared a quarterly cash dividend in the amount of $0.06 per share that will be paid on March 17, 2010 to stockholders of record as of February 24, 2010. 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 interest of Applied s stockholders.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

## Note 15 Employee Benefit Plans

Applied sponsors a number of employee benefit plans, including defined benefit plans of certain foreign subsidiaries, and a plan that provides certain medical and vision benefits to eligible retirees. A summary of the components of net periodic benefit costs of these defined and postretirement benefit plans for the three months ended January 31, 2010 and January 25, 2009 is presented below:

| | Three Months Ended | |
|---|---|---|
| | January 31, 2010 | January 25, 2009 |
| | (In thousands) | |
| Service cost | $ 3,350 | $ 3,290 |
| Interest cost | 3,444 | 3,007 |
| Expected return on plan assets | (1,913) | (1,863) |
| Amortization of actuarial loss | 286 | 174 |
| Amortization of prior service credit | (63) | (70) |
| Amortization of transition obligation | 14 | 19 |
| Net periodic pension cost | $ 5,118 | $ 4,557 |

## Note 16 Borrowing Facilities

Applied has credit facilities for unsecured borrowings in various currencies of up to $1.1 billion, of which $1.0 billion is comprised of a 5-year revolving credit agreement with a group of banks that is scheduled to expire in January 2012. This agreement provides for borrowings in United States dollars at interest rates keyed to one of the two rates selected by Applied for each advance and includes financial and other covenants with which Applied was in compliance at January 31, 2010. Remaining credit facilities in the amount of approximately $90 million are with Japanese banks. Applied s ability to borrow under these facilities is subject to bank approval at the time of the borrowing request, and any advances will be at rates indexed to the banks prime reference rate denominated in Japanese yen. No amounts were outstanding under any of these facilities at January 31, 2010.

## Note 17 Income Taxes

Applied s effective income tax rate for the first quarter of fiscal 2010 was a provision of 30.3 percent, and the income tax rate for the first quarter of fiscal 2009 was a benefit of 34.4 percent. Both periods included the impact of restructuring charges. Applied s future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of Applied s pre-tax income, and the tax rate on equity compensation. Management carefully monitors these factors and timely adjusts the interim income tax rate accordingly.

During fiscal 2009, the Internal Revenue Service began an examination of Applied s federal income tax returns for fiscal years 2007 and 2006. Applied believes it has adequately reserved for any income tax uncertainties that may arise as a result of this examination.

A number of Applied s tax returns remain subject to examination by taxing authorities. These include U.S. federal returns for fiscal 2005 and later years, California returns for fiscal 2006 and later years, tax returns for certain states for fiscal 2002 and later years, and tax returns in certain jurisdictions outside of the United States for fiscal 2003 and later years.

The timing of the resolution of income tax examinations is highly uncertain as well as the amounts and timing of various tax payments that may be part of the settlement process. This could cause large fluctuations in the balance sheet classification of current assets and non-current assets and liabilities. The Company does not expect a material change in unrecognized tax benefits in the next 12 months.

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

**Note 18 Industry Segment Operations**

Applied s four reportable segments are: Silicon, Applied Global Services, Display, and Energy and Environmental Solutions. 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 January 31, 2010 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the Company s reportable segments.

Each reportable 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.

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. Effective in the first quarter of fiscal 2010, Applied changed its methodology for allocating certain expenses to its reportable segments. Applied has reclassified segment operating results for the three months ended January 25, 2009 to conform to the fiscal 2010 presentation. Management measures the performance of each reportable segment based upon several metrics including orders, net sales and operating income. Management uses these results to evaluate the performance of, and to assign resources to, each of the reportable segments. Applied does not allocate to its reportable segments certain operating expenses that it manages separately at the corporate level, which include costs related to equity-based compensation and certain corporate functions (certain management, finance, legal, human resources, and research, development and engineering), 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. Segment operating income excludes interest income/expense and other financial charges and income taxes according to how a particular reportable segment s management is measured. Management does not consider the unallocated costs in measuring the performance of the reportable segments.

The Silicon segment includes semiconductor capital equipment for etch, rapid thermal processing, deposition, chemical mechanical planarization, and metrology and inspection.

The Applied Global Services segment includes technically differentiated products and services to improve operating efficiency, reduce operating costs and lessen the environmental impact of semiconductor, display and solar customers factories. Applied Global Services products consist of spares, services, certain earlier generation products, and remanufactured equipment. Customer demand for these products and services is fulfilled through a global distribution system with trained service engineers located in close proximity to customer sites.

The Display segment encompasses products for manufacturing LCDs for TVs, personal computers and other video-enabled devices. The Display segment also includes the design and manufacture of differentiated stand-alone equipment for the Applied SunFab thin film line.

The Energy and Environmental Solutions segment includes products for fabricating solar photovoltaic cells and modules, high throughput roll-to-roll coating systems for flexible electronics and web products, and systems used in the manufacture of energy-efficient glass.

Table of Contents

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

Net sales and operating income (loss) for each reportable segment for the three months ended January 31, 2010 and January 25, 2009 were as follows:

| | Net Sales | Operating Income (loss) |
|---|---|---|
| | (In thousands) | |
| 2010: | | |
| Silicon | $ 970,164 | $ 305,995 |
| Applied Global Services | 425,552 | 63,158 |
| Display | 132,108 | 24,927 |
| Energy and Environmental Solutions | 321,078 | (36,267) |
| Total Segment | $ 1,848,902 | $ 357,813 |
| 2009: | | |
| Silicon | $ 546,011 | $ 46,239 |
| Applied Global Services | 345,094 | 25,904 |
| Display | 149,009 | 21,127 |
| Energy and Environmental Solutions | 293,282 | (63,643) |
| Total Segment | $ 1,333,396 | $ 29,627 |

Reconciliations of total segment operating income to Applied s consolidated operating income (loss) for the three months ended January 31, 2010 and January 25, 2009 were as follows:

| | Three Months Ended January 31, 2010 | Three Months Ended January 25, 2009 |
|---|---|---|
| | (In thousands) | |
| Total segment operating income | $ 357,813 | $ 29,627 |
| Corporate and unallocated costs | (137,626) | (92,947) |
| Restructuring and asset impairment charges | (103,844) | (132,772) |
| Income (loss) from operations | $ 116,343 | $ (196,092) |

**Note 19 Business Combinations**

On December 21, 2009, Applied acquired Semitool, a public company based in the state of Montana, for a purchase price of $323 million in cash, net of cash acquired, pursuant to a tender offer and subsequent short-form merger. The acquired business is a leading supplier of electrochemical plating and wafer surface preparation equipment used by semiconductor packaging and manufacturing companies globally. Applied s primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The acquired business will be included in the Silicon segment results beginning in the second quarter of fiscal 2010.

In November 2009, Applied acquired substantially all the assets, including the intellectual property, of Advent Solar, a developer of advanced technology for crystalline silicon (c-Si) PVs. This acquisition complemented Applied s portfolio of solar PV technologies and enhanced Applied s position in the c-Si equipment market. The acquisition is included in results for the Energy and Environmental Solutions segment.

Applied allocated the purchase price of each of these acquisitions to tangible assets, liabilities and identifiable intangible assets acquired, based on their estimated fair values. The excess of purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was based on estimates and assumptions made by management. These estimates were determined through established and

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

generally accepted calculation techniques. Applied calculated the fair value of the tangible and intangible assets acquired to allocate the purchase prices at the respective acquisition dates. Based upon these calculations, the purchase prices for the above acquisitions were allocated as follows:

| Fair Market Values | Acquisitions 2010 (In thousands) |
|---|---|
| Cash and cash equivalents | $ 38,744 |
| Accounts receivable, net | 37,961 |
| Inventories | 61,838 |
| Other current assets | 3,837 |
| Property and equipment, net | 45,578 |
| Goodwill | 165,495 |
| Purchased intangible assets | 93,376 |
| Total assets acquired | 446,829 |
| Accounts payable and accrued expenses | (46,246) |
| Other liabilities | (25,240) |
| Total liabilities assumed | (71,486) |
| Purchase price allocated | $ 375,343 |

| | Useful Life (In years) | Acquisitions 2010 (In thousands) |
|---|---|---|
| Developed technology | 6-10 | $ 65,700 |
| Customer relationships | 8 | 10,900 |
| Trade names | 3-10 | 5,700 |
| Patents and trademarks | 7-10 | 5,462 |
| Backlog | 1 | 4,100 |
| Other | 5 | 1,514 |
| | | $ 93,376 |

**Note 20 Recent Accounting Pronouncements**

In January 2010, the FASB issued authoritative guidance for fair value measurements, which requires additional disclosures and clarifications to existing disclosures. This authoritative guidance requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and also to describe the reasons for these transfers. This authoritative guidance also requires enhanced disclosure of activity in Level 3 fair value measurements. The new disclosures and clarifications of existing disclosures for Level 1 and Level 2 fair value measurements becomes effective the first interim reporting period after December 15, 2009 and will be effective for Applied in the second quarter of fiscal 2010. Disclosures regarding activity within Level 3 fair value measurements becomes effective the first interim reporting period after December 15, 2010 and will be effective for Applied in the second quarter of fiscal 2011. Applied is evaluating the potential impact of the implementation of this authoritative guidance on its consolidated financial statements. See Note 5 for information and related disclosures regarding Applied s fair value measurements.

In June 2009, the FASB issued authoritative guidance on variable interest entities, which requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities,

**APPLIED MATERIALS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)**

and additional disclosures for variable interests. In December 2009, the FASB issued authoritative guidance on the financial reporting by entities involved with variable interest entities which amends previously issued guidance on variable interest entities. The amendments in this authoritative guidance replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. This authoritative guidance becomes effective the first annual reporting period after November 15, 2009 and will be effective for Applied in fiscal 2011. Applied is evaluating the potential impact of the implementation of this authoritative guidance on its consolidated financial statements.

**Note 21 Subsequent Events**

On March 8, 2010, Applied s Board of Directors approved an increase in the quarterly cash dividend to $0.07 per share, payable on June 16, 2010 to stockholders of record as of May 26, 2010. Applied s Board of Directors also approved a new stock repurchase program authorizing up to $2 billion in repurchases over the next three years ending in March 2013.

Table of Contents

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

All statements in this Quarterly Report on Form 10-Q and those made by the management of Applied, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding Applied s future financial or operating results, fiscal 2010 expectations, cash flows and cash deployment strategies, declaration of dividends, share repurchases, business strategies, projected costs, products, competitive positions, management s plans and objectives for future operations, research and development, acquisitions and joint ventures, growth opportunities, customers, working capital, liquidity, investment portfolio and policies, and legal proceedings, as well as industry trends and outlooks. These forward-looking statements are based on management s estimates, projections and assumptions as of the date hereof and include the assumptions that underlie such statements. Forward-looking statements may contain words such as may, will, should, could, would expect, plan, anticipate, believe, estimate, predict, potential and continue, the negative of these terms, o comparable terminology. Any expectations based on these 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. Other risks and uncertainties may be disclosed in Applied s prior Securities and Exchange Commission (SEC) filings. 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. Applied undertakes no obligation to revise or update any forward-looking statements.

**Overview**

Applied provides Nanomanufacturing Technology$^{tm}$ solutions for the global semiconductor, flat panel display, solar and related industries, with a broad portfolio of innovative equipment, service and software products. Applied s customers are primarily manufacturers of semiconductors, flat panel liquid crystal displays (LCDs), solar photovoltaic cells and modules (solar PVs), flexible electronics and energy-efficient glass. Applied operates in four reportable segments: Silicon, Applied Global Services, Display, and Energy and Environmental Solutions. Product development and manufacturing activities occur primarily in North America, 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 historically have been driven primarily by worldwide demand for semiconductors, which in turn depends on end-user demand for electronic products. Each of Applied s businesses is subject to cyclical industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for chips, LCDs, solar PVs and other electronic devices, as well as other factors, such as global economic and market conditions, and technological advances in fabrication processes. After a challenging year in fiscal 2009 that was characterized by credit constraints in the financial markets and a weak global economy, industry conditions generally improved in the first quarter of fiscal 2010.

The following table presents certain significant measurements for the three months ended January 31, 2010 and January 25, 2009:

| | Three Months Ended | | |
|---|---|---|---|
| | January 31, 2010 | January 25, 2009 | Change |
| | (In millions, except per share amounts and percentages) | | |

| | | | | | |
|---|---|---|---|---|---|
| New orders | $ | 1,965 | $ | 903 | 117% |
| Net sales | $ | 1,849 | $ | 1,333 | 39% |
| Gross margin | $ | 711 | $ | 392 | 82% |
| Gross margin percent | | 38.5% | | 29.4% | 9 points |
| Operating income (loss) | $ | 116 | $ | (196) | 159% |
| Net income (loss) | $ | 83 | $ | (133) | 162% |
| Earnings (loss) per share | $ | 0.06 | $ | (0.10) | 160% |

Fiscal year 2010 is a 53-week year with 14 weeks in the first quarter, while fiscal 2009 was a 52-week year with 13 weeks in the first quarter.

Financial results for the first quarter of fiscal 2010 reflected increased demand for manufacturing equipment and services due to more favorable global economic and industry conditions compared to the first quarter of fiscal 2009. Total orders in the quarter increased year-over-year, primarily due to greater demand for semiconductor and display equipment and services, partially offset by decreased demand for SunFab thin film manufacturing lines. Net sales and net income increased during the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, led primarily by stronger sales of semiconductor equipment. Net income in both periods included restructuring charges. Applied currently expects net sales in fiscal 2010 to be greater than net sales in fiscal 2009.

**Results of Operations**

New orders of $2.0 billion for the first quarter of fiscal 2010 were up 117 percent from the first quarter of fiscal 2009. The increase was primarily attributable to an increase in demand for semiconductor products and services from memory and foundry customers, as well as increased demand for display equipment.

New orders by geographic region (determined by the location of customers facilities) for the three months ended January 31, 2010 and January 25, 2009 were as follows:

| | Three Months Ended | | | |
|---|---|---|---|---|
| | January 31, 2010 | | January 25, 2009 | |
| | ($) | (%) | ($) | (%) |
| | (In millions, except percentages) | | | |
| Taiwan | 658 | 34 | 19 | 2 |
| Korea | 387 | 20 | 66 | 7 |
| North America* | 256 | 13 | 237 | 26 |
| China | 215 | 11 | 69 | 8 |
| Japan | 178 | 9 | 154 | 17 |
| Europe | 146 | 7 | 346 | 39 |
| Southeast Asia | 125 | 6 | 12 | 1 |
| Total | 1,965 | 100 | 903 | 100 |

* Primarily the United States.

Applied s backlog for the most recent three fiscal quarters was as follows: $2.9 billion at January 31, 2010, $2.7 billion at October 25, 2009, and $3.0 billion at July 26, 2009. Backlog increased 7 percent for the first quarter of 2010 compared to the fourth quarter of fiscal 2009. Backlog increased in the first quarter of 2010 primarily due to the inclusion of orders for products obtained through the acquisition of Semitool. Backlog consists of: (1) orders for which written authorizations have been accepted and assigned shipment dates are within the next 12 months, or shipment has occurred but revenue has not been recognized; (2) contractual service revenue and maintenance fees to be earned within the next 12 months; and (3) orders for SunFab lines that are anticipated to be recognized as revenue within the next 12 months. Due to the potential for customer changes in delivery schedules or cancellation of orders, Applied s backlog at any particular time is not necessarily indicative of actual sales for any future periods.

Net sales of $1.8 billion for the first quarter of fiscal 2010 increased 39 percent from the first quarter of fiscal 2009. Net sales for the first quarter of fiscal 2010 reflected higher sales primarily to semiconductor equipment customers.

Table of Contents

Net sales by geographic region (determined by the location of customers facilities) for the three months ended January 31, 2010 and January 25, 2009 were as follows:

| | Three Months Ended | | | |
|---|---|---|---|---|
| | January 31, 2010 | | January 25, 2009 | |
| | ($) | (%) | ($) | (%) |
| | (In millions, except percentages) | | | |
| Taiwan | 514 | 28 | 144 | 11 |
| Korea | 331 | 18 | 187 | 14 |
| Europe | 310 | 17 | 197 | 15 |
| North America* | 241 | 13 | 383 | 29 |
| Japan | 174 | 9 | 216 | 16 |
| China | 143 | 8 | 118 | 8 |
| Southeast Asia | 136 | 7 | 88 | 7 |
| Total | 1,849 | 100 | 1,333 | 100 |

* Primarily the United States.

Gross margin as a percentage of net sales was 38.5 percent for the first quarter of fiscal 2010, up from 29.4 percent for the first quarter of fiscal 2009. The increase was principally attributable to higher net sales, product mix, improved factory utilization and continued cost control measures. Gross margin during the first quarters of fiscal 2010 and 2009 included $5 million and $7 million of equity-based compensation expense, respectively.

Operating expenses included expenses related to research, development and engineering (RD&E), marketing and selling (M&S), and general and administrative (G&A). Expenses related to RD&E, M&S and G&A totaled $491 million for the first quarter of fiscal 2010 compared to $455 million for the first quarter of fiscal 2009. The first quarter of fiscal 2010 included fewer shutdown days than the first quarter of fiscal 2009, an extra week, elimination of temporary salary reductions, and the resumption of variable compensation programs. Operating expenses for the first quarter of fiscal 2010 also included transaction and legal costs related to the Semitool, Inc. (Semitool) acquisition and the Advent Solar, Inc. (Advent Solar) asset purchase.

Operating expenses for the first quarter of fiscal 2010 included restructuring charges of $104 million associated with a program that was announced in November 2009. Operating expenses for the first quarter of fiscal 2009 included restructuring charges of $133 million associated with a program that was announced in November 2008. (See Note 13 of Notes to Consolidated Condensed Financial Statements.)

Net interest income was $4 million for the first quarter of fiscal 2010, down from $9 million for the first quarter of fiscal 2009. The decline was primarily due to a decrease in interest rates.

Applied s effective income tax rate for the first quarter of fiscal 2010 was a provision of 30.3 percent as compared to a benefit of 34.4 percent in the first quarter of fiscal 2009. The income tax rate for both the first quarter of fiscal 2010 and 2009 included the effect of restructuring charges as discrete items. Applied s future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of Applied s pre-tax income, and the tax rate on equity compensation. Management carefully monitors these factors and timely adjusts the interim income tax rate accordingly.

**Segment Information**

Applied reports financial results in four segments: Silicon, Applied Global Services, Display, and Energy and Environmental Solutions. A description of the products and services, as well as financial data, for each reportable segment can be found in Note 18 of Notes to Consolidated Condensed Financial Statements. Applied does not allocate to its reportable segments certain operating expenses that it manages separately at the corporate level. These unallocated costs include those for equity-based compensation and certain corporate functions (certain management, finance, legal, human resources, and RD&E), 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.

Effective in the first quarter of fiscal 2010, Applied changed its methodology for allocating certain expenses to its reportable segments. Applied has reclassified segment operating results for the three months ended January 25, 2009 to conform to the fiscal 2010 presentation.

The results for each reportable segment are discussed below.

***Silicon Segment***

The Silicon segment includes semiconductor capital equipment for deposition, etch, rapid thermal processing, chemical mechanical planarization, and metrology and inspection. Development efforts are focused on solving customers key technical challenges, including transistor performance and nanoscale patterning, and on improving chip manufacturing productivity to reduce costs.

| | Three Months Ended | |
|---|---|---|
| | January 31, 2010 | January 25, 2009 |
| | (In millions) | |
| New orders | $ 1,135 | $ 246 |
| Net sales | $ 970 | $ 546 |
| Operating income | $ 306 | $ 46 |

Silicon new orders increased significantly to $1.1 billion for the first quarter of fiscal 2010, compared to $0.2 billion for the first quarter of fiscal 2009. The increase in new orders was primarily from memory and foundry customers and reflected the general recovery in the semiconductor equipment industry.

Net sales increased 78 percent to $970 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009. The increase in net sales was due to increased investment by memory and foundry customers. Three customers accounted for 63 percent of net sales for the Silicon segment in the first quarter of fiscal 2010. Approximately 70 percent of net sales in the first quarter of fiscal 2010 was attributable to orders placed during the quarter.

Operating income increased significantly to $306 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009. The increase in operating income was due to the considerably higher revenue from semiconductor equipment sales.

***Applied Global Services Segment***

The Applied Global Services segment encompasses technically differentiated products, including spares, services, certain earlier generation equipment products, and remanufactured equipment, to improve operating efficiency, reduce operating costs, and lessen the environmental impact of semiconductor, display and solar customers factories. Customer demand for products and services is fulfilled through a global distribution system with trained service engineers located in close proximity to customer sites.

**Three Months Ended**

| | January 31, 2010 | January 25, 2009 |
|---|---|---|
| | (In millions) | |
| New orders | $ 474 | $ 310 |
| Net sales | $ 426 | $ 345 |
| Operating income | $ 63 | $ 26 |

New orders increased 53 percent to $474 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, due primarily to higher demand for spare parts, reflecting customers higher factory utilization rates.

Net sales increased 23 percent to $426 million for the first quarter of fiscal 2010, primarily due to higher sales of spare parts.

Table of Contents

Operating income more than doubled to $63 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, reflecting increased sales of spare parts.

***Display Segment***

The Display segment encompasses products for manufacturing LCDs for TVs, personal computers and other video-enabled devices. The business is focused on expanding market share by differentiation with larger-scale substrates, entry into new markets, and development of products to enable cost reductions through productivity and uniformity.

| | Three Months Ended | |
|---|---|---|
| | January 31, 2010 | January 25, 2009 |
| | (In millions) | |
| New orders | $ 126 | $ 26 |
| Net sales | $ 132 | $ 149 |
| Operating income | $ 25 | $ 21 |

New orders increased significantly to $126 million for the first quarter of fiscal 2010 compared to $26 million for the first quarter of fiscal 2009. The increase in new orders reflected the general recovery in the LCD market, as customers increased production levels in response to higher end-use demand.

Net sales decreased 11 percent to $132 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, reflecting the cyclical nature of the LCD market.

Operating income increased 19 percent to $25 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, due to more favorable product mix.

***Energy and Environmental Solutions Segment***

The Energy and Environmental Solutions segment includes products for fabricating thin film and crystalline silicon (c-Si) solar PVs, high throughput roll-to-roll coating systems for flexible electronics and web products, and systems used in the manufacture of energy-efficient glass. This business is focused on delivering solutions to generate and conserve energy, with an emphasis on lowering the cost to produce solar power by providing equipment to enhance manufacturing scale and efficiency.

| | Three Months Ended | |
|---|---|---|
| | January 31, 2010 | January 25, 2009 |
| | (In millions) | |
| New orders | $ 230 | $ 321 |
| Net sales | $ 321 | $ 293 |
| Operating loss | $ 36 | $ 64 |

New orders decreased 28 percent to $230 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, due to decreased demand for SunFab thin film manufacturing lines, partially offset by increased demand for c-Si products, particularly wafering and metallization products. The continued challenging credit environment and uncertain thin film solar market conditions contributed to the reduction in orders for SunFab lines in the first quarter of fiscal 2010.

Net sales increased 9 percent to $321 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, reflecting higher sales to SunFab customers.

Operating loss decreased 44 percent to $36 million for the first quarter of fiscal 2010 compared to the first quarter of fiscal 2009, attributable to higher net sales and more favorable product mix, offset in part by higher RD&E expenses and costs associated with the asset purchase from Advent Solar.

**Financial Condition, Liquidity and Capital Resources**

During the three months ended January 31, 2010, cash, cash equivalents and investments decreased by $67 million from $3.3 billion as of October 25, 2009.

Cash, cash equivalents and investments consisted of the following:

| | January 31, 2010 | October 25, 2009 |
|---|---|---|
| | (In millions) | |
| Cash and cash equivalents | $ 1,399 | $ 1,577 |
| Short-term investments | 755 | 638 |
| Long-term investments | 1,046 | 1,052 |
| Total cash, cash equivalents and investments | $ 3,200 | $ 3,267 |

Applied generated $372 million of cash in operating activities for the three months ended January 31, 2010. The primary sources of cash from operating activities for the three months ended January 31, 2010 were net income, as adjusted to exclude the effect of non-cash charges including restructuring and asset impairments, depreciation, amortization, and equity based compensation, and changes in components of working capital. Applied utilized programs to discount letters of credit issued by customers of $27 million and $13 million for the three months ended January 31, 2010 and January 25, 2009, respectively. 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. For the three months ended January 31, 2010 and January 25, 2009, Applied factored accounts receivable and discounted promissory notes totaling $26 million and $4 million, respectively. Days sales outstanding for the first quarter of fiscal 2010 increased to 67 days, compared to 62 days in the fourth quarter of fiscal 2009, primarily due to increased revenue and an additional week in the first quarter of fiscal 2010.

Applied used $490 million of cash from investing activities during the three months ended January 31, 2010, primarily due to the acquisition of Semitool, a public company based in the state of Montana, for $323 million, net of cash acquired. Purchases of investments, net of proceeds from sales and maturities of investments, totaled $114 million. Capital expenditures were $53 million for the first quarter of fiscal 2010 and included investment in the construction of a solar R&D/demonstration center in Xi an, China and also included investment in the construction of a facility in Singapore.

Applied used $60 million of cash for financing activities during the three months ended January 31, 2010, consisting primarily of $80 million in cash dividends paid to stockholders, offset by proceeds from common stock issuances. Since November 2008, Applied has temporarily suspended stock repurchases in order to maintain financial flexibility in light of uncertain global economic and market conditions.

In December 2009, Applied s Board of Directors declared a quarterly cash dividend in the amount of $0.06 per share that will be paid on March 17, 2010 to stockholders of record as of February 24, 2010. In March 2010, Applied s Board of Directors approved an increase in the quarterly cash dividend to $0.07 per share, payable on June 16, 2010 to stockholders of record as of May 26, 2010. Applied s Board of Directors also approved a new stock repurchase program authorizing up to $2 billion in repurchases over the next three years ending in March 2013. 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 $1.1 billion, of which $1.0 billion is comprised of a 5-year revolving credit agreement with a group of banks that is scheduled to expire in January 2012. This agreement provides for borrowings in United States dollars at interest rates keyed to one of the two rates selected by Applied for each advance and includes financial and other covenants with which Applied was in compliance at January 31, 2010. Remaining credit facilities in the amount of approximately $90 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 the above credit facilities at January 31, 2010.

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 January 31, 2010, the maximum potential amount of future payments that Applied could be required to make under these guarantee arrangements was $54 million. Applied has not recorded any liability in connection with these guarantee arrangements 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 arrangements.

Applied expects that changes in its business will affect its working capital components, primarily related to its Energy and Environmental Solutions segment, which includes products for manufacturing solar PVs. Applied has entered into contracts with multiple customers for its SunFab thin film line for projects of varying scale. Fulfillment of these contracts requires Applied to invest in inventory, particularly work in process, which investment may be offset by customer deposits. Changes in these contracts may result in inventory charges if Applied determines the inventory to be in excess of anticipated demand.

Applied s investment portfolio consists principally of investment grade money market mutual funds, U.S. Treasury and agency securities, municipal bonds, corporate bonds and, to a small extent, 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 three months ended January 31, 2010, as part of its regular investment review process, Applied recorded impairment charges of $1 million associated with equity investments in privately-held companies. At January 31, 2010, Applied had a gross unrealized loss in its investment portfolio of $0.8 million due to a decrease in the fair value of certain fixed income securities. Applied regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary 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 any anticipated recovery in fair value. Generally, the contractual terms of the investments do not permit settlement at prices less than the amortized cost of the investments. While Applied cannot predict future market conditions or market liquidity, Applied believes that its investment policies provide an appropriate means to manage the risks in its investment portfolio.

During the three months ended January 31, 2010, Applied recorded a bad debt provision of $6 million as a result of certain customers financial condition. During the three months ended January 25, 2009, Applied recorded a bad debt provision of $48 million as a result of certain customers deteriorating financial condition. While Applied believes that its allowance for doubtful accounts at January 31, 2010 is adequate, it will continue to closely monitor customer liquidity and economic conditions.

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 Statements of Cash Flows in this report.

**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 requires management to make judgments, assumptions and estimates that affect the amounts reported. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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:

***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. 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 results of operations.

In 2009, the Financial Accounting Standards Board issued amended revenue recognition guidance for arrangements with multiple deliverables and certain software sold with tangible products. This new guidance eliminates the residual method of revenue recognition and allows the use of management s best estimate of selling price for individual elements of an arrangement when vendor specific evidence or third party evidence is unavailable. Applied implemented this guidance prospectively beginning in the first quarter of fiscal 2010 for transactions that were initiated or materially modified during fiscal 2010. The implementation of the new guidance had an insignificant impact on reported net sales as compared to net sales under previous guidance, as the new guidance did not change the units of accounting within sales arrangements and the elimination of the residual method for the allocation of arrangement consideration had an inconsequential impact on the amount and timing of reported net sales.

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

***Goodwill and Intangible Assets***

Applied reviews goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also annually reviews goodwill and intangibles with indefinite lives for impairment. Intangible assets, such as purchased technology, are generally recorded in connection with a business acquisition. The value assigned to intangible assets is usually based on estimates and judgments regarding expectations for the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from the estimates, Applied may be required to record an impairment charge to reduce the carrying value of the reporting unit to its realizable value. The fair value of a reporting unit is estimated using both the income approach and the market approach taking into account such factors as future anticipated operating results and estimated cost of capital. Management uses significant judgment when assessing goodwill for potential impairment, especially in new emerging markets. A severe decline in market value could result in an unexpected impairment charge for impaired goodwill, which could have a material adverse effect on Applied s business, financial condition and results of operations.

***Income Taxes***

The effective tax rate is highly dependent upon the geographic composition of worldwide earnings, tax regulations governing each region, non-tax deductible expenses incurred in connection with acquisitions and availability of tax credits. Management carefully monitors the changes in many factors and adjusts the effective income tax rate as required. If actual results differ from these estimates, Applied could be required to record a valuation allowance on deferred tax assets or adjust its effective income tax rate, which could have a material adverse effect on Applied s business, financial condition and results of operations.

Applied accounts for income taxes by recognizing deferred tax assets and liabilities using statutory tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities, net operating losses and tax credit carryforwards. Deferred tax assets are also reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. Management has determined that it is more likely than not that Applied s future taxable income will be sufficient to realize its deferred tax assets.

The calculation of tax liabilities 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 a material impact on Applied s results of operations and financial condition.

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

Applied s investment portfolio includes fixed-income securities with a fair value of approximately $1.7 billion at January 31, 2010. These securities are subject to interest rate risk and will decline in value if interest rates increase. Based on Applied s investment portfolio at January 31, 2010, an immediate 100 basis point increase in interest rates would result in a decrease in the fair value of the portfolio of approximately $20 million. While an increase in interest rates reduces the fair value of the investment portfolio, Applied will not realize the losses in the consolidated condensed statement of operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary.

Certain operations of Applied are conducted in foreign currencies. Applied enters into currency forward exchange and option contracts to hedge a portion of, but not all, existing and anticipated foreign currency denominated transactions expected to occur within 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. Net foreign currency gains and losses were not material for the three months ended January 31, 2010 and January 25, 2009.

**Item 4.** ***Controls and Procedures***

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (Exchange Act), Applied s management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of Applied s disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the 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 in Applied s SEC reports is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and (ii) accumulated and communicated to Applied s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As required by Rule 13a-15(d), Applied s management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of Applied s internal control over financial reporting to determine whether any changes occurred during the fiscal quarter that have materially affected, or are reasonably likely to materially affect, Applied s internal control over financial reporting. Based on that evaluation, there has been no such change during the fiscal quarter.

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

Table of Contents

## PART II. OTHER INFORMATION

### Item 1. *Legal Proceedings*

The information set forth above under the caption Legal Matters in Note 12 contained 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 Item 1A of Applied s 2009 Form 10-K.

***The industries that Applied serves are volatile and difficult to predict.***

As a supplier to the global semiconductor, flat panel display, solar and related industries, Applied is subject to business cycles, the timing, length and volatility of which can be difficult to predict and which vary by reportable segment. These industries historically have been cyclical due to sudden changes in customers manufacturing capacity and advanced technology requirements and spending, which depend in part on customers capacity utilization, production volumes, end-use demand, and inventory levels relative to demand, as well as the rate of technology transitions and customers access to affordable capital. These changes have affected the timing and amounts of customers purchases and investments in technology, and continue to affect Applied s orders, net sales, operating expenses and net income.

To meet rapidly changing demand in the industries it serves, Applied must effectively manage its resources and production capacity for each of its segments as well as across multiple segments. 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 individuals; and continue to control costs. During periods of decreasing demand, Applied must be able to appropriately align its cost structure with prevailing market conditions; effectively manage its supply chain; and motivate and retain key employees. If Applied is not able to timely and appropriately adapt to changes in its business environment, Applied s business, financial condition or results of operations may be materially and adversely affected.

***Applied is exposed to risks associated with the difficult financial markets and weak global economy.***

The tightening of the credit markets, disruption in the financial markets, and global economic downturn that began in 2008 contributed to significant slowdowns in the industries in which Applied operates. Although economic and market conditions have improved, continuing difficulties in the credit markets and uncertainty regarding the global economic recovery are posing challenges. The markets for semiconductors and flat panel displays in particular depend largely on consumer spending. Economic uncertainty exacerbates negative trends in consumer spending and may cause certain Applied customers to push out, cancel, or refrain from placing orders for equipment or services, which may reduce net sales, reduce backlog, and affect Applied s ability to convert backlog to sales. Difficulties in obtaining capital and uncertain market conditions may also lead some customers to scale back operations, exit businesses, merge with other manufacturers, or file for bankruptcy protection and potentially cease operations, resulting in lower sales and/or additional inventory or bad debt expense for Applied. These conditions may also similarly affect key suppliers, which could impair their ability to deliver parts and result in delays for Applied s products or added costs. In addition, these conditions may lead to strategic alliances by, or consolidation of, other equipment manufacturers, which could adversely affect Applied s ability to compete effectively.

Uncertainty about future economic and industry conditions also makes it more challenging for Applied to forecast its operating results, make business decisions, and identify the risks that may affect its business, sources and uses of cash, financial condition and results of operations. Applied may be required to implement additional cost reduction efforts, including restructuring activities, and/or modify its business model, which may adversely affect Applied s ability to capitalize on opportunities in a market recovery. In addition, Applied maintains an investment portfolio that is subject to general credit, liquidity, foreign exchange, 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 could be negatively impacted and lead to impairment charges. If Applied is not able to timely and appropriately adapt to changes resulting from the uncertain macroeconomic environment and industry conditions, Applied s business, financial condition or results of operations may be materially and adversely affected.

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

The global semiconductor, flat panel display, solar and related industries in which Applied operates are characterized by ongoing changes affecting some or all of these industries, including:

- increasing capital requirements for building and operating new fabrication plants and customers ability to raise the necessary capital, particularly in a difficult financial market;
- differences in growth rates among the semiconductor, display and solar industries;
- abrupt and unforeseen shifts in the nature and amount of customer and end-user demand;
- the increasing cost and complexity for customers to move from product design to volume manufacturing, which may slow the adoption rate for new manufacturing technology;
- the need to reduce the total cost of manufacturing system ownership, due in part to greater demand for lower-cost consumer electronics as compared to business information technology spending;
- 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;
- 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, LCDs and solar PVs, 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.

If Applied does not successfully manage the risks resulting from the ongoing changes in the semiconductor, flat panel display, solar and related industries, its business, financial condition and results of operations could be materially and adversely affected.

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

The greatest portion of Applied s revenues and profitability historically has been derived from sales of manufacturing equipment to the global semiconductor industry. In addition, a majority of the revenues of Applied Global Services is from sales of service products to semiconductor manufacturers. The semiconductor industry is characterized by ongoing changes particular to that industry in addition to the general industry changes described in the preceding risk factor, including:

- the increasing cost of research and development due to many factors, including: decreasing linewidths on a chip; the use of new materials such as cobalt and yttrium; more complex device structures; more applications and process steps; increasing chip design costs; and the increasing cost and complexity of an integrated manufacturing process;

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

differing market growth rates and capital requirements for different applications, such as memory (including NAND flash and DRAM), logic and foundry, and Applied s ability to compete in these market segments;

the increasing cost and complexity for semiconductor manufacturers to move more technically advanced capability and smaller linewidths to volume manufacturing, and the resulting impact on the rates of technology transition and investment in capital equipment;

semiconductor manufacturers increasing adoption of more productive 300mm systems and reductions in 200mm system capacity, and the resulting effect on demand for manufacturing equipment and services;

the decreasing rate of capital expenditures as a percentage of semiconductor manufacturers revenue;

the decreasing profitability of many semiconductor manufacturers, causing them to enter into collaboration or cost-sharing arrangements with other manufacturers, outsource manufacturing activities, focus only on specific markets or applications, and/or purchase less manufacturing equipment, which may reduce the rate of investment in capital equipment and/or reduce Applied s margins on these products;

customers increasing need for shorter cycle times between order placement and product shipment;

technology developments in related markets, such as lithography, to which Applied may need to adapt;

competitive factors that make it difficult to enhance market position, especially in larger market segments such as etch;

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; and

the cost, technical complexity and timing of a proposed transition from 300mm to 450mm wafers.

If Applied does not successfully manage the risks resulting from the ongoing changes occurring in the semiconductor industry, its business, financial condition and results of operations could be materially and adversely affected.

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

The global flat panel display industry historically has experienced considerable volatility in capital equipment investment levels, due in part to the limited number of LCD manufacturers and the concentrated nature of LCD end-use applications. Recently, industry growth has depended to a considerable extent on consumer demand for increasingly larger and more advanced TVs. In addition to the general industry changes described above in the third risk factor, the display industry is characterized by ongoing changes particular to that industry, including:

technical and financial difficulties associated with transitioning to larger substrate sizes for LCDs;

the effect of a slowing rate of transition to larger substrate sizes on capital intensity and product differentiation;

new energy efficiency standards for large-screen LCD TVs ; and uncertainty with respect to future LCD technology end-use applications and growth drivers.

If Applied does not successfully manage the risks resulting from the ongoing changes occurring in the display industry, its business, financial condition and results of operations could be materially and adversely affected.

Table of Contents

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

Applied anticipates that an increasing portion of its business will be in the emerging solar market, which, in addition to the general industry changes described above in the third risk factor, is characterized by ongoing changes specific to the solar industry, including:

- the impact on demand for solar PV products arising from the cost of electricity generated by solar PV technology compared to the cost of electricity from the existing grid or other energy sources;
- the critical role played by energy policies of governments around the world in influencing the rate of growth of the solar market, including the availability and amount of government incentives for solar power such as tax credits, incentives, rebates, renewable portfolio standards that require electricity providers to sell a targeted amount of energy from renewable sources, and goals for solar installations on government facilities;
- changes in the nature and amount of end demand for solar PVs that adversely impact the sales growth rates and profitability of Applied s products;
- the uncertain rate of growth for the thin film solar market, which depends in part on the relative cost and performance of competing solar products, as well as the extent of investment or participation in the solar market by utilities and other power providers that generate, transmit or distribute power to end-users;
- evolving industry standards, such as a standard form factor for thin film solar modules;
- varying levels of infrastructure investment for smart grid technologies to modernize and enhance the transmission, distribution and use of electricity, which link distributed solar PV sources to population centers, increase transmission capability, and optimize power usage;
- regulatory and third party certification requirements, and customers ability to timely satisfy such requirements;
- the increasing rate of production of solar PVs in China;
- access to affordable financing and capital by customers and end-users; and
- increasingly greater factory output and scalability of solar PVs.

If Applied does not successfully manage the risks resulting from the ongoing changes occurring in the solar industry, its business, financial condition and results of operations could be materially and adversely affected.

***Applied must adapt its business and product offerings to respond to competition and rapid technological changes.***

As Applied operates in a highly competitive environment, its future success depends on many factors, including the effective commercialization and customer acceptance of its nanomanufacturing technology equipment, service and related products. In addition, Applied must successfully execute its growth strategy, including enhancing market share in existing markets, expanding into related markets, cultivating new markets and exceeding industry growth rates, while constantly improving its operational performance. The development, introduction and support of a broadening set of products in more varied competitive environments have grown increasingly complex and expensive over time. Furthermore, new or improved products may entail higher costs and reduced profits. Applied s success is subject to many risks, including its ability to timely, cost-effectively and successfully:

develop new products, improve and/or develop new applications for existing products, and adapt similar products for use by customers in different applications and/or markets with varying technical requirements;

appropriately price and achieve market acceptance of products;

differentiate its products from those of competitors and any disruptive technologies, meet performance specifications, and drive efficiencies and cost reductions;

maintain operating flexibility to enable different responses to different markets, customers and applications;

grow the market acceptance and profitability of its thin film solar products;

allocate resources, including people and R&D funding, among Applied s products and between the development of new products and the enhancement of existing products, as most appropriate and effective for future growth;

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 volume manufacturing with its customers;

implement changes in its design engineering methodology, including those that enable reduction of material costs and cycle time, greater commonality of platforms and types of parts used in different systems, greater effectiveness of product life cycle management, and reduced energy usage and environmental impact; and

accomplish the simultaneous start-up of multiple integrated thin film solar production lines.

If Applied does not successfully manage these challenges, its business, financial condition and results of operations could be materially and adversely affected.

***Operating in multiple industries, and the entry into new markets and industries, entail additional challenges.***

As part of its growth strategy, Applied must successfully expand into related or new markets and industries, either with its existing nanomanufacturing technology products or with new products developed internally or obtained through acquisitions. The entry into different markets involves additional challenges, including those arising from:

the need to devote additional resources to develop new products for, and operate in, new markets;

differing rates of profitability and growth among its 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, such as the supply of an integrated production line consisting of a suite of Applied and non-Applied equipment to manufacture solar PVs;

the need to undertake activities to grow demand for end-products;

the need to develop adequate new business processes and systems;

Applied s ability to rapidly expand its operations to meet increased demand and the associated effect on working capital;

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 and/or limited funding, evolving business models and/or locations in regions where Applied does not have existing operations;

different customer service requirements;

new and/or different competitors with potentially more financial or other resources and industry experience;

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.

If Applied does not successfully manage the risks resulting from its diversification and entry into new markets and industries, its business, financial condition and results of operations could be materially and adversely affected.

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

In the first quarter of fiscal 2010, approximately 87 percent of Applied s net sales were to customers in regions outside the United States. Certain of Applied s R&D and/or manufacturing facilities, as well as suppliers to Applied, are also located outside the United States, including in China. Applied is also expanding its business and operations in new countries. The global nature of Applied s business and operations presents challenges, including but not limited to those arising from:

varying regional and geopolitical 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;

variations among, and changes in, local, regional, national or international laws and regulations (including protection of intellectual property and other legal rights, and tax and import /export restrictions), as well as the interpretation and application of such laws and regulations;

global trade issues, including those related to the interpretation and application of import and export licenses;

positions taken by U.S. governmental agencies regarding possible national commercial and/or security issues posed by international business operations;

fluctuating raw material and energy costs;

challenges associated with managing more geographically and culturally diverse operations, projects and people;

variations in the ability to develop relationships with suppliers and other local businesses;

fluctuations in interest rates and currency exchange rates, including the relative strength or weakness of the U.S. dollar;

the need to provide sufficient levels of technical support in different locations;

political instability, natural disasters (such as earthquakes, floods or storms), pandemics, terrorism or acts of war in locations where Applied has operations, suppliers or sales;

cultural and language differences;

shipping costs and/or delays;

- the need to continually improve the Company s operating cost structure;
- difficulties and uncertainties associated with the entry into new countries;
- uncertainties with respect to economic growth rates in various countries; and
- uncertainties with respect to growth rates for the manufacture and sales of semiconductors, LCDs and solar PVs in the developing economies of certain countries.

Many of these challenges are present in China, which is experiencing significant growth of both suppliers and competitors to Applied. Applied further believes that China presents a large potential market for its products and opportunity for growth over the long term, although at lower projected levels of profitability and margins than historically have been achieved in other regions. In addition, Applied must regularly reassess the size, capability and location of its global infrastructure and make appropriate changes, and must have effective change management processes and procedures to address changes in its business and operations. These challenges may materially and adversely affect Applied s business, financial condition and results of operations.

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

Applied s semiconductor and flat panel display customer bases historically have been, and are becoming even more, highly concentrated as a result of industry conditions. These conditions are also adversely affecting customers profitability and access to capital, which leads to lower R&D funding and capital expenditures. In addition, certain customers have entered into strategic alliances or industry consortia that have increased the influence of key industry participants in technology decisions made by their partners. In the solar area, while the number of solar PV manufacturing customers increases as the number of market entrants grows, the size of contracts with particular customers is expected to rise substantially as the industry moves to greater solar module factory output capacity. The adverse conditions in the credit and financial markets and industry slowdowns in recent periods have caused, and may continue to cause, some customers to postpone delivery, reduce or cancel orders, scale back operations, exit businesses, merge with other manufacturers, or file for bankruptcy protection and potentially cease operations. In this environment, contracts or orders from a relatively limited number of semiconductor, display and solar manufacturers have accounted for, and are expected to continue to account for, a substantial portion of Applied s business. In addition, the mix and type of customers, and sales to any single customer, may vary significantly from quarter to quarter and from year to year. If customers do not place orders, or they substantially reduce, delay or cancel orders, Applied may not be able to replace the business. As Applied s products are configured to customer specifications, changing, rescheduling or canceling orders may result in significant, non-recoverable costs. Major customers may also seek, and on occasion receive, pricing, payment, intellectual property-related, or other commercial terms that are less favorable to Applied. In addition, certain customers have undergone significant ownership and/or management changes, outsourced manufacturing activities, engaged in collaboration or cooperation arrangements with other customers, or consolidated with other customers, each of which may result in additional complexities in managing customer relationships and transactions, as well as cancelled or decreased orders and lower net sales. These factors could have a material adverse effect on Applied s business, financial condition and results of operations.

***Manufacturing interruptions or delays could affect Applied s ability to meet customer demand, while the failure to estimate customer demand accurately could result in excess or obsolete inventory.***

Applied s business depends on its ability to timely supply 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, components and subassemblies (collectively, parts) from suppliers. Some key parts may be subject to long lead-times and/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 United States, including China. Further, the adverse conditions in the credit and financial markets and industry slowdowns in recent periods have caused, and may continue to cause, some suppliers to scale back operations, exit businesses, merge with other companies, or file for bankruptcy protection and possibly cease operations, potentially affecting Applied s ability to obtain quality parts on a timely basis. Applied may 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 of suppliers to timely deliver quality parts;
- volatility in the availability and cost of materials;
- difficulties or delays in obtaining required import or export approvals;

information technology or infrastructure failures;

natural disasters (such as earthquakes, floods or storms); or

other causes (such as regional economic downturns, pandemics, political instability, terrorism, or acts of war) that could result in delayed deliveries, manufacturing inefficiencies, increased costs or order cancellations.

Table of Contents

In addition, Applied s need to rapidly increase its business and manufacturing capacity to meet increases in demand or expedited shipment schedules 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. The volatility of demand for capital equipment increases capital, technical and other risks for companies in the supply chain. Any or all of these factors could materially and adversely affect Applied s business, financial condition and results of operations.

***Applied is exposed to risks associated with acquisitions and strategic investments.***

Applied has made, and in the future intends to make, acquisitions of, and investments in, companies, technologies or products in existing, related or new markets for Applied. Acquisitions involve numerous risks, including but not limited to:

diversion of management s attention from other operational matters;

inability to complete acquisitions as anticipated or at all;

inability to realize anticipated benefits;

failure to commercialize purchased technologies;

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;

failure to attract, retain and motivate key employees from the acquired business;

exposure to new operational risks, rules, regulations, customs and practices to the extent acquired businesses are located in countries 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, and/or environmental, health & safety, human resource, or other policies;

impairment of acquired intangible assets as a result of technological advancements or worse-than-expected performance of the acquired company or its product offerings;

the risk of litigation or disputes with customers, suppliers, partners or stockholders of an acquisition target arising from a proposed or completed transaction;

unknown, underestimated and/or undisclosed commitments or liabilities;

inappropriate scale of acquired entities critical resources or facilities for business needs; and

ineffective integration of operations, systems, technologies, products or employees of an acquired business.

Applied also makes strategic investments in other companies, including companies formed as joint ventures, which may decline in value and/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. Mergers and acquisitions and strategic investments are inherently subject to significant risks, and the inability to effectively manage these risks could materially and adversely affect Applied s business, financial condition and results of operations. If Applied does not successfully manage the risks associated with acquisitions and strategic investments, its business, financial condition and results of operations could be materially and adversely affected.

***The failure to successfully implement and conduct off-shoring and outsourcing activities and other operational initiatives could adversely affect results of operations.***

To better align its costs with market conditions, increase its presence in growing markets, enhance productivity, and improve efficiencies, Applied conducts engineering, software development and other operations in regions outside the United States, particularly India and China, and outsources certain functions to third parties, including companies in the United States, India, China and other countries. Outsourced functions include certain engineering, manufacturing, customer support, software development, information technology support, finance and administrative activities. The expanding role of third party providers has required changes to Applied s existing operations and the adoption of new procedures and processes for retaining and managing these providers, as well as redistributing responsibilities as warranted, in order to realize the potential productivity and operational efficiencies, assure quality and continuity of supply, and protect Applied s intellectual property.

In addition, Applied is implementing a comprehensive program to better align its global organizations and processes, including initiatives to enhance the Asia supply chain, integrate its sales teams into the business units, and improve back office and information technology infrastructure for more efficient transaction processing. Applied also is implementing a multi-year, company-wide program to transform certain business processes, including the transition to a single enterprise resource planning (ERP) software system to perform various functions. The implementation of additional functionality to the ERP system entails certain risks, including difficulties with changes in business processes that could disrupt Applied s operations, such as its ability to track orders and timely ship products, project inventory requirements, manage its supply chain and aggregate financial and operational data. The implementation of new initiatives may not achieve the anticipated benefits and may divert management s attention from other operational activities, negatively affect employee morale, or have other unintended consequences.

If Applied does not effectively develop and implement its off-shoring and outsourcing strategies, if required export and other governmental approvals are not timely obtained, if Applied s third party providers do not perform as anticipated, or if there are delays or difficulties in enhancing business processes, Applied may not realize anticipated productivity improvements or cost efficiencies, and may experience operational difficulties, increased costs (including energy and transportation), manufacturing interruptions or delays, inefficiencies in the structure and/or operation of its supply chain, loss of its intellectual property rights, quality issues, increased product time-to-market, and/or inefficient allocation of human resources, any or all of which could materially and adversely affect Applied s business, financial condition and results of operations.

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

Applied s success and competitiveness depend in large part on its ability to attract, retain and motivate key employees. Achieving this objective may be difficult due to many factors, including fluctuations in global economic and industry conditions, changes in Applied s management or leadership, competitors hiring practices, cost reduction activities (including workforce reductions), and the effectiveness of Applied s compensation and benefit programs, including its equity-based programs. Applied periodically evaluates its overall compensation program and makes adjustments, as appropriate, to enhance its competitiveness. If Applied does not successfully attract, retain and motivate key employees, Applied may be unable to capitalize on its opportunities and its operating results may be materially and adversely affected.

***Changes in tax rates or tax assets and liabilities could affect results of operations.***

As a global company, Applied is subject to taxation in the United States and various other countries. Significant judgment is required to determine and estimate worldwide tax liabilities. Applied s future annual and quarterly tax rates could be affected by numerous factors, including changes in the: (1) applicable tax laws; (2) amount and composition of pre-tax income in countries with differing tax rates; or (3) valuation of Applied s deferred tax assets and liabilities. In addition, Applied is subject to regular examination by the Internal Revenue Service and other tax authorities, and from time to time initiates amendments to 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. 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 accruals, which could materially and adversely affect Applied s financial condition and results of operations.

***Applied is exposed to various risks related to legal proceedings or claims and protection of intellectual property rights.***

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, employment and other matters. In addition, Applied 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. Recently, the Seoul Prosecutor s Office for the Eastern District in Korea indicted and/or arrested several employees of Applied Materials Korea (AMK), including the former head of AMK who is currently a vice president of Applied Materials, Inc., in connection with a criminal investigation into the alleged improper receipt and use of a customer s confidential information.

These legal proceedings and claims, whether with or without merit, may be time-consuming and expensive to prosecute or defend, divert management s attention and resources, inhibit Applied s ability to sell its products, and/or negatively affect its business relationships. There can be no assurance regarding the outcome of current or future legal proceedings or claims. Applied previously entered into a mutual covenant-not-to-sue arrangement with one of its competitors to decrease the risk of patent infringement lawsuits in the future. There can be no assurance that the intended results of this arrangement will be achieved or that Applied will be able to adequately protect its intellectual property rights with the restrictions associated with such a covenant. In addition, Applied s success depends in significant part on the protection of its intellectual property and other 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. Applied s intellectual property rights may not provide significant competitive advantages if they are circumvented, invalidated, rendered obsolete by the rapid pace of technological change, or if Applied does not adequately protect or assert these rights. Furthermore, the laws and practices of other countries, including China, India, Taiwan and Korea, permit the protection and enforcement of Applied s rights to varying extents, which may not be sufficient to protect Applied s rights. If Applied is not able to resolve or settle claims, obtain or enforce intellectual property rights, obtain necessary licenses on commercially reasonable terms, and/or successfully prosecute or defend its intellectual property position, Applied s business, financial condition and results of operations could be materially and adversely affected and Applied may suffer harm to its reputation.

***Applied is subject to risks of non-compliance 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; recycling and disposal of 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, such as those related to climate change, could result in: (1) significant remediation liabilities; (2) the imposition of fines; (3) the suspension or termination of the development, manufacture, sale or use of certain of its products; (4) limitations on the operation of its facilities or ability to use its real property; and/or (5) a decrease in the value of its real property, each of which could have a material adverse effect on Applied s business, financial condition and results of operations.

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

Applied is subject to various risks related to: (1) new, different, inconsistent or even conflicting laws, rules and regulations that may be enacted by legislative bodies and/or regulatory agencies in the countries in which Applied operates; (2) disagreements or disputes between national or regional regulatory agencies related to international trade; and (3) the interpretation and application of laws, rules and regulations. If Applied is found by a court or

Table of Contents

regulatory agency not to be in compliance with applicable laws, rules or regulations, Applied s business, financial condition and results of operations could be materially and adversely affected.

***Applied is subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act.***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, Applied must include in its Annual Report on Form 10-K a report of management on the effectiveness of Applied s internal control over financial reporting. Ongoing compliance with this requirement is complex, costly and time-consuming. If Applied fails to maintain effective internal control over financial reporting or Applied s management does not timely assess the adequacy of such internal control, Applied could be subject to regulatory sanctions and the public s perception of Applied may decline.

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

None.

**Item 3.** ***Defaults Upon Senior Securities***

None.

**Item 4.** ***[Reserved]***

**Item 5.** ***Other Information***

None.

Table of Contents

## Item 6. *Exhibits*

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

| Exhibit No | Description |
|---|---|
| 2.2 | Agreement and Plan of Merger, dated November 16, 2009, among Applied Materials, Inc., Semitool, Inc. and Jupiter Acquisition Sub, Inc. |
| 10.65 | Applied Materials, Inc. Stock Purchase Plan for Offshore Employees, amended and restated effective December 7, 2009, incorporated by reference to Applied s Form S-8 (file no. 333-165035) filed February 23, 2010. |
| 10.66 | Applied Materials, Inc. Employees Stock Purchase Plan, amended and restated effective February 23, 2010, incorporated by reference to Applied s Post-Effective Amendment No. 2 to Registration Statement on Form S-8 (file no. 333-143377) filed February 23, 2010. |
| 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.LAB | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Label Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Presentation Linkbase Document |

## 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/ GEORGE S. DAVIS
George S. Davis
*Executive Vice President,*
*Chief Financial Officer*
*(Principal Financial Officer)*

March 9, 2010

By: /s/ YVONNE WEATHERFORD
Yvonne Weatherford
*Corporate Vice President,*
*Corporate Controller*
*(Principal Accounting Officer)*

March 9, 2010