

Theravance Biopharma, Inc.  
Form SC 13G/A  
February 14, 2017

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

SCHEDULE 13G

**(Rule 13d-102)**

**INFORMATION TO BE INCLUDED IN THE STATEMENTS FILED**

**PURSUANT TO RULES 13d-1(b), (c), AND (d) AND AMENDMENTS THERETO**

**FILED PURSUANT TO RULE 13d-2(b)**

(Amendment No. 3)\*

Theravance Biopharma, Inc.

(Name of Issuer)

Ordinary Shares, par value \$0.00001

(Title of Class of Securities)

G8807B106

(CUSIP Number)

December 31, 2016

(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:

Rule 13d-1(b)

Rule 13d-1(c)

Rule 13d-1(d)

\*The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.

The information required in the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 ("Act") or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

CUSIP NO. G8807B106 SCHEDULE 13G

NAMES OF REPORTING PERSONS

**1** I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (Entities Only)

**2** Woodford Investment Management Ltd  
CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (a)   
(b)

**3** SEC USE ONLY

**4** CITIZENSHIP OR PLACE OF ORGANIZATION

United Kingdom  
SOLE VOTING POWER

**5**

NUMBER OF 0  
SHARES SHARED VOTING POWER

**6**  
BENEFICIALLY

10,507,608 Ordinary Shares  
OWNED BY SOLE DISPOSITIVE POWER  
EACH

**7**  
REPORTING

0  
PERSON WITH SHARED DISPOSITIVE POWER

**8**

**9** 10,507,608 Ordinary Shares  
AGGREGATE AMOUNT  
BENEFICIALLY OWNED BY EACH

REPORTING PERSON

**10** 10,507,608 Ordinary Shares  
CHECK BOX IF THE AGGREGATE  
AMOUNT IN ROW (9) EXCLUDES  
CERTAIN SHARES

**11** PERCENT OF CLASS REPRESENTED  
BY AMOUNT IN ROW (9)

20.2% (See Item 4)  
**12** TYPE OF REPORTING PERSON

OO

2

CUSIP NO. G8807B106 **SCHEDULE 13G**

NAMES OF REPORTING PERSONS

**1** I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (Entities Only)

**2** Neil Woodford  
CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (a)  (b)

**3** SEC USE ONLY

**4** CITIZENSHIP OR PLACE OF ORGANIZATION

United Kingdom  
SOLE VOTING POWER

**5**

NUMBER OF 0  
SHARED VOTING POWER  
SHARES

**6**  
BENEFICIALLY 10,507,608 Ordinary Shares  
OWNED BY SOLE DISPOSITIVE POWER  
EACH

**7**  
REPORTING 0  
PERSON WITH SHARED DISPOSITIVE POWER

**8**

**9** 10,507,608 Ordinary Shares  
AGGREGATE AMOUNT  
BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

10,507,608 Ordinary Shares  
CHECK BOX IF THE AGGREGATE  
AMOUNT IN ROW (9) EXCLUDES  
CERTAIN SHARES

**10**

PERCENT OF CLASS REPRESENTED  
BY AMOUNT IN ROW (9)

**11**

20.2% (See Item 4)  
TYPE OF REPORTING PERSON

**12**

IN

3

CUSIP NO. G8807B106 **SCHEDULE 13G**

**Item 1(a). Name of Issuer:**

Theravance Biopharma, Inc. (the "Issuer").

**Item 1(b). Address of Issuer's Principal Executive Offices:**

Ugland House, South Church Street

George Town, Grand Cayman, Cayman Islands

**Items 2(a),  
(b) and (c). Name of Persons Filing, Address of Principal Business Office and Citizenship:**

This Amendment No. 3 to Schedule 13G is being filed jointly by Woodford Investment Management Ltd (the "Reporting Person") and Neil Woodford, the Head of Investment for the Reporting Person. The joint filing agreement of the Reporting Person and Mr. Woodford is attached as Exhibit 1 to this Amendment No. 3 to Schedule 13G. The filers of this statement are collectively referred to herein as the "Group."

The principal business office of the Reporting Person and Mr. Woodford is 9400 Garsington Road, Oxford, OX4 2HN, UK. The Reporting Person and Mr. Woodford are citizens of the United Kingdom.

**Item 2(d). Title of Class of Securities:**

Ordinary Shares, par value \$0.00001 ("Ordinary Shares").

**Item 2(e). CUSIP Number:**

G8807B106

**Item 3.** If this statement is filed pursuant to §§240.13d-1(b) or 240.13d-2(b) or (c), check whether the person filing is a:

- (a) Broker or dealer registered under section 15 of the Act (15 U.S.C. 78o).
- (b) Bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c).
- (c) Insurance company as defined in section 3(a)(19) of the Act (15 U.S.C. 78c).
- (d) Investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C 80a-8).
- (e) An investment adviser in accordance with §240.13d-1(b)(1)(ii)(E).
- (f) An employee benefit plan or endowment fund in accordance with §240.13d-1(b)(1)(ii)(F).
- (g) A parent holding company or control person in accordance with § 240.13d-1(b)(1)(ii)(G).
- (h) A savings associations as defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813).
- (i) A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3).
- (j) A non-U.S. institution in accordance with §240.13d-1(b)(1)(ii)(J).
- (k) Group, in accordance with §240.13d-1(b)(1)(ii)(K). If filing as a non-U.S. institution in accordance with §240.13d-1(b)(1)(ii)(J), please specify the type of institution:



CUSIP NO. G8807B106 SCHEDULE 13G

**Item 4. Ownership.**

(a) Amount beneficially owned:

The members of the Group may be deemed to have beneficial ownership of 10,507,608 Ordinary Shares. Mr. Woodford, who by virtue of acting as Head of Investments for the Reporting Person may be deemed to share beneficial ownership of such Ordinary Shares with the Reporting Person, expressly disclaims beneficial ownership of the Ordinary Shares beneficially owned by the Reporting Person, except to the extent of any pecuniary interest therein.

(b) Percent of class:

Based on 51,942,489 Ordinary Shares of the Issuer issued and outstanding as of as of November 3, 2016, as reported in the Issuer's Form 10-Q filed with the Securities and Exchange Commission on November 9, 2016, the members of the Group hold approximately 20.2% of the issued and outstanding Ordinary Shares of the Issuer.

(c) Number of shares to which such person has:

(i) Sole power to vote or direct the vote: 0

(ii) Shared power to vote or direct the vote: 10,507,608

(iii) Sole power to dispose or to direct the disposition of: 0

(iv) Shared power to dispose of or direct the disposition of: 10,507,608

CUSIP NO. G8807B106 SCHEDULE 13G

**Item 5. Ownership of Five Percent or Less of a Class.**

Not applicable

**Item 6. Ownership of More than Five Percent on Behalf of Another Person.**

Not applicable

**Item 7. Identification and Classification of the Subsidiary Which Acquired the Security Being Reported By the Parent Holding Company.**

Not applicable

**Item 8. Identification and Classification of Members of the Group.**

Not applicable

**Item 9. Notice of Dissolution of a Group.**

Not applicable

**Item 10. Certification.**

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.



CUSIP NO. G8807B106 **SCHEDULE 13G**

**SIGNATURES**

After reasonable inquiry and to the best of our knowledge and belief, the undersigned certify that the information set forth in this statement is true, complete and correct.

Dated: February 14, 2017

**WOODFORD INVESTMENT  
MANAGEMENT LTD**

By: /s/ Simon Osborne  
Name: Simon Osborne  
Title: Head of Compliance and  
Authorized Signatory

/s/ Neil Woodford  
Neil Woodford

**This Amendment No. 3 to Schedule 13G is being jointly filed by Woodford Investment Management Ltd ("WIM") and Neil Woodford. WIM is an investment manager, authorized and regulated by the Financial Conduct Authority, in the business of investment management. Mr. Woodford serves as the Head of Investment for the Reporting Person. Mr. Woodford, as a controlling person of WIM, may be deemed to have beneficial ownership under Section 13 of the Securities Exchange Act of 1934, as amended, of the securities beneficially owned by WIM. Securities reported on this Amendment No. 3 to Schedule 13G as being beneficially owned by WIM were purchased on behalf of its clients.**

**Pursuant to Rule 13d-4, Mr. Woodford declares that the filing of this Amendment No. 3 to Schedule 13G shall not be deemed an admission by that he is, for the purposes of Section 13 of the Securities Exchange Act of 1934, as amended, the beneficial owner of any securities covered by this Amendment No. 3 to Schedule 13G.**

CUSIP NO. G8807B106 **SCHEDULE 13G**

**EXHIBIT 1**

**JOINT FILING AGREEMENT**

In accordance with Rule 13d-1(k) under the Securities Exchange Act of 1934, as amended, the persons named below agree to the joint filing on behalf of each of them of a statement on Schedule 13G (including amendments thereto) with respect to the Ordinary Shares of the Issuer and further agree that this Joint Filing Agreement be included as an Exhibit to such joint filings.

Dated: February 14, 2017

**WOODFORD INVESTMENT  
MANAGEMENT LTD**

By: /s/ Simon Osborne  
Name: Simon Osborne  
Title: Head of Compliance and  
Authorized Signatory

/s/ Neil Woodford  
Neil Woodford

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(16  
)

(5  
)  
Change in defined and postretirement benefit plans

—

—

(43  
)  
Change in cumulative translation adjustments  
—

11

—

9  
Other comprehensive income (loss), net of tax  
8

7

5

(42  
)  
Comprehensive income  
\$  
513

\$  
336

\$  
1,116

\$  
999

See accompanying Notes to Consolidated Condensed Financial Statements.



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

	July 31, 2016	October 25, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$2,828	\$ 4,797
Short-term investments	438	168
Accounts receivable, net	1,852	1,739
Inventories	2,026	1,833
Other current assets	255	724
Total current assets	7,399	9,261
Long-term investments	960	946
Property, plant and equipment, net	905	892
Goodwill	3,305	3,302
Purchased technology and other intangible assets, net	621	762
Deferred income taxes and other assets	509	145
Total assets	\$13,699	\$ 15,308

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:		
Short-term debt	\$—	\$ 1,200
Accounts payable and accrued expenses	1,800	1,833
Customer deposits and deferred revenue	1,164	765
Total current liabilities	2,964	3,798
Long-term debt	3,343	3,342
Other liabilities	573	555
Total liabilities	6,880	7,695
Stockholders' equity:		
Common stock	11	11
Additional paid-in capital	6,714	6,575
Retained earnings	14,750	13,967
Treasury stock	(14,569 )	(12,848 )
Accumulated other comprehensive loss	(87 )	(92 )
Total stockholders' equity	6,819	7,613
Total liabilities and stockholders' equity	\$13,699	\$ 15,308

Amounts as of July 31, 2016 are unaudited. Amounts as of October 25, 2015 are derived from the October 25, 2015 audited consolidated financial statements.

See accompanying Notes to Consolidated Condensed Financial Statements.



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APPLIED MATERIALS, INC  
CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY  
(In millions)

Nine Months Ended July 31, 2016	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
	(Unaudited)							
Balance at October 25, 2015	1,160	\$ 11	\$ 6,575	\$ 13,967	793	\$(12,848)	\$ (92 )	\$ 7,613
Net income	—	—	—	1,111	—	—	—	1,111
Other comprehensive income (loss), net of tax	—	—	—	—	—	—	5	5
Dividends	—	—	—	(328 )	—	—	—	(328 )
Share-based compensation	—	—	150	—	—	—	—	150
Issuance under stock plans, net of a tax benefit of \$18 and other	11	—	(11 )	—	—	—	—	(11 )
Common stock repurchases	(90 )	—	—	—	90	(1,721 )	—	(1,721 )
Balance at July 31, 2016	1,081	\$ 11	\$ 6,714	\$ 14,750	883	\$(14,569)	\$ (87 )	\$ 6,819
Nine Months Ended July 26, 2015	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
	(Unaudited)							
Balance at October 26, 2014	1,221	\$ 12	\$ 6,384	\$ 13,072	717	\$(11,524)	\$ (76 )	\$ 7,868
Net income	—	—	—	1,041	—	—	—	1,041
Other comprehensive loss, net of tax	—	—	—	—	—	—	(42 )	(42 )
Dividends	—	—	—	(366 )	—	—	—	(366 )
Share-based compensation	—	—	141	—	—	—	—	141
Issuance under stock plans, net of a tax benefit of \$54 and other	12	—	(40 )	—	—	—	—	(40 )
Common stock repurchases	(32 )	—	—	—	32	(625 )	—	(625 )
Balance at July 26, 2015	1,201	\$ 12	\$ 6,485	\$ 13,747	749	\$(12,149)	\$ (118 )	\$ 7,977

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.  
 CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
 (In millions)

	Nine Months Ended	
	July 31, 2016	July 26, 2015
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$1,111	\$1,041
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	289	275
Share-based compensation	150	141
Excess tax benefits from share-based compensation	(18 )	(54 )
Deferred income taxes	14	25
Other	20	64
Changes in operating assets and liabilities:		
Accounts receivable	(112 )	(322 )
Inventories	(192 )	(172 )
Other current and non-current assets	52	(2 )
Accounts payable and accrued expenses	(84 )	(174 )
Customer deposits and deferred revenue	399	(82 )
Income taxes payable	38	(72 )
Other liabilities	2	24
Cash provided by operating activities	1,669	692
Cash flows from investing activities:		
Capital expenditures	(165 )	(162 )
Cash paid for acquisitions, net of cash acquired	(5 )	(2 )
Proceeds from sales and maturities of investments	681	900
Purchases of investments	(947 )	(960 )
Cash used in investing activities	(436 )	(224 )
Cash flows from financing activities:		
Debt repayments	(1,207 )	—
Proceeds from common stock issuances	44	43
Common stock repurchases	(1,721 )	(625 )
Excess tax benefits from share-based compensation	18	54
Payments of dividends to stockholders	(336 )	(368 )
Cash used in financing activities	(3,202 )	(896 )
Decrease in cash and cash equivalents	(1,969 )	(428 )
Cash and cash equivalents — beginning of period	4,797	3,002
Cash and cash equivalents — end of period	\$2,828	\$2,574
Supplemental cash flow information:		
Cash payments for income taxes	\$144	\$258
Cash refunds from income taxes	\$104	\$10
Cash payments for interest	\$110	\$85

See accompanying Notes to Consolidated Condensed Financial Statements.



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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation

Basis of Presentation

In the opinion of management, the unaudited interim consolidated condensed financial statements of Applied Materials, Inc. and its subsidiaries (Applied or the Company) included herein have been prepared on a basis consistent with the October 25, 2015 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, 2015 (2015 Form 10-K). Applied's results of operations for the three and nine months ended July 31, 2016 are not necessarily indicative of future operating results. Applied's fiscal year ends on the last Sunday in October of each year. Fiscal 2016 and 2015 contain 53 weeks and 52 weeks, respectively, and the first nine months of fiscal 2016 and 2015 contained 40 weeks and 39 weeks, respectively.

Effective in the third quarter of fiscal 2016, Applied began to account for its roll-to-roll web coating systems (previously included in the Energy and Environmental Solutions segment) and display upgrade equipment (previously included in the Applied Global Services segment) under the Display and Adjacent Markets segment (previously Display). As a result of these changes, Applied's solar business (previously included in the Energy and Environmental Solutions segment) is included in Corporate and Other as it did not meet the threshold for a separate reportable segment. Results for prior periods have been recast to conform to the current presentation. As of July 31, 2016, Applied's three primary reportable segments are: Semiconductor Systems (previously Silicon Systems), Applied Global Services and Display and Adjacent Markets. See Note 14 of Notes to the Consolidated Condensed Financial Statements for further detail on reportable segments.

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

Use of Estimates

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

Revenue Recognition

Applied recognizes revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; seller's price to buyer is fixed or determinable; and collectability is probable. Applied's shipping terms are customarily FOB Applied shipping point or equivalent terms. Applied's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment or delivery, Applied recognizes revenue upon passage of title for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer technical acceptance; (3) for transactions where legal title does not pass at shipment or delivery, revenue is recognized when legal title passes to the customer, which is generally at customer technical acceptance; and (4) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred using the relative selling price method utilizing estimated sales prices

until delivery of the deferred elements. Applied limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or adjustment. In cases where Applied has sold products that have been demonstrated to meet product specifications prior to shipment, Applied believes that at the time of delivery, it has an enforceable claim to amounts recognized as revenue. Spare parts revenue is generally recognized upon shipment, and services revenue is generally recognized over the period that the services are provided.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

When a sales arrangement contains multiple elements, such as hardware and services and/or software products, Applied allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or estimated selling price (ESP) if neither VSOE nor TPE is available. Applied generally utilizes the ESP due to the nature of its products. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables, and to the software deliverables as a group, using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue.

Recent Accounting Pronouncements

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

In March 2016, the FASB issued authoritative guidance that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The authoritative guidance will be effective for Applied in the first quarter of fiscal 2018. Early adoption is permitted as of the beginning of an interim or annual reporting period. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

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

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

In November 2015, the FASB issued authoritative guidance requiring all deferred tax assets and liabilities, and any related valuation allowance, to be classified as noncurrent on the balance sheet. Applied elected to prospectively adopt the authoritative guidance in the beginning of the first quarter of fiscal 2016. Prior periods were not retrospectively adjusted.

In July 2015, the FASB issued authoritative guidance that requires inventory to be measured at the lower of cost and net realizable value instead of at lower of cost or market. This guidance does not apply to inventory that is measured using last-in, first out (LIFO) or the retail inventory method but applies to all other inventory including those measured using first-in, first-out (FIFO) or the average cost method. The authoritative guidance will be effective for

Applied in the first quarter of fiscal 2018 and should be applied prospectively. Early adoption is permitted as of the beginning of an interim or annual reporting period. Applied is currently evaluating the effect of this new guidance on Applied's consolidated financial statements.

In May 2015, the FASB issued authoritative guidance to remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The new guidance also removes the requirement of certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. The guidance becomes effective retrospectively for Applied in the first quarter of fiscal 2017. Early adoption is permitted. The adoption of this guidance will only impact disclosures in Applied's financial statements.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

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

In April 2015, the FASB issued authoritative guidance that requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability, consistent with debt discounts. The authoritative guidance is effective for Applied in the first quarter of fiscal 2017 and should be applied retrospectively. Early adoption is permitted. The adoption of this guidance is not expected to have a significant impact on Applied's consolidated financial statements.

In May 2014, the FASB issued authoritative guidance that requires revenue recognition to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This new standard will supersede most current revenue recognition guidance, including industry-specific guidance. Entities will have the option of using either a full retrospective or modified retrospective approach to adopting the guidance. Under the modified approach, an entity would recognize the cumulative effect of initially applying the guidance with an adjustment to the opening balance of retained earnings in the period of adoption. In addition, the modified approach will require additional disclosures. In August 2015, the FASB issued an amendment to defer the effective date by one year and allow entities to early adopt no earlier than the original effective date. With this amendment, the guidance will be effective for Applied in the first quarter of fiscal 2019. Subsequent to the amendment, the FASB issued additional clarifying implementation guidance. Applied is currently evaluating the effect of this new guidance on Applied's financial position, results of operations and its ongoing financial reporting, including the selection of a transition method.

## Note 2 Earnings Per Share

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

	Three Months Ended		Nine Months Ended	
	July 31, 2016	July 26, 2015	July 31, 2016	July 26, 2015
	(In millions, except per share amounts)			
Numerator:				
Net income	\$505	\$ 329	\$1,111	\$1,041
Denominator:				
Weighted average common shares outstanding	1,083	1,221	1,115	1,225



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Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	10	10	8	13
Denominator for diluted earnings per share	1,093	1,231	1,123	1,238
Basic earnings per share	\$0.47	\$ 0.27	\$1.00	\$0.85
Diluted earnings per share	\$0.46	\$ 0.27	\$0.99	\$0.84
Potentially dilutive securities	—	—	—	1

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Note 3 Cash, Cash Equivalents and Investments

## Summary of Cash, Cash Equivalents and Investments

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

July 31, 2016	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	\$1,084	\$ —	\$ —	\$ 1,084
Cash equivalents:				
Money market funds	1,380	—	—	1,380
U.S. Treasury and agency securities	40	—	—	40
Municipal securities	167	—	—	167
Commercial paper, corporate bonds and medium-term notes	157	—	—	157
Total Cash equivalents	1,744	—	—	1,744
Total Cash and Cash equivalents	\$2,828	\$ —	\$ —	\$ 2,828
Short-term and long-term investments:				
U.S. Treasury and agency securities	\$253	\$ —	\$ —	\$ 253
Non-U.S. government securities*	20	—	—	20
Municipal securities	409	3	—	412
Commercial paper, corporate bonds and medium-term notes	306	1	—	307
Asset-backed and mortgage-backed securities	264	1	1	264
Total fixed income securities	1,252	5	1	1,256
Publicly traded equity securities	33	48	4	77
Equity investments in privately-held companies	65	—	—	65
Total short-term and long-term investments	\$1,350	\$ 53	\$ 5	\$ 1,398
Total Cash, Cash equivalents and Investments	\$4,178	\$ 53	\$ 5	\$ 4,226

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

October 25, 2015	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	\$1,010	\$ —	\$ —	—\$ 1,010
Cash equivalents:				
Money market funds	3,272	—	—	3,272
Non-U.S. government securities	60	—	—	60
Municipal securities	73	—	—	73
Commercial paper, corporate bonds and medium-term notes	382	—	—	382
Total Cash equivalents	3,787	—	—	3,787
Total Cash and Cash equivalents	\$4,797	\$ —	\$ —	—\$ 4,797
Short-term and long-term investments:				
U.S. Treasury and agency securities	\$84	\$ —	\$ —	—\$ 84
Non-U.S. government securities	9	—	—	9
Municipal securities	384	2	—	386
Commercial paper, corporate bonds and medium-term notes	250	—	—	250
Asset-backed and mortgage-backed securities	262	—	—	262
Total fixed income securities	989	2	—	991
Publicly traded equity securities	28	17	—	45
Equity investments in privately-held companies	78	—	—	78
Total short-term and long-term investments	\$1,095	\$ 19	\$ —	—\$ 1,114
Total Cash, Cash equivalents and Investments	\$5,892	\$ 19	\$ —	—\$ 5,911

## Maturities of Investments

The following table summarizes the contractual maturities of Applied's investments at July 31, 2016:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	\$422	\$ 422
Due after one through five years	566	570
No single maturity date**	362	406
	\$1,350	\$ 1,398

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Gains and Losses on Investments

During the three and nine months ended July 31, 2016 and July 26, 2015, gross realized gains and losses on investments were not material.

At July 31, 2016 and October 25, 2015, gross unrealized losses related to Applied's investment portfolio were not material. Applied regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether an unrealized loss is considered to be temporary, or other-than-temporary and therefore impaired, include: the length of time and extent to which fair value has been lower than the cost basis; the financial condition, credit quality and near-term prospects of the investee; and whether it is more likely than not that Applied will be required to sell the security prior to recovery. Generally, the contractual terms of investments in marketable securities do not permit settlement at prices less than the amortized cost of the investments. Applied determined that the gross unrealized losses on its marketable securities at July 31, 2016 and July 26, 2015 were temporary in nature and therefore it did not recognize any impairment of its marketable securities during the three and nine months ended July 31, 2016 or July 26, 2015. Impairment charges on equity investments in privately-held companies during the three and nine months ended July 31, 2016 and July 26, 2015 were not material. These impairment charges are included in interest and other income, net in the Consolidated Condensed Statement of Operations.

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

Note 4 Fair Value Measurements

Applied's financial assets are measured and recorded at fair value, except for equity investments in privately-held companies. These equity investments are generally accounted for under the cost method of accounting and are periodically assessed for other-than-temporary impairment when events or circumstances indicate that an other-than-temporary decline in value may have occurred. Applied's nonfinancial assets, such as goodwill, intangible assets, and property, plant and equipment, are recorded at cost and are assessed for impairment when events or circumstances indicate that an other-than-temporary decline in value may have occurred.

Fair Value Hierarchy

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

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

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

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

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

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

Investments with remaining effective maturities of 12 months or less from the balance sheet date are classified as short-term investments. Investments with remaining effective maturities of more than 12 months from the balance sheet date are classified as long-term investments. As of July 31, 2016, substantially all of Applied's available-for-sale, short-term and long-term investments were recognized at fair value that was determined based upon observable inputs.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Assets Measured at Fair Value on a Recurring Basis

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

	July 31, 2016			October 25, 2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(In millions)					
Assets:						
Money market funds	\$1,380	\$—	\$1,380	\$3,272	\$—	\$3,272
U.S. Treasury and agency securities	90	203	293	72	12	84
Non-U.S. government securities	—	20	20	—	69	69
Municipal securities	—	579	579	—	459	459
Commercial paper, corporate bonds and medium-term notes	—	464	464	—	632	632
Asset-backed and mortgage-backed securities	—	264	264	—	262	262
Publicly traded equity securities	77	—	77	45	—	45
Total	\$1,547	\$1,530	\$3,077	\$3,389	\$1,434	\$4,823

There were no transfers between Level 1 and Level 2 fair value measurements during the three and nine months ended July 31, 2016 or July 26, 2015. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of July 31, 2016 or October 25, 2015.

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

Equity investments in privately-held companies are generally accounted for under the cost method of accounting and are periodically assessed for other-than-temporary impairment when an event or circumstance indicates that an other-than-temporary decline in value may have occurred. If Applied determines that an other-than-temporary impairment has occurred, the investment will be written down to its estimated fair value based on available information, such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. At July 31, 2016, equity investments in privately-held companies totaled \$65 million, of which \$58 million of investments were accounted for under the cost method of accounting and \$7 million of investments had been measured at fair value on a non-recurring basis within Level 3 fair value measurements due to an other-than-temporary decline in value. At October 25, 2015, equity investments in privately-held companies totaled \$78 million, of which \$70 million of investments were accounted for under the cost method of accounting and \$8 million of investments had been measured at fair value on a non-recurring basis within Level 3 fair value measurements due to an other-than-temporary decline in value. Impairment charges on equity investments in privately-held companies during the three and nine months ended July 31, 2016 and July 26, 2015 were not material.

## Other

The carrying amounts of Applied's financial instruments, including cash and cash equivalents, accounts receivable, notes payable - short term, and accounts payable and accrued expenses, approximate fair value due to their short maturities. At July 31, 2016, the carrying amount of long-term debt was \$3.3 billion and the estimated fair value was \$3.8 billion. At October 25, 2015, the carrying amount of long-term debt was \$3.3 billion and the estimated fair value was \$3.5 billion. The estimated fair value of long-term debt is determined by Level 2 inputs and is based primarily on quoted market prices for the same or similar issues. See Note 9 of the Notes to the Consolidated Condensed Financial Statements for further detail of existing debt.



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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 5 Derivative Instruments and Hedging Activities

Derivative Financial Instruments

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

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

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

Hedges related to anticipated transactions are designated and documented at the inception of the hedge as cash flow hedges and foreign exchange derivatives are typically entered into once per month. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of AOCI in stockholders' equity and is reclassified into earnings when the hedged transaction affects earnings. The majority of the after-tax net income or loss related to foreign exchange derivative instruments included in AOCI at July 31, 2016 is expected to be reclassified into earnings within 12 months. Changes in the fair value of currency forward exchange and option contracts due to changes in time value are excluded from the assessment of effectiveness. Both ineffective hedge amounts and hedge components excluded from the assessment of effectiveness are recognized in earnings. If the transaction being hedged is no longer probable to occur, or if a portion of any derivative is deemed to be ineffective, Applied promptly recognizes the gain or loss on the associated financial instrument in earnings. The amount recognized due to discontinuance of cash flow hedges that were probable not to occur by the end of the originally specified time period was not significant for the three and nine months ended July 31, 2016 and July 26, 2015.

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

In September 2013, Applied purchased foreign exchange option contracts to limit its foreign exchange risk associated with the then-anticipated business combination with Tokyo Electron Limited (TEL). These derivatives did not qualify for hedge accounting treatment and were marked to market at the end of each reporting period with gains and losses recorded as part of operating expenses. Due to the termination of the then-anticipated business combination with TEL on April 26, 2015, these foreign exchange option contracts were sold during the third quarter of fiscal 2015. During the three and nine months ended July 26, 2015, Applied recorded a loss of \$3 million and a gain of \$89 million, respectively, related to these contracts. The cash flow impact of these derivatives has been classified as operating cash



flows in the Consolidated Condensed Statements of Cash Flows.

The fair values of foreign exchange derivative instruments at July 31, 2016 and October 25, 2015 were not material.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

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

	Location of Gain or (Loss) Reclassified from AOCI into Income	Three Months Ended		July 26, 2015			
		July 31, 2016		July 26, 2015			
		Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Effective Portion Excluded from Effectiveness Testing	Ineffective Portion and Amount Excluded from Effectiveness Testing	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income
(In millions)							
Derivatives in Cash Flow Hedging Relationships							
Foreign exchange contracts	Cost of products sold	\$(26)	\$ (13 )	\$ 1	\$5	\$ 2	\$ (1 )
Foreign exchange contracts	General and administrative	—	1	(1 )	—	3	—
Interest rate swaps	Interest expense	—	(1 )	—	\$(8)	\$ —	\$ —
Total		\$(26)	\$ (13 )	\$ —	\$(3)	\$ 5	\$ (1 )
	Location of Gain or (Loss) Reclassified from AOCI into Income	Nine Months Ended		July 26, 2015			
		July 31, 2016		July 26, 2015			
		Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Effective Portion Excluded from Effectiveness Testing	Ineffective Portion and Amount Excluded from Effectiveness Testing	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income

(In millions)

Derivatives in Cash Flow Hedging Relationships

Foreign exchange contracts	Cost of products sold	\$(49)	\$ (21 )	\$ 1	\$10	\$ 15	\$ (3 )
Foreign exchange contracts	General and administrative	—	(1 )	(2 )	—	(5 )	(1 )
Interest rate swaps	Interest expense	—	(1 )	—	(8 )	—	—
Total		\$(49)	\$ (23 )	\$ (1 )	\$2	\$ 10	\$ (4 )

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

		Amount of Gain or (Loss) Recognized in Income			
		Three Months Ended		Nine Months Ended	
Location of Gain or (Loss) Recognized in Income		July 31, 2016	July 26, 2015	July 31, 2016	July 26, 2015
(In millions)					
Derivatives Not Designated as Hedging Instruments					
Foreign exchange contracts	Gain on derivatives associated with terminated business combination	\$—	\$ (3 )	\$—	\$ 89
Foreign exchange contracts	General and administrative	(31 )	11	(67 )	31
Total		\$(31 )	\$ 8	\$(67 )	\$ 120

**Credit Risk Contingent Features**

If Applied's credit rating were to fall below investment grade, it would be in violation of credit risk contingent provisions of the derivative instruments discussed above, and certain counterparties to the derivative instruments could request immediate payment on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk related contingent features that were in a net liability position was immaterial as of July 31, 2016.

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

**Note 6 Accounts Receivable, Net**

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

Applied sold \$57 million of accounts receivable during the three and nine months ended July 31, 2016. Applied did not sell accounts receivable during the three and nine months ended July 26, 2015. Applied did not discount letters of credit issued by customers or discount promissory notes during the three and nine months ended July 31, 2016 and July 26, 2015. 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 \$48 million at July 31, 2016 and \$49 million at October 25, 2015. Applied sells its products principally to manufacturers within the semiconductor and display industries. While Applied believes that its allowance for doubtful accounts is adequate and represents its best estimate as of July 31, 2016, it continues to closely monitor customer liquidity and industry and economic conditions, which may result in changes to Applied's estimates.

**Note 7 Balance Sheet Detail**

July 31, October 25,  
2016 2015

(In millions)

Inventories

Customer service spares	\$432	\$ 382
Raw materials	461	461
Work-in-process	392	271
Finished goods	741	719
	\$2,026	\$ 1,833

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Included in finished goods inventory are \$183 million at July 31, 2016, and \$155 million at October 25, 2015, of newly-introduced systems at customer locations where the sales transaction did not meet Applied's revenue recognition criteria as set forth in Note 1. Finished goods inventory includes \$205 million and \$185 million of evaluation inventory at July 31, 2016 and October 25, 2015, respectively.

July 31, 2016  
October 25, 2015

(In millions)

## Other Current Assets

Deferred income taxes, net <sup>1</sup>	\$—	\$ 403
Prepaid income taxes and income taxes receivable	76	127
Prepaid expenses and other	179	194
	\$255	\$ 724

<sup>1</sup> July 31, 2016 balance reflects the effects of the prospective adoption of the authoritative guidance in the first quarter of fiscal 2016, which required all deferred tax assets and liabilities, and any related valuation allowance to be classified as noncurrent on the balance sheet.

Useful Life July 31, 2016  
October 25, 2015

(In years) (In millions)

## Property, Plant and Equipment, Net

Land and improvements		\$ 159	\$ 157
Buildings and improvements	3-30	1,259	1,247
Demonstration and manufacturing equipment	3-5	1,017	920
Furniture, fixtures and other equipment	3-15	569	574
Construction in progress		54	48
Gross property, plant and equipment		3,058	2,946
Accumulated depreciation		(2,153)	(2,054)
		\$905	\$ 892

July 31, 2016  
October 25, 2015

(In millions)

## Accounts Payable and Accrued Expenses

Accounts payable	\$717	\$ 658
Compensation and employee benefits	449	509
Warranty	139	126
Dividends payable	108	116
Income taxes payable	23	60
Other accrued taxes	45	58
Interest payable	35	36
Other	284	270
	\$1,800	\$ 1,833



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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

July 31, October 25,  
2016 2015

(In millions)

Customer Deposits and Deferred Revenue

Customer deposits	\$383	\$ 132
Deferred revenue	781	633
	\$1,164	\$ 765

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

July 31, October 25,  
2016 2015

(In millions)

Other Liabilities

Deferred income taxes	\$16	\$ 56
Income taxes payable	284	227
Defined and postretirement benefit plans	190	187
Other	83	85
	\$573	\$ 555



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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Note 8 Goodwill, Purchased Technology and Other Intangible Assets

Goodwill and Purchased Intangible Assets

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

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

As of July 31, 2016, Applied's reporting units include Transistor and Interconnect Group, Patterning and Packaging Group, and Imaging and Process Control Group, which combine to form the Semiconductor Systems reporting segment, Applied Global Services, and Display and Adjacent Markets.

Effective in the third quarter of fiscal 2016, Applied began to account for its roll-to-roll web coating systems (previously included in the Energy and Environmental Solutions segment) and display upgrade equipment (previously included in the Applied Global Services segment) under the Display and Adjacent Markets segment (previously Display). See Note 14, Industry Segment Operations. These changes did not affect the Semiconductor Systems reporting segment.

Due to this change, Applied performed a goodwill impairment test for Applied Global Services and Display and Adjacent Markets immediately before the changes in the composition of the segments, reallocated \$31 million of goodwill from Applied Global Services associated with the display upgrade equipment business to Display and Adjacent Markets based on the estimated relative fair value of each business unit and, then performed another goodwill impairment test for Applied Global Services and Display and Adjacent Markets after the change. There was no goodwill associated with the roll-to-roll web coating systems business. Prior period information in the tables below has been reclassified to conform to current presentation, which reflects the new organizational structure.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

In performing the goodwill impairment test, Applied utilized both the discounted cash flow method (weighted 75%) and the guideline company method (weighted 25%) to estimate the fair value of the reporting units. The estimates used in the impairment testing were consistent with the discrete forecasts that Applied uses to manage its business, and considered any significant developments that occurred during the quarter. Under the discounted cash flow method, cash flows beyond the discrete forecast were estimated using a terminal growth rate, which considered the long-term earnings growth rate specific to the reporting units. The estimated future cash flows were discounted to present value using each reporting unit's weighted average cost of capital. The weighted average cost of capital measures a reporting unit's cost of debt and equity financing weighted by the percentage of debt and equity in a reporting unit's target capital structure. In addition, the weighted average cost of capital was derived using both known and estimated market metrics, and was adjusted to reflect both the timing and risks associated with the estimated cash flows. The tax rate used in the discounted cash flow method was the median tax rate of comparable companies which reflected Applied's current international structure, which is consistent with the market participant perspective. Under the guideline company method, market multiples were applied to forecasted revenues and earnings before interest, taxes, depreciation and amortization. The market multiples used were consistent with comparable publicly-traded companies and considered each reporting unit's size, growth and profitability relative to its comparable companies. Based on Applied's analysis, the estimated fair value exceeded the carrying value for Applied Global Services and Display and Adjacent Markets segments before and after the change in their compositions, and therefore, the second step of the goodwill impairment test was not required.

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

Details of goodwill and other indefinite-lived intangible assets as of July 31, 2016 and October 25, 2015 were as follows:

	July 31, 2016			October 25, 2015		
	Other			Other		
	Goodwill	Intangible	Total	Goodwill	Intangible	Total
	Assets			Assets		
	(In millions)					
Semiconductor Systems	\$2,151	\$ —	\$2,151	\$2,151	\$ —	\$2,151
Applied Global Services	999	5	1,004	996	5	1,001
Display and Adjacent Markets	155	20	175	155	20	175
Carrying amount	\$3,305	\$ 25	\$3,330	\$3,302	\$ 25	\$3,327

From time to time, Applied makes acquisitions of and investments in companies related to existing or new markets for Applied.

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

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

July 31, 2016  
October 25, 2015

	(In millions)	
Purchased technology, net	\$450	\$ 575
Intangible assets - finite-lived, net	146	162
Intangible assets - indefinite-lived	25	25
Total	\$621	\$ 762

## Finite-Lived Purchased Intangible Assets

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

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

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

Details of finite-lived intangible assets were as follows:

	July 31, 2016			October 25, 2015		
	Purchased Technology	Other Intangible Assets	Total	Purchased Technology	Other Intangible Assets	Total
	(In millions)					
Gross carrying amount:						
Semiconductor Systems	\$1,449	\$ 252	\$1,701	\$1,449	\$ 252	\$1,701
Applied Global Services	28	44	72	28	44	72
Display and Adjacent Markets	113	36	149	113	36	149
Corporate and Other	2	9	11	1	9	10
Gross carrying amount	\$1,592	\$ 341	\$1,933	\$1,591	\$ 341	\$1,932
Accumulated amortization:						
Semiconductor Systems	\$(1,001)	\$(109)	\$(1,110)	\$(876)	\$(95)	\$(971)

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Applied Global Services	(27 )	(44 )	(71 )	(26 )	(44 )	(70 )
Display and Adjacent Markets	(113 )	(34 )	(147 )	(113 )	(34 )	(147 )
Corporate and Other	(1 )	\$ (8 )	(9 )	(1 )	(6 )	(7 )
Accumulated amortization	\$(1,142)	\$ (195 )	\$(1,337)	\$(1,016)	\$ (179 )	\$(1,195)
Carrying amount	\$450	\$ 146	\$596	\$575	\$ 162	\$737

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Details of amortization expense by segment were as follows:

	Three Months Ended July 31, 2016	Three Months Ended July 26, 2015	Nine Months Ended July 31, 2016	Nine Months Ended July 26, 2015
--	--	--	--	--

(In millions)

Semiconductor Systems	\$47	\$ 45	\$139	\$ 132
Applied Global Services	—	—	1	1
Display and Adjacent Markets	—	1	—	3
Corporate & Other	—	—	2	2
Total	\$47	\$ 46	\$142	\$ 138

Amortization expense was charged to the following categories:

	Three Months Ended July 31, 2016	Three Months Ended July 26, 2015	Nine Months Ended July 31, 2016	Nine Months Ended July 26, 2015
--	--	--	--	--

(In millions)

Cost of products sold	\$42	\$ 40	\$126	\$ 120
Research, development and engineering	—	1	1	1
Marketing and selling	5	5	15	15
General and administrative	—	—	—	2
Total	\$47	\$ 46	\$142	\$ 138

As of July 31, 2016, future estimated amortization expense is expected to be as follows:

	Amortization Expense (In millions)
2016 (remaining 3 months)	\$ 47
2017	187
2018	185
2019	44
2020	39
Thereafter	94
Total	\$ 596

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Note 9 Borrowing Facilities and Debt

Applied has credit facilities for unsecured borrowings in various currencies of up to \$1.6 billion, of which \$1.5 billion is comprised of a committed revolving credit agreement with a group of banks that is scheduled to expire in September 2020. This agreement provides for borrowings in United States dollars at interest rates keyed to one of various benchmark rates selected by Applied for each advance, plus a margin based on Applied's public debt rating and includes financial and other covenants. Remaining credit facilities in the amount of approximately \$76 million are with Japanese banks. Applied's ability to borrow under these facilities is subject to bank approval at the time of the borrowing request, and any advances will be at rates indexed to the banks' prime reference rate denominated in Japanese yen. No amounts were outstanding under any of these facilities at both July 31, 2016 and October 25, 2015, and Applied has not utilized these credit facilities.

In September 2015, Applied issued senior unsecured notes in the aggregate principal amount of \$1.8 billion and used a portion of the net proceeds to redeem \$400 million in principal amount of its 2.650% senior notes due in 2016 at a redemption price of \$405 million in November 2015. After adjusting for the carrying value of debt issuance costs and discounts, Applied recorded a \$5 million loss on the prepayment of the \$400 million debt, which is included in interest and other income, net in the Consolidated Condensed Statement of Operations for the first quarter of fiscal 2016.

In October 2015, a wholly-owned foreign subsidiary of Applied entered into a short-term loan agreement with multiple lenders, under which it borrowed \$800 million to facilitate the return of capital to Applied. In January 2016, the \$800 million aggregated principal amount of the loan was repaid.

Debt outstanding as of July 31, 2016 and October 25, 2015 was as follows:

	Principal Amount		Effective Interest Rate	Interest Pay Dates
	July 31, 2016	October 25, 2015		
	(In millions)			
Short-term debt:				
2.650% Senior Notes Due 2016	\$ —	\$ 400	2.666%	June 15, December 15
Other debt	—	800	1.0% - 1.25%	
Total short-term debt	—	1,200		
Long-term debt:				
7.125% Senior Notes Due 2017	200	200	7.190%	April 15, October 15
2.625% Senior Notes Due 2020	600	600	2.640%	April 1, October 1
4.300% Senior Notes Due 2021	750	750	4.326%	June 15, December 15
3.900% Senior Notes Due 2025	700	700	3.944%	April 1, October 1
5.100% Senior Notes Due 2035	500	500	5.127%	April 1, October 1
5.850% Senior Notes Due 2041	600	600	5.879%	June 15, December

	3,350	3,350
Total unamortized discount	(7 )	(8 )
Total long-term debt	3,343	3,342
Total debt	\$ 3,343	\$ 4,542

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Note 10 Stockholders' Equity, Comprehensive Income and Share-Based Compensation

Accumulated Other Comprehensive Income (Loss)

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

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

	Unrealized Gain (Loss) on Investments Net	Derivative Instruments Qualifying as Cash Flow Hedges	Defined and Postretirement Benefit Plans	Cumulative Translation Adjustments	Total
	(in millions)				
Balance at October 26, 2014	\$24	\$ —	\$ (105 )	\$ 5	\$(76 )
Other comprehensive income (loss) before reclassifications	(3 )	1	(45 )	—	(47 )
Amounts reclassified out of AOCI	—	(6 )	2	9	5
Other comprehensive income (loss), net of tax	(3 )	(5 )	(43 )	9	(42 )
Balance at July 26, 2015	\$21	\$ (5 )	\$ (148 )	\$ 14	\$(118)

The tax effects on net income of amounts reclassified from AOCI for the three and nine months ended July 31, 2016 and July 26, 2015 were not material.

## Stock Repurchase Program

On June 9, 2016, Applied's Board of Directors approved a new common stock repurchase program authorizing up to \$2.0 billion in repurchases, which followed the completion of a \$3.0 billion common stock repurchase program approved on April 26, 2015. At July 31, 2016, \$1.95 billion remained available for future stock repurchases under the new repurchase program.





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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

The following table summarizes Applied's stock repurchases for the three and nine months ended July 31, 2016 and July 26, 2015:

	Three Months Ended July 31, 2016		Nine Months Ended July 26, 2015	
	9.0	32.1	89.5	32.1
Shares of common stock repurchased	\$ 196	\$ 625	\$ 1,721	\$ 625
Cost of stock repurchased	\$ 21.88	\$ 19.47	\$ 19.22	\$ 19.47
Average price paid per share	(in millions, except per share amount)			

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

**Dividends**

In June 2016, March 2016 and December 2015, Applied's Board of Directors declared quarterly cash dividends in the amount of \$0.10 per share. Dividends paid during the nine months ended July 31, 2016 and July 26, 2015 totaled \$336 million and \$368 million, respectively. Applied currently anticipates that cash dividends will continue to be paid on a quarterly basis, although the declaration of any future cash dividend is at the discretion of the Board of Directors and will depend on Applied's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination by the Board of Directors that cash dividends are in the best interests of Applied's stockholders.

**Share-Based Compensation**

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

During the three and nine months ended July 31, 2016 and July 26, 2015, Applied recognized share-based compensation expense related to stock options, ESPP shares, restricted stock, restricted stock units, performance shares and performance units. The effect of share-based compensation on the results of operations was as follows:

	Three Months Ended July 31, 2016	Nine Months Ended July 26, 2015

(In millions)

Cost of products sold	\$14	\$ 14	\$46	\$ 43
Research, development, and engineering	18	17	56	52
Marketing and selling	7	6	20	19
General and administrative	9	9	28	27
Total share-based compensation	\$48	\$ 46	\$150	\$ 141

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

At July 31, 2016, Applied had \$297 million in total unrecognized compensation expense, net of estimated forfeitures, related to grants of share-based awards and shares issued under Applied's ESPP, which will be recognized over a weighted average period of 2.6 years. At July 31, 2016, there were 107 million shares available for grants of share-based awards under the Employee Stock Incentive Plan, and an additional 26 million shares available for issuance under the ESPP.

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

A summary of the changes in restricted stock units, restricted stock, performance shares and performance units outstanding under Applied's equity compensation plans during the nine months ended July 31, 2016 is presented below:

	Shares	Weighted Average Grant Date Fair Value
		(In millions, except per share amounts)
Outstanding at October 25, 2015	27	\$ 16.41
Granted	11	\$ 18.36
Vested	(11)	\$ 14.16
Canceled	(2 )	\$ 17.54
Outstanding at July 31, 2016	25	\$ 18.16

At July 31, 2016, 1 million additional performance-based awards could be earned upon certain levels of achievement of Applied's total shareholder return relative to a peer group at a future date.

During the first quarter of fiscal 2016, certain executive officers were granted awards that are subject to the achievement of specified performance goals (performance-based awards). These performance-based awards become eligible to vest only if performance goals are achieved and will vest only if the grantee remains employed by Applied through each applicable vesting date. These performance-based awards require the achievement of a targeted level of adjusted annual operating profit margin. Additional shares become eligible for time-based vesting if Applied achieves certain levels of total shareholder return (TSR) relative to a peer group, comprised of companies in the Standard & Poor's 500 Information Technology Index, measured at the end of a two-year period.

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

## Employee Stock Purchase Plans

Under the ESPP, substantially all employees may purchase Applied common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value of Applied common stock at the beginning or end of each 6-month purchase period, subject to certain limits. Applied issued 3 million shares during the nine months ended July 31, 2016 and 2 million shares during the nine months ended July 26, 2015. Compensation expense is calculated using the fair value of the employees' purchase rights under the Black-Scholes model. Underlying assumptions used in the model are outlined in the following table:

	Nine Months Ended	
	July 31, 2016	July 26, 2015
ESPP:		
Dividend yield	2.07%	1.56%
Expected volatility	29.8%	31.4%
Risk-free interest rate	0.49%	0.07%
Expected life (in years)	0.5	0.5
Weighted average estimated fair value	\$4.47	\$6.04

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Note 11 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 and nine months ended July 31, 2016 and July 26, 2015 is presented below:

	Three Months Ended July 31, 2016		Nine Months Ended July 26, 2015	
	(In millions)			
Service cost	\$3	\$ 4	\$10	\$ 11
Interest cost	3	3	10	10
Expected return on plan assets	(4)	(4)	(12)	(12)
Amortization of actuarial loss	2	2	4	5
Curtailment and settlement gain	—	—	(5)	(1)
Net periodic benefit cost	\$4	\$ 5	\$7	\$ 13

## Note 12 Income Taxes

Applied's effective tax rates for the third quarters of fiscal 2016 and 2015 were 10.5 percent and 12.3 percent, respectively. Applied's effective tax rates for the first nine months of fiscal 2016 and 2015 were 12.7 percent and 13.3 percent, respectively. The effective tax rates for the third quarter and first nine months of fiscal 2016 were lower than in the same periods in the prior year primarily due to changes in the geographical composition of income, partially offset by resolutions and changes related to income tax liabilities for prior years. The effective tax rate for the first nine months of fiscal 2015 included the effect of an adjustment primarily to correct an error in the recognition of cost of sales in the U.S. related to intercompany sales. While this error had no impact on Applied's consolidated cost of sales, it resulted in overstating profitability in the U.S. and the provision for income taxes, income taxes payable and other tax balance sheet accounts in each year since fiscal 2010. The impact of the adjustment to the first nine months of fiscal 2015 was a decrease in provision for income taxes of \$35 million which was determined to be immaterial on the originating periods and fiscal 2015. Accordingly, a restatement was not considered necessary. In addition, the effective tax rates for the first nine months of fiscal 2015 included the tax benefit from acquisition costs that became deductible as a result of the termination of the proposed business combination with TEL. The effective tax rates for the first nine months of fiscal 2016 and 2015 both included the tax benefit from the reinstatement of the U.S. federal research and development tax credit during these periods retroactive to its expiration in December of the prior years. During the next twelve months, it is reasonably possible that existing liabilities for unrecognized tax benefits could be reduced by up to \$15 million as a result of the lapse of statutes of limitation.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

## Note 13 Warranty, Guarantees and Contingencies

## Warranty

Changes in the warranty reserves are presented below:

	Three Months Ended July 31, 2016		Nine Months Ended July 31, 2015	
	(In millions)			
Beginning balance	\$ 121	\$ 123	\$ 126	\$ 113
Warranties issued	35	29	91	98
Change in reserves related to preexisting warranty	7	(2 )	(9 )	(4 )
Consumption of reserves	(24 )	(25 )	(69 )	(82 )
Ending balance	\$ 139	\$ 125	\$ 139	\$ 125

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

## Guarantees

In the ordinary course of business, Applied provides standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated by either Applied or its subsidiaries. As of July 31, 2016, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately \$50 million. Applied has not recorded any liability in connection with these guarantee agreements beyond that required to appropriately account for the underlying transaction being guaranteed. Applied does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these guarantee agreements.

Applied also has agreements with various banks to facilitate subsidiary banking operations worldwide, including overdraft arrangements, issuance of bank guarantees, and letters of credit. As of July 31, 2016, Applied has provided parent guarantees to banks for approximately \$100 million to cover these arrangements.

## Legal Matters

## Korea Criminal Proceedings

In 2010, the Seoul Eastern District Court began hearings on indictments brought by the Seoul Prosecutor's Office for the Eastern District of Korea (the Prosecutor's Office) alleging that employees of several companies improperly received and used confidential information belonging to Samsung Electronics Co., Ltd. (Samsung), a major Applied customer based in Korea. The individuals charged included the former head of Applied Materials Korea (AMK), who at the time of the indictment was a vice president of Applied Materials, Inc., and certain other AMK employees. Neither Applied nor any of its subsidiaries was named as a party to the proceedings. Hearings on these matters concluded in November 2012 and the Court issued its decision on February 7, 2013. As part of the ruling, nine AMK employees (including the former head of AMK) were acquitted of all charges, while one AMK employee was found guilty on some of the charges and received a suspended jail sentence. The Prosecutor's Office and various individuals appealed the matter to the High Court. On June 20, 2014, the High Court rendered its decision, finding all defendants not guilty, including all ten AMK employees. The prosecutor has appealed the High Court decision to the Korean

Supreme Court.

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Other Matters

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

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

Note 14 Industry Segment Operations

Applied's three reportable segments are: Semiconductor Systems, Applied Global Services, and Display and Adjacent Markets. As defined under the accounting literature, Applied's chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Applied's management organization structure as of July 31, 2016 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to Applied's reportable segments.

Effective in the third quarter of fiscal 2016, Applied began to account for its roll-to-roll web coating systems (previously included in the Energy and Environmental Solutions segment) and display upgrade equipment (previously included in the Applied Global Services segment) under the Display and Adjacent Markets segment (previously Display). As a result of these changes, Applied's solar business (previously in the Energy and Environmental Solutions segment) is included in Corporate and Other as it did not meet the threshold as a separate reportable segment. Results for prior periods have been recast to conform to the current presentation, which reflects the new organizational structure.

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

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

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

Each operating segment is separately managed and has separate financial results that are reviewed by Applied's chief operating decision-maker. Each reportable segment contains closely related products that are unique to the particular segment. Segment operating income is determined based upon internal performance measures used by Applied's chief operating decision-maker.

Applied derives the segment results directly from its internal management reporting system. The accounting policies Applied uses to derive reportable segment results are substantially the same as those used for external reporting purposes. Management measures the performance of each reportable segment based upon several metrics including 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.

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

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APPLIED MATERIALS, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

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

	Three Months Ended		Nine Months Ended	
	Net Sales	Operating Income (Loss)	Net Sales	Operating Income (Loss)
	(In millions)			
July 31, 2016:				
Semiconductor Systems	\$1,786	\$ 511	\$4,746	\$ 1,140
Applied Global Services	657	175	1,896	489
Display and Adjacent Markets	313	63	754	142
Corporate and Other	65	(153 )	132	(396 )
Total	\$2,821	\$ 596	\$7,528	\$ 1,375
July 26, 2015:				
Semiconductor Systems	\$1,635	\$ 411	\$4,641	\$ 1,092
Applied Global Services	646	162	1,836	470
Display and Adjacent Markets	185	35	709	163
Corporate and Other	24	(212 )	105	(455 )
Total	\$2,490	\$ 396	\$7,291	\$ 1,270

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

	Three Months Ended		Nine Months Ended	
	July 31, 2016	July 26, 2015	July 31, 2016	July 26, 2015
	(In millions)			
Unallocated net sales	\$ 65	\$ 24	\$ 132	\$ 105
Unallocated cost of products sold and expenses	(170 )	(186 )	(378 )	(458 )
Share-based compensation	(48 )	(46 )	(150 )	(141 )
Certain items associated with terminated business combination	—	(1 )	—	(50 )
Gain (loss) on derivatives associated with	—	(3 )	—	89

terminated  
business  
combination

Total                   \$   (153   )           \$   (212   )           \$   (396   )           \$   (455   )

The following customers accounted for at least 10 percent of Applied's net sales for the nine months ended July 31, 2016, which were for products in multiple reportable segments.

	Percentage of Net Sales
Taiwan Semiconductor Manufacturing Company Limited	13 %
Micron Technology, Inc.	13 %
Samsung Electronics Co., Ltd.	12 %
Intel Corporation	11 %

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

The following management's discussion and analysis is provided in addition to the accompanying consolidated condensed financial statements and notes to assist in understanding Applied's results of operations and financial condition. Financial information as of July 31, 2016 should be read in conjunction with the financial statements for the fiscal year ended October 25, 2015 contained in the Company's Form 10-K filed December 9, 2015.

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

Overview

Applied provides manufacturing equipment, services and software to the global semiconductor, display, and related industries. Applied's customers include manufacturers of semiconductor wafers and chips, liquid crystal and other displays, and other electronic devices. These customers may use what they manufacture in their own end products or sell the items to other companies for use in advanced electronic components. Applied operates in three reportable segments: Semiconductor Systems (previously Silicon Systems), Applied Global Services and Display and Adjacent Markets (previously Display). A summary of financial information for each reportable segment is found in Note 14 of Notes to Consolidated Condensed Financial Statements. A discussion of factors that could affect Applied's operations is set forth under "Risk Factors" in Part II, Item 1A, which is incorporated herein by reference. Product development and manufacturing activities occur primarily in the United States, Europe, Israel, and Asia. Applied's broad range of equipment and service products are highly technical and are sold primarily through a direct sales force.

Applied's results are driven primarily by 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, display technologies and other electronic devices, as well as other factors, such as global economic and market conditions, and the nature and timing of technological advances in fabrication processes. In addition, a significant driver in the semiconductor and display industries is end-demand for mobile consumer products, which is characterized by seasonality that impacts the timing of customer investments in manufacturing equipment and, in turn, Applied's business. In light of these conditions, Applied's results can vary significantly year-over-year, as well as quarter-over-quarter.

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

	Three Months Ended			Change	
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015
(In millions, except per share amounts and percentages)					
New orders	\$3,658	\$3,451	\$2,892	\$207	\$766
Net sales	\$2,821	\$2,450	\$2,490	\$371	\$331
Gross profit	\$1,192	\$1,004	\$1,018	\$188	\$174
Gross margin	42.3 %	41.0 %	40.9 %	1.3 points	1.4 points
Operating income	\$596	\$425	\$396	\$171	\$200
Operating margin	21.1 %	17.3 %	15.9 %	3.8 points	5.2 points
Net income	\$505	\$320	\$329	\$185	\$176
Earnings per diluted share	\$0.46	\$0.29	\$0.27	\$0.17	\$0.19
Non-GAAP Adjusted Results					
Non-GAAP adjusted gross profit	\$1,233	\$1,045	\$1,093	\$188	\$140
Non-GAAP adjusted gross margin	43.7 %	42.7 %	43.9 %	1.0 points	(0.2) points
Non-GAAP adjusted operating income	\$644	\$470	\$517	\$174	\$127
Non-GAAP adjusted operating margin	22.8 %	19.2 %	20.8 %	3.6 points	2.0 points
Non-GAAP adjusted net income	\$550	\$376	\$410	\$174	\$140
Non-GAAP adjusted earnings per diluted share	\$0.50	\$0.34	\$0.33	\$0.16	\$0.17

	Nine Months Ended		Change
	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015
(In millions, except per share amounts and percentages)			
New orders	\$9,384	\$7,680	\$1,704
Net sales	\$7,528	\$7,291	\$237
Gross profit	\$3,112	\$2,993	\$119
Gross margin	41.3 %	41.1 %	0.2 points

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Operating income	\$1,375	\$1,270	\$105
Operating margin	18.3 %	17.4 %	0.9 points
Net income	\$1,111	\$1,041	\$70
Earnings per diluted share	\$0.99	\$0.84	\$0.15
Non-GAAP Adjusted Results			
Non-GAAP adjusted gross profit	\$3,235	\$3,147	\$88
Non-GAAP adjusted gross margin	43.0 %	43.2 %	(0.2) points
Non-GAAP adjusted operating income	\$1,515	\$1,440	\$75
Non-GAAP adjusted operating margin	20.1 %	19.8 %	0.3 points
Non-GAAP adjusted net income	\$1,228	\$1,110	\$118
Non-GAAP adjusted earnings per diluted share	\$1.09	\$0.90	\$0.19

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results." Fiscal 2016 and 2015 contains 53 weeks and 52 weeks, respectively, and the first nine months of fiscal 2016 and 2015 contained 40 weeks and 39 weeks, respectively.

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Mobility, and the increasing technological functionality of mobile devices, continues to be a strong driver of semiconductor industry spending. During the first nine months of fiscal 2016, memory manufacturers invested in technology upgrades and additional capacity, both of which were driven in part by the transition from planar NAND to 3D NAND. Foundry customers also invested in technology upgrades and new capacity to meet demand for advanced mobile chips. For the remainder of the year, Applied anticipates advanced foundry and 3D NAND spending will drive our semiconductor business. Mobility investments, including increasing investments in new technology, represents a significant driver of display industry spending, which has resulted in higher manufacturing capacity expansion for mobile applications. As a result, new orders for display equipment increased in the first nine months of fiscal 2016 compared to the same period in the prior year. Applied expects strong investments in mobile display manufacturing equipment for the remainder of fiscal 2016. Demand for larger LCD TVs is also a factor for display industry investments, although demand for TV manufacturing equipment remains susceptible to highly cyclical conditions.

Effective in the third quarter of fiscal 2016, Applied began to account for its roll-to-roll web coating systems (previously in Energy and Environmental Solutions) and display upgrade equipment (previously in Applied Global Services) under the Display and Adjacent Markets segment. As a result of the change, Applied's solar business (previously in Energy and Environmental Solutions) is included in Corporate and Other as it did not meet the threshold for a separate reportable segment. Results for prior periods have been recast to conform to the current presentation.

## Results of Operations

## New Orders

New orders for the periods indicated were as follows:

	Three Months Ended			Change				
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015			
	(In millions, except percentages)							
Semiconductor Systems	\$2,215	61%	\$1,966	57%	\$2,007	69%	13%	10%
Applied Global Services	590	16%	636	18%	543	19%	(7)%	9%
Display and Adjacent Markets	803	22%	762	22%	318	11%	5%	153%
Corporate and Other	50	1%	87	3%	24	1%	(43)%	108%
Total	\$3,658	100%	\$3,451	100%	\$2,892	100%	6%	26%

	Nine Months Ended			Change	
	July 31, 2016	July 26, 2015		YTD Q3 2016 over YTD Q3 2015	
	(In millions, except percentages)				
Semiconductor Systems	\$5,456	58%	\$5,137	67%	6%
Applied Global Services	1,981	21%	1,839	24%	8%
Display and Adjacent Markets	1,773	19%	609	8%	191%
Corporate and Other	174	2%	95	1%	83%
Total	\$9,384	100%	\$7,680	100%	22%



New orders for the third quarter of fiscal 2016 increased compared to the prior quarter primarily due to higher demand for semiconductor and display equipment, partially offset by lower orders for services. New orders for the third quarter and first nine months of fiscal 2016 increased across all segments compared to the same periods in the prior year, primarily due to higher demand for semiconductor and display equipment. New orders for the Semiconductor Systems continued to comprise the majority of Applied's consolidated total new orders.

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New orders by geographic region, determined by the product shipment destination specified by the customer, were as follows:

	Three Months Ended				Change		Q3 2016 over Q3 2015	
	July 31, 2016	May 1, 2016	July 26, 2015	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015		
	(In millions, except percentages)							
Taiwan	\$ 1,240	34%	\$ 445	13%	\$ 828	29%	179%	50%
China	849	23%	903	26%	442	15%	(6)%	92%
Korea	689	19%	792	23%	349	12%	(13)%	97%
Japan	270	7%	339	10%	727	25%	(20)%	(63)%
Southeast Asia	139	4%	392	11%	142	5%	(65)%	(2)%
Asia Pacific	3,187	87%	2,871	83%	2,488	86%	11%	28%
United States	259	7%	386	11%	262	9%	(33)%	(1)%
Europe	212	6%	194	6%	142	5%	9%	49%
Total	\$ 3,658	100%	\$ 3,451	100%	\$ 2,892	100%	6%	26%

	Nine Months Ended		Change		
	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015		
	(In millions, except percentages)				
Taiwan	\$ 2,219	24%	\$ 1,962	26%	13%
China	2,254	24%	1,090	14%	107%
Korea	1,854	20%	1,502	20%	23%
Japan	718	7%	1,334	17%	(46)%
Southeast Asia	763	8%	330	4%	131%
Asia Pacific	7,808	83%	6,218	81%	26%
United States	1,014	11%	1,041	14%	(3)%
Europe	562	6%	421	5%	33%
Total	\$ 9,384	100%	\$ 7,680	100%	22%

The increase in new orders from customers in Taiwan in the third quarter of fiscal 2016 compared to the prior quarter, and in the first nine months of fiscal 2016 compared to the same periods in the prior year, was primarily due to higher demand from foundry customers. The decreases in new orders from customers in Southeast Asia and Korea in the third quarter of fiscal 2016 compared to the prior quarter was primarily due to a decrease in memory orders, while the decreases in the United States and Japan reflected lower demand for display equipment from customers in those regions. The decrease in new orders from China primarily reflected a decrease in memory orders partially offset by higher demand for display equipment.

The changes in new orders from customers in China, Korea, Japan and Europe in the third quarter and first nine months of fiscal 2016 compared to the same periods in the prior year primarily reflected changes in customer mix for semiconductor equipment. In addition, the changes in new orders from customers in Korea, China and Japan also reflected changes in customer mix for display equipment. The increase in new orders from customers in Southeast Asia in the first nine months of fiscal 2016 compared to the same period in the prior year primarily reflected higher demand from memory customers.



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Changes in backlog during the nine months ended July 31, 2016 were as follows:

	July 31, 2016 (In millions)
Beginning balance	\$ 3,142
New orders	9,384
Net sales	(7,528 )
Net adjustments	(49 )
Ending balance	\$ 4,949

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; and (2) contractual service revenue and maintenance fees to be earned within the next 12 months. Applied's backlog at any particular time is not necessarily indicative of actual sales for any future periods due to the potential for customer changes in delivery schedules or cancellation of orders. Approximately 67 percent of backlog as of the end of the third quarter of fiscal 2016 is anticipated to be shipped within the next two quarters. Backlog adjustments were negative during the first nine months of fiscal 2016 and totaled \$49 million, primarily consisting order cancellations, partially offset by favorable foreign currency impact.

Backlog as of the end of the most recent three fiscal quarters was as follows:

	July 31, 2016	May 1, 2016	January 31, 2016	Q3 2016 over Q2 2016	Q3 2016 over Q1 2016
	(In millions, except percentages)				
Semiconductor Systems	\$2,461	\$2,044	\$1,602	20%	54%
Applied Global Services	765	876	896	(13)%	(15)%
Display and Adjacent Markets	1,640	1,144	553	43%	197%
Corporate and Other	83	104	58	(20)%	43%
Total	\$4,949	\$4,168	\$3,109	19%	59%

Total backlog in the third quarter of fiscal 2016 compared to the prior quarter increased primarily due to higher demand for semiconductor and display equipment. In the third quarter of fiscal 2016, approximately 64 percent of net sales in the Semiconductor Systems segment, Applied's largest business segment, were for orders received and shipped within the quarter, up from 62 percent in the prior quarter.

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## Net Sales

Net sales for the periods indicated were as follows:

	Three Months Ended			Change				
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015			
	(In millions, except percentages)							
Semiconductor Systems	\$1,786	64%	\$1,587	65%	\$1,635	66%	13%	9%
Applied Global Services	657	23%	633	26%	646	26%	4%	2%
Display and Adjacent Markets	313	11%	187	7%	185	7%	67%	69%
Corporate and Other	65	2%	43	2%	24	1%	51%	171%
Total	\$2,821	100%	\$2,450	100%	\$2,490	100%	15%	13%

	Nine Months Ended		Change		
	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015		
	(In millions, except percentages)				
Semiconductor Systems	\$4,746	63%	\$4,641	64%	2%
Applied Global Services	1,896	25%	1,836	25%	3%
Display and Adjacent Markets	754	10%	709	10%	6%
Corporate and Other	132	2%	105	1%	26%
Total	\$7,528	100%	\$7,291	100%	3%

	(In millions, except percentages)				
Semiconductor Systems	\$4,746	63%	\$4,641	64%	2%
Applied Global Services	1,896	25%	1,836	25%	3%
Display and Adjacent Markets	754	10%	709	10%	6%
Corporate and Other	132	2%	105	1%	26%
Total	\$7,528	100%	\$7,291	100%	3%

Net sales for the third quarter of fiscal 2016 compared to the prior quarter, and for the third quarter and first nine months of fiscal 2016 compared to the same periods in the prior year, increased primarily due to increased investments in semiconductor and display equipment. The Semiconductor Systems segment's relative share of total net sales decreased slightly compared to the prior quarter but still remains the largest contributor of net sales.

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

	Three Months Ended			Change				
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015			
	(In millions, except percentages)							
Taiwan	\$ 741	26%	\$ 311	13%	\$ 825	33%	138%	(10)%
China	571	20%	752	31%	302	12%	(24)%	89%
Korea	472	17%	506	21%	343	14%	(7)%	38%
Japan	321	11%	260	10%	283	11%	23%	13%
Southeast Asia	303	11%	252	10%	101	4%	20%	200%
Asia Pacific	2,408	85%	2,081	85%	1,854	74%	16%	30%
United States	289	10%	272	11%	488	20%	6%	(41)%
Europe	124	5%	97	4%	148	6%	28%	(16)%
Total	\$ 2,821	100%	\$ 2,450	100%	\$ 2,490	100%	15%	13%



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	Nine Months Ended		Change	
	July 31,	July 26,	YTD Q3 2016	
	2016	2015	over	
			YTD Q3 2015	

(In millions, except percentages)

Taiwan	\$1,689	22%	\$1,842	25%	(8)%
China	1,818	24%	1,146	16%	59%
Korea	1,251	17%	1,415	19%	(12)%
Japan	915	12%	800	11%	14%
Southeast Asia	642	9%	289	4%	122%
Asia Pacific	6,315	84%	5,492	75%	15%
United States	854	11%	1,329	18%	(36)%
Europe	359	5%	470	7%	(24)%
Total	\$7,528	100%	\$7,291	100%	3%

The changes in net sales from customers in Taiwan and China for the third quarter of fiscal 2016 compared to the prior quarter primarily reflected changes in investments by foundry customers.

The changes in net sales from customers in all regions for the third quarter and first nine months of fiscal 2016 compared to the same periods in the prior year reflected changes in customer mix for semiconductor equipment. In addition, the changes in net sales from customers in Korea, Taiwan and China also reflected changes in display equipment customer mix. The increase in net sales from customers in Japan in the first nine months of fiscal 2016 compared to the same period in the prior year also reflected higher spending in services and display equipment.

**Gross Margin**

Gross margins for the periods indicated were as follows:

	Three Months Ended			Change		Nine Months Ended		Change	
	July 31,	May 1,	July 26,	Q3	Q3	July 31,	July 26,	YTD	
	2016	2016	2015	2016	2016	2016	2015	2016	
				over	over			over	
				Q2	Q3			YTD	
				2016	2015			Q3	
								2015	

(In millions, except percentages)

Gross profit	\$1,192	\$1,004	\$1,018	\$188	\$174	\$3,112	\$2,993	\$119
Gross margin	42.3	% 41.0	% 40.9	% 1.3	1.4	41.3	% 41.1	% 0.2
				points	points			points
<b>Non-GAAP Adjusted Results</b>								
Non-GAAP adjusted gross profit	\$1,233	\$1,045	\$1,093	\$188	\$140	\$3,235	\$3,147	\$88
Non-GAAP adjusted gross margin	43.7	% 42.7	% 43.9	% 1.0	(0.2)	43.0	% 43.2	% (0.2)
				points	points			points

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results."

Gross profit, non-GAAP adjusted gross profit, gross margin and non-GAAP adjusted gross margin in the third quarter of fiscal 2016 increased compared to the prior quarter, primarily reflecting higher net sales, partially offset by unfavorable changes in product mix. Gross profit and gross margin during the third quarter of fiscal 2015 also included inventory charges associated with the restructuring actions in the solar business. Gross profit, gross margin and non-GAAP adjusted gross profit in the third quarter and first nine months of fiscal 2016 increased compared to

the same periods in the prior year, primarily due to higher net sales, however non-GAAP adjusted gross margin decreased slightly for the same periods compared to the prior year due to unfavorable changes in product mix. Gross profit and non-GAAP adjusted gross profit during each of the three months ended July 31, 2016, May 1, 2016 and July 26, 2015 included \$14 million, \$15 million and \$14 million, respectively, of share-based compensation expense. Gross profit and non-GAAP adjusted gross margin during the nine months ended July 31, 2016 and July 26, 2015 included \$46 million and \$43 million, respectively, of share-based compensation expense.



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## Research, Development and Engineering

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

Three Months Ended	Change	Nine Months Ended	Change
			YTD
	Q3 Q3		Q3
July 3, 2016	May 1, 2016	July 31, 2016	2016
July 26, 2015	over	July 26, 2015	over
	Q2 Q3		YTD
	2015		Q3
			2015

(In millions)

Research, development and engineering \$386 \$ 386 \$ 372 \$-\$ 14 \$1,146 \$1,088 \$ 58

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

Management believes that it is critical to continue to make substantial investments in RD&E to assure the availability of innovative technology that meets the current and projected requirements of its customers' most advanced designs. Applied has maintained and intends to continue its commitment to investing in RD&E in order to continue to offer new products and technologies. RD&E expenses remained flat during the third quarter of fiscal 2016 compared to the prior quarter, but increased during the third quarter and first nine months of fiscal 2016 compared to the same periods in the prior year, reflecting ongoing investment in product development initiatives. RD&E expenses during the three months ended July 31, 2016, May 1, 2016 and July 26, 2015 included \$18 million, \$18 million and \$17 million, respectively, of share-based compensation expense. RD&E expense during the nine months ended July 31, 2016 and July 26, 2015 included \$56 million and \$52 million, respectively, of share-based compensation expense.

## Marketing and Selling

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

Three Months Ended	Change	Nine Months Ended	Change
			YTD
	Q3 Q3		Q3
July 3, 2016	May 1, 2016	July 31, 2016	2016
July 26, 2015	over	July 26, 2015	over
	Q2 Q3		YTD
	2015		Q3
			2015

(In millions)

Marketing and selling \$107 \$ 102 \$ 112 \$5 \$(5 ) \$315 \$ 332 \$ (17 )

Marketing and selling expenses increased slightly in the third quarter of fiscal 2016 compared to the prior quarter, but decreased in the third quarter and first nine months of fiscal 2016 compared to the same periods in the prior year

primarily due to continued cost management efforts. Marketing and selling expenses during the three months ended July 31, 2016, May 1, 2016 and July 26, 2015 included \$7 million, \$6 million and \$6 million, respectively, of share-based compensation expense. Marketing and selling expenses during the nine months ended July 31, 2016 and July 26, 2015 included \$20 million and \$19 million, respectively, of share-based compensation expense.

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## General and Administrative

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

Three Months Ended	Change	Nine Months Ended		Change
		YTD	YTD	
		Q3	Q3	Q3
		2016	2016	2016
July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
		over	over	over
		Q2	Q3	YTD
		2016	2015	Q3
				2015

(In millions)

General and administrative \$103 \$ 91 \$ 135 \$ 12 \$(32) \$276 \$ 392 \$(116)

G&A expenses for the third quarter of fiscal 2016 increased compared to the prior quarter primarily due to higher variable compensation and unfavorable impact from foreign exchange, partially offset by savings from a temporary shutdown. G&A expenses for the third quarter and first nine months of fiscal 2016 decreased compared to the same periods in the prior year. G&A expenses were higher for the same periods in the prior year primarily due to acquisition-related and integration costs related to the terminated business combination with Tokyo Electron Limited (TEL), restructuring charges and impact of foreign currency exchange loss as a result of functional currency correction, all recorded during the third quarter of fiscal 2015.

G&A expenses during the three months ended July 31, 2016, May 1, 2016 and July 26, 2015 each included \$9 million of share-based compensation expense. G&A expenses during the nine months ended July 31, 2016 and July 26, 2015 included \$28 million and \$27 million, respectively, of share-based compensation expense.

## Gain on Derivatives Associated with Terminated Business Combination

During the three and nine months ended July 26, 2015, Applied recorded a loss of \$3 million and a gain of \$89 million, respectively, on the foreign exchanges option contracts associated with the then-anticipated business combination with TEL. Due to the termination of the then-anticipated business combination, the derivatives were sold during the third quarter of fiscal 2015. For further details, see Note 5 of Notes to Consolidated Condensed Financial Statements.

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

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

Three Months Ended	Change	Nine Months Ended		Change
		YTD	YTD	
		Q3	Q3	Q3
		2016	2016	2016
July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
		over	over	over
		Q2	Q3	YTD
		2016	2015	Q3
				2015

(In millions)

Interest expense \$38 \$ 37 \$ 24 \$ 1 \$ 14 \$117 \$ 71 \$ 46

Interest and other income, net \$6 \$ 7 \$ 3 \$(1) \$ 3 \$15 \$ 2 \$ 13

Interest expenses incurred were primarily associated with the senior unsecured notes issued in June 2011 and September 2015. Interest expense in the third quarter of fiscal 2016 compared to the prior quarter remained flat.

Interest expense increased in the third quarter and the first nine months of fiscal 2016 compared to the same periods in the prior year primarily due to the issuance of senior unsecured notes in September 2015.

Interest and other income, net in the third quarter of fiscal 2016 compared to the prior quarter and the same period in the prior year remained relatively flat. Interest and other income, net in the first nine months of fiscal 2016 compared to the same period in the prior year increased primarily due to lower impairment of strategic investments, net of realized gain and higher interest income from investments.

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## Income Taxes

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

	Three Months Ended			Change		Nine Months Ended		Change
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015
Provision for income taxes	\$59	\$75	\$46	\$(16)	\$13	\$162	\$160	\$2
Effective tax rate	10.5%	19.0%	12.3%	(8.5) points	(1.8) points	12.7%	13.3%	(0.6) points

(In millions, except percentages)

Provision for income taxes	\$59	\$75	\$46	\$(16)	\$13	\$162	\$160	\$2
Effective tax rate	10.5%	19.0%	12.3%	(8.5) points	(1.8) points	12.7%	13.3%	(0.6) points

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

The effective tax rate for the third quarter of fiscal 2016 was lower than in the prior quarter primarily due to changes in the geographical composition of income and resolutions and changes related to income tax liabilities for prior years. Applied's effective tax rates for the third quarters of fiscal 2016 and 2015 were 10.5 percent and 12.3 percent, respectively. Applied's effective tax rates for the first nine months of fiscal 2016 and 2015 were 12.7 percent and 13.3 percent, respectively. The effective tax rates for the third quarter of fiscal 2016 and the first nine months of 2016 were lower than in the same periods in the prior year primarily due to changes in the geographical composition of income, partially offset by resolutions and changes related to income tax liabilities for prior years. The effective tax rate for the first nine months of fiscal 2015 included the effect of an adjustment primarily to correct an error in the recognition of cost of sales in the U.S. related to intercompany sales. While this error had no impact on Applied's consolidated cost of sales, it resulted in overstating profitability in the U.S. and the provision for income taxes, income taxes payable and other tax balance sheet accounts in each year since fiscal 2010. The impact of the adjustment to the first nine months of fiscal 2015 was a decrease in provision for income taxes of \$35 million which was determined to be immaterial on the originating periods and fiscal 2015. Accordingly, a restatement was not considered necessary. In addition, the effective tax rate for the first nine months of fiscal 2015 included the tax benefit from acquisition costs that became deductible as a result of the termination of the proposed business combination with TEL. The effective tax rates for the first nine months of fiscal 2016 and 2015 both included the tax benefit from the reinstatement of the U.S. federal research and development tax credit during these periods retroactive to its expiration in December of the prior years.

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## Segment Information

Applied reports financial results in three segments: Semiconductor Systems (previously Silicon Systems), Applied Global Services, and Display and Adjacent Markets. Effective in the third quarter of fiscal 2016, Applied began to account for its roll-to-roll web coating systems (previously included in the Energy and Environmental Solutions segment) and display upgrade equipment (previously included in the Applied Global Services segment) under the Display and Adjacent Markets segment (previously Display). As a result of the change, Applied's solar business (previously included in the Energy and Environmental Solutions segment) is included in Corporate and Other as it did not meet the threshold as a separate reportable segment. Results for prior periods have been recast to conform to the current presentation. A description of the products and services, as well as financial data, for each reportable segment can be found in Note 14 of Notes to Consolidated Condensed Financial Statements.

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

The results for each reportable segment are discussed below.

## Semiconductor Systems Segment

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

The market for Semiconductor Systems in the first nine months of fiscal 2016 reflected continued investment by semiconductor manufacturers. Memory manufacturers invested in technology upgrades and additional capacity, both of which were driven in part by the transition from planar NAND to 3D NAND. Foundry customers also invested in technology upgrades and new capacity to meet demand for advanced mobile chips.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended			Change Q3 2016 over Q2 2016	Q3 2016 over Q3 2015
	July 31, 2016	May 1, 2016	July 26, 2015		
	(In millions, except percentages and ratios)				
New orders	\$2,215	\$1,966	\$2,007	\$249 13%	\$208 10%
Net sales	1,786	1,587	1,635	199 13%	151 9%
Book to bill ratio	1.2	1.2	1.2		
Operating income	511	364	411	147 40%	100 24%
Operating margin	28.6	% 22.9	% 25.1	% 5.7 points	3.5 points
Non-GAAP Adjusted Results					
Non-GAAP adjusted operating income	\$556	\$410	\$455	146 36%	101 22%
Non-GAAP adjusted operating margin	31.1	% 25.8	% 27.8	% 5.3 points	3.3 points

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	Nine Months Ended		Change	
	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015	
	(In millions, except percentages and ratios)			
New orders	\$5,456	\$5,137	\$319	6%
Net sales	4,746	4,641	105	2%
Book to bill ratio	1.1	1.1		
Operating income	1,140	1,092	48	4%
Operating margin	24.0 %	23.5 %		0.5 points
Non-GAAP Adjusted Results				
Non-GAAP adjusted operating income	\$1,278	\$1,223	55	4%
Non-GAAP adjusted operating margin	26.9 %	26.4 %		0.5 points

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results."

New orders for Semiconductor Systems by end use application for the periods indicated were as follows:

	Three Months Ended			Nine Months Ended	
	July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
Foundry	57%	23%	32%	40%	34%
Memory	29%	66%	57%	47%	54%
Logic and other	14%	11%	11%	13%	12%
	100%	100%	100%	100%	100%

New orders for the third quarter and first nine months of fiscal 2016 increased compared to the prior quarter and to the same period in the prior year primarily due to higher demand from foundry customers, partially offset by lower demand from memory customers. Net sales for the third quarter of fiscal 2016 increased compared to the prior quarter, primarily due to higher spending from foundry customers. Approximately 64 percent of net sales in the third quarter of fiscal 2016 were for orders received and shipped within the quarter. The increase in the operating income, non-GAAP adjusted operating income, operating margin and non-GAAP adjusted operating margin for the third quarter and first nine months of fiscal 2016 compared to the prior quarter and the same periods in the prior year primarily reflected higher net sales. In the third quarter of fiscal 2016, two customers accounted for approximately 50 percent of this segment's total new orders with one customer accounting for approximately 40 percent of this segment's total new orders and three customers accounted for approximately 57 percent of this segment's total net sales.

Net sales for the third quarter and first nine months of fiscal 2016 increased compared to the same periods in the prior year primarily due to higher spending from memory customers.

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

Three Months Ended			Change	
July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015

(In millions, except percentages)

China	\$361	20%	\$588	37%	\$110	7%	(39)%	228%
Taiwan	\$547	31%	\$169	11%	\$668	41%	224%	(18)%

Nine Months Ended		Change
July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015

(In millions, except percentages)

China	\$1,162	24%	\$385	8%	202%
Taiwan	\$1,218	26%	\$1,399	30%	(13)%

#### Applied Global Services Segment

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

Industry conditions that affected Applied Global Services' sales of spares and services during the first nine months of fiscal 2016 were principally semiconductor manufacturers' wafer starts, as well as utilization rates.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended			Change			
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016		Q3 2016 over Q3 2015	
	(In millions, except percentages and ratios)						
New orders	\$590	\$636	\$543	\$(46)	(7)%	\$47	9%
Net sales	657	633	646	24	4%	11	2%
Book to bill ratio	0.9	1.0	0.8				
Operating income	175	165	162	10	6%	13	8%
Operating margin	26.6 %	26.1 %	25.1 %			0.5 points	1.5 points
Non-GAAP Adjusted Results							
Non-GAAP adjusted operating income	176	165	165	11	7%	11	7%
Non-GAAP adjusted operating margin	26.8 %	26.1 %	25.5 %			0.7 points	1.3 points



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	Nine Months Ended		Change	
	July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015	
	(In millions, except percentages and ratios)			
New orders	\$1,981	\$1,839	\$142	8%
Net sales	1,896	1,836	60	3%
Book to bill ratio	1.0	1.0		
Operating income	489	470	19	4%
Operating margin	25.8	% 25.6	%	0.2 points
Non-GAAP Adjusted Results				
Non-GAAP adjusted operating income	\$490	\$474	16	3%
Non-GAAP adjusted operating margin	25.8	% 25.8	%	—%

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results."

New orders for the third quarter of fiscal 2016 decreased compared to the prior quarter primarily due to lower demand for services. Net sales for the third quarter of fiscal 2016 compared to the prior quarter slightly increased primarily due to higher spending on semiconductor spares and services. Operating income, operating margin, non-GAAP adjusted operating income and non-GAAP adjusted operating margin for the third quarter of fiscal 2016 increased compared to the prior quarter primarily due to higher net sales.

New orders for the third quarter of fiscal 2016 increased compared to the same period in the prior year due to higher demand for spares. New orders for the first nine months of fiscal 2016 compared to the same period in the prior year reflected increased demand for spares and services, partially offset by lower demand for 200mm equipment systems. Net sales for the third quarter and first nine months of fiscal 2016 increased compared to the same periods in the prior year due to higher customer spending for semiconductor services and spares, partially offset by lower investments in 200mm equipment systems. Operating income and non-GAAP adjusted operating income, operating margin and non-GAAP adjusted operating margin for the third quarter of fiscal 2016 compared to the same period in the prior year increased due to higher net sales. Operating income and non-GAAP adjusted operating income for the first nine months of fiscal 2016 increased compared to the same periods in the prior, reflecting higher net sales, while operating margin and non-GAAP adjusted operating margin remained flat primarily due to increased headcount to support business growth.

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

#### Display and Adjacent Markets Segment

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

The market environment for Applied's Display and Adjacent Markets segment in the first nine months of fiscal 2016 has been characterized by increasing demand for manufacturing equipment for high-end mobile devices and continued demand for TV manufacturing equipment, although the TV manufacturing equipment sector remains susceptible to highly cyclical conditions. Uneven order and revenue patterns in the Display and Adjacent Markets segment can cause

significant fluctuations quarter-over-quarter, as well as year-over year.

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Certain significant measures for the periods presented were as follows:

	Three Months Ended			Change			
	July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016		Q3 2016 over Q3 2015	
	(In millions, except percentages and ratios)						
New orders	\$803	\$762	\$318	\$41	5%	\$485	153%
Net sales	313	187	185	126	67%	128	69%
Book to bill ratio	2.6	4.1	1.7				
Operating income	63	31	35	32	103%	28	80%
Operating margin	20.1 %	16.6 %	18.9 %		3.5 points		1.2 points
Non-GAAP Adjusted Results							
Non-GAAP adjusted operating income	\$63	\$31	\$36	32	103%	27	75%
Non-GAAP adjusted operating margin	20.1 %	16.6 %	19.5 %		3.5 points		0.6 points

	Nine Months Ended			Change			
	July 31, 2016	July 26, 2015		YTD Q3 2016 over YTD Q3 2015			
	(In millions, except percentages and ratios)						
New orders	\$1,773	\$609	\$1,164		191%		
Net sales	754	709	45		6%		
Book to bill ratio	2.4	0.9					
Operating income	142	163	(21)		(13)%		
Operating margin	18.8 %	23.0 %			(4.2) points		
Non-GAAP Adjusted Results							
Non-GAAP adjusted operating income	\$142	\$166	(24)		(14)%		
Non-GAAP adjusted operating margin	18.8 %	23.4 %			(4.6) points		

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results." New orders for the third quarter of fiscal 2016 increased compared to the prior quarter primarily due to increased orders for mobile display manufacturing equipment, reflecting increased demand for new technology, and TV manufacturing equipment. Net sales for the third quarter of fiscal 2016 were higher compared to the prior quarter which reflected higher customer investments for mobile display manufacturing equipment. Operating income, operating margin, non-GAAP adjusted operating income and non-GAAP adjusted operating margin for the third quarter of fiscal 2016 increased compared to the prior quarter and the same period in the prior year, as a result of higher net sales, partially offset by unfavorable product mix. Two customers accounted for approximately 83 percent of new orders for this segment during the third quarter of fiscal 2016, accounting for approximately 45 percent and 38 percent of new orders, respectively. Two customers accounted for approximately 54 percent of net sales for the Display and Adjacent Markets segment in the third quarter of fiscal 2016, with one customer accounting for approximately 42 percent of net sales for the Display and Adjacent Markets segment.

New orders for the third quarter and first nine months of fiscal 2016 increased compared to the same periods in the prior year primarily due to increased orders for mobile display and TV manufacturing equipment. In addition, new orders for the first nine months of fiscal 2016 reflected demand for new mobile display technology. Net sales for the

third quarter and first nine months of fiscal 2016 increased compared to the same period in the prior year primarily due to higher customer investments in mobile display manufacturing equipment. Operating income, operating margin, non-GAAP adjusted operating income and non-GAAP adjusted operating margin for the first nine months of fiscal 2016 decreased compared to the same period in the prior year, reflecting unfavorable product mix and higher research and new product development costs.

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The following regions accounted for at least 30 percent of total net sales for the Display and Adjacent Markets segment for one or more of the periods presented:

Three Months Ended			Change	
July 31, 2016	May 1, 2016	July 26, 2015	Q3 2016 over Q2 2016	Q3 2016 over Q3 2015

(In millions, except percentages)

China	\$86	27%	\$46	25%	\$108	58%	87%	(20)%
Korea	\$143	46%	\$109	58%	\$54	29%	31%	165%

Nine Months Ended		Change	
July 31, 2016	July 26, 2015	YTD Q3 2016 over YTD Q3 2015	

(In millions, except percentages)

China	\$326	43%	\$509	72%	(36)%
Korea	\$265	35%	\$122	17%	117%

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## Financial Condition, Liquidity and Capital Resources

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

	July 31, October 25, 2016 2015	
	(In millions)	
Cash and cash equivalents	\$2,828	\$ 4,797
Short-term investments	438	168
Long-term investments	960	946
Total cash, cash-equivalents and investments	\$4,226	\$ 5,911

## Sources and Uses of Cash

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

	Nine Months Ended	
	July 31, 2016	July 26, 2015
	(In millions)	
Cash provided by operating activities	\$1,669	\$692
Cash used in investing activities	\$(436 )	\$(224)
Cash used in financing activities	\$(3,202)	\$(896)

## Operating Activities

Cash from operating activities for the nine months ended July 31, 2016 was \$1.7 billion, which reflects net income adjusted for the effect of non-cash charges and changes in working capital components. Non-cash charges included depreciation, amortization, share-based compensation and deferred income taxes. The primary drivers of cash from operating activities during the first nine months of fiscal 2016 included higher net income and increases in customer deposits and deferred revenue, partially offset by increases in accounts receivable and inventory. Cash from operating activities for the nine months ended July 31, 2016 increased compared to prior year primarily due to increases in customer deposits, deferred revenue and income taxes payable, lower increase in accounts receivable and higher net income.

Applied has agreements with various financial institutions to sell accounts receivable and discount promissory notes from selected customers. Applied sells its accounts receivable without recourse. Applied, from time to time, also discounts letters of credit issued by customers through various financial institutions. The discounting of letters of credit depends on many factors, including the willingness of financial institutions to discount the letters of credit and the cost of such arrangements. Applied sold \$57 million of accounts receivable during the three and nine months ended July 31, 2016. Applied did not sell accounts receivable during the three and nine months ended July 26, 2015. Applied did not discount promissory notes or utilize programs to discount letters of credit issued by customers during the nine months ended July 31, 2016 or July 26, 2015.

Applied's working capital was \$4.4 billion at July 31, 2016 and \$5.5 billion at October 25, 2015. Applied's working capital at July 31, 2016 includes the effects of the adoption of the authoritative guidance requiring all deferred tax assets and liabilities, and any related valuation allowance, to be classified as noncurrent on the balance sheet. Prior periods were not retrospectively adjusted.

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Days sales, inventory and payable outstanding at the end of each of the periods indicated were:

	July 31, May 1, July 26,		
	2016	2016	2015
Days sales outstanding	60	71	73
Days inventory outstanding	113	121	108
Days payable outstanding	40	41	43

Days sales outstanding varies due to the timing of shipments and payment terms. Days sales outstanding decreased in the third quarter of fiscal 2016 compared to the prior quarter primarily due to improved revenue linearity. Days inventory outstanding decreased during the third quarter of fiscal 2016 compared to the prior quarter primarily due to higher revenue and cost of products sold. The increase in days inventory outstanding during the current quarter compared to the same period in the prior year reflected higher inventory balances at the end of the third quarter of fiscal 2016 due to higher expected future business volume. Days payable outstanding decreased slightly during the third quarter of fiscal 2016 compared to the prior quarter primarily reflecting higher total cost of products sold due to higher business volume.

**Investing Activities**

Applied used \$436 million of cash in investing activities during the nine months ended July 31, 2016. Purchases of investments, net of proceeds from sales and maturities of investments, totaled \$266 million and capital expenditures were \$165 million during the nine months ended July 31, 2016.

Applied's investment portfolio consists principally of investment grade money market mutual funds, U.S. Treasury and agency securities, municipal bonds, corporate bonds and mortgage-backed and asset-backed securities, as well as equity securities. Applied regularly monitors the credit risk in its investment portfolio and takes appropriate measures, which may include the sale of certain securities, to manage such risks prudently in accordance with its investment policies. During the three and nine months ended July 31, 2016, Applied did not recognize any impairment of its fixed income or publicly traded equity securities. At July 31, 2016, gross unrealized losses related to Applied's investment portfolio were not material.

**Financing Activities**

Applied used cash for financing activities in the amount of \$3.2 billion during the nine months ended July 31, 2016, consisting primarily of \$1.2 billion in debt repayments, \$1.7 billion in repurchases of common stock, and \$336 million in cash dividends to stockholders, offset by excess tax benefits from share-based compensation of \$18 million and proceeds from common stock issuances of \$44 million.

In June 2016, March 2016 and December 2015, Applied's Board of Directors declared quarterly cash dividends in the amount of \$0.10 per share. Applied currently anticipates that cash dividends will continue to be paid on a quarterly basis, although the declaration of any future cash dividend is at the discretion of the Board of Directors and will depend on Applied's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination by the Board of Directors that cash dividends are in the best interests of Applied's stockholders.

Applied has credit facilities for unsecured borrowings in various currencies of up to \$1.6 billion, of which \$1.5 billion is comprised of a committed revolving credit agreement with a group of banks that is scheduled to expire in September 2020. This agreement provides for borrowings in United States dollars at interest rates keyed to one of the two rates selected by Applied for each advance and includes financial and other covenants with which Applied was in compliance at July 31, 2016. Remaining credit facilities in the amount of approximately \$76 million are with Japanese banks. Applied's ability to borrow under these facilities is subject to bank approval at the time of the borrowing request, and any advances will be at rates indexed to the banks' prime reference rate denominated in Japanese yen. No amounts were outstanding under any of these facilities at both July 31, 2016 and October 25, 2015, and Applied has not utilized these credit facilities.

In fiscal 2011, Applied established a short-term commercial paper program of up to \$1.5 billion. At July 31, 2016, Applied did not have any commercial paper outstanding, but may issue commercial paper notes under this program from time to time in the future.

Applied had senior unsecured notes in the aggregate principal amount of \$3.4 billion outstanding as of July 31, 2016. The indentures governing these notes include covenants with which Applied was in compliance at July 31, 2016. See Note 9 of Notes to Consolidated Condensed Financial Statements for additional discussion of existing debt. Applied may seek to refinance its existing debt and may incur additional indebtedness depending on Applied's capital requirements and the availability of financing.



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In the ordinary course of business, Applied provides standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated by either Applied or its subsidiaries. As of July 31, 2016, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately \$50 million. Applied has not recorded any liability in connection with these guarantee agreements beyond that required to appropriately account for the underlying transaction being guaranteed. Applied does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid under these guarantee agreements.

Applied also has agreements with various banks to facilitate subsidiary banking operations worldwide, including overdraft arrangements, issuance of bank guarantees, and letters of credit. As of July 31, 2016, Applied Materials, Inc. has provided parent guarantees to banks for approximately \$100 million to cover these arrangements.

Others

During the three and nine months ended July 31, 2016, Applied did not record a bad debt provision. While Applied believes that its allowance for doubtful accounts at July 31, 2016 is adequate, it will continue to closely monitor customer liquidity and economic conditions.

As of July 31, 2016, approximately \$3.3 billion of cash, cash equivalents and marketable securities held by non-U.S. subsidiaries may be subject to U.S. income tax if repatriated for U.S. operations. Of this amount, Applied intends to indefinitely reinvest approximately \$2.8 billion of these funds outside of the U.S. and does not plan to repatriate these funds. Applied would need to accrue and pay U.S. income tax if these funds were repatriated. For the remaining cash, cash equivalents and marketable securities held by non-U.S. subsidiaries, U.S. income tax has been provided for in the financial statements.

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

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### Critical Accounting Policies and Estimates

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

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

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

#### Revenue Recognition

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

#### Warranty Costs

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

#### 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.

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### Inventory Valuation

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

### Goodwill and Intangible Assets

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

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

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

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

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



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Income Taxes

Applied's effective tax rate is affected by the geographical composition of income and income tax laws and regulations in multiple jurisdictions.

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 carryovers. 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, net of existing valuation allowance.

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.

Non-GAAP Adjusted Financial Results

Applied provides investors with certain non-GAAP adjusted financial measures, which are adjusted to exclude the impact of certain costs, expenses, gains and losses, including certain items related to mergers and acquisitions; restructuring charges and any associated adjustments; impairments of assets, or investments; gain or loss on sale of strategic investments; certain other discrete adjustments and income tax items. Reconciliations of these non-GAAP measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are provided in the financial tables presented below.

Management uses these non-GAAP adjusted financial measures to evaluate the Company's operating and financial performance and for planning purposes, and as performance measures in its executive compensation program. Applied believes these measures enhance an overall understanding of our performance and investors' ability to review the Company's business from the same perspective as the Company's management and facilitate comparisons of this period's results with prior periods on a consistent basis by excluding items that we do not believe are indicative of our ongoing operating performance. There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles, may be different from non-GAAP financial measures used by other companies, and may exclude certain items that may have a material impact upon our reported financial results. The presentation of this additional information is not meant to be considered in isolation or as a substitute for the directly comparable financial measures prepared in accordance with GAAP.

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The following tables present a reconciliation of the GAAP and non-GAAP adjusted consolidated results:  
APPLIED MATERIALS, INC.

## UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

(In millions, except percentages)	Three Months Ended			Nine Months Ended	
	July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
Non-GAAP Adjusted Gross Profit					
Reported gross profit - GAAP basis	\$1,192	\$1,004	\$1,018	\$3,112	\$2,993
Certain items associated with acquisitions <sup>1</sup>	42	41	41	125	120
Inventory charges (reversals) related to restructuring <sup>3,5</sup>	(1 )	—	34	(2 )	34
Non-GAAP adjusted gross profit	\$1,233	\$1,045	\$1,093	\$3,235	\$3,147
Non-GAAP adjusted gross margin	43.7 %	42.7 %	43.9 %	43.0 %	43.2 %
Non-GAAP Adjusted Operating Income					
Reported operating income - GAAP basis	\$596	\$425	\$396	\$1,375	\$1,270
Certain items associated with acquisitions <sup>1</sup>	47	46	47	141	138
Acquisition integration and deal costs	2	—	1	2	2
Loss (gain) on derivatives associated with terminated business combination, net	—	—	3	—	(89 )
Certain items associated with terminated business combination <sup>2</sup>	—	—	1	—	50
Inventory charges (reversals) related to restructuring and asset impairments, net <sup>3,4,5</sup>	(1 )	(1 )	50	(3 )	50
Foreign exchange loss due to functional currency change <sup>6</sup>	—	—	19	—	19
Non-GAAP adjusted operating income	\$644	\$470	\$517	\$1,515	\$1,440
Non-GAAP adjusted operating margin	22.8 %	19.2 %	20.8 %	20.1 %	19.8 %
Non-GAAP Adjusted Net Income					
Reported net income - GAAP basis <sup>7</sup>	\$505	\$320	\$329	\$1,111	\$1,041
Certain items associated with acquisitions <sup>1</sup>	47	46	47	141	138
Acquisition integration and deal costs	2	—	1	2	2
Loss (gain) on derivatives associated with terminated business combination, net	—	—	3	—	(89 )
Certain items associated with terminated business combination <sup>2</sup>	—	—	1	—	50
Inventory charges (reversals) related to restructuring and asset impairments, net <sup>3,4,5</sup>	(1 )	(1 )	50	(3 )	50
Impairment (gain on sale) of strategic investments, net	—	(1 )	(1 )	(3 )	6
Foreign exchange loss due to functional currency change <sup>6</sup>	—	—	19	—	19
Loss on early extinguishment of debt	—	—	—	5	—
Reinstatement of federal R&D tax credit, resolution of prior years' income tax filings and other tax items <sup>7</sup>	1	16	(21 )	(12 )	(92 )
Income tax effect of non-GAAP adjustments <sup>8</sup>	(4 )	(4 )	(18 )	(13 )	(15 )
Non-GAAP adjusted net income	\$550	\$376	\$410	\$1,228	\$1,110

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

2 These items are incremental charges related to the terminated business combination agreement with Tokyo Electron Limited, consisting of acquisition-related and integration planning costs.

3 Results for the three and nine months ended July 31, 2016 primarily included benefit from sales of solar equipment tools for which inventory had been previously reserved related to the cost reductions in the solar business.

4

Results for the three months ended May 1, 2016 included a \$1 million favorable adjustment of employee-related costs associated with the cost reductions in the solar business.

5 Results for the three and nine months ended July 26, 2015 primarily included \$34 million of inventory charges and \$17 million of restructuring charges and asset impairments related to cost reductions in the solar business.

6 Results for the three and nine months ended July 26, 2015 included a \$19 million foreign exchange loss due to an immaterial correction of an error related to functional currency change.

7 Amounts for nine months ended July 26, 2015 included an adjustment to decrease the provision for income taxes by \$35 million with a corresponding increase in net income, resulting in an increase in diluted earnings per share of \$0.03. The adjustment was excluded in Applied's non-GAAP adjusted results and was made primarily to correct an error in the recognition of cost of sales in the U.S. related to intercompany sales, which resulted in overstating profitability in the U.S. and the provision for income taxes in immaterial amounts in each year since fiscal 2010.

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



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## APPLIED MATERIALS, INC.

## UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

(In millions, except per share amounts)	Three Months Ended			Nine Months Ended	
	July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
Non-GAAP Adjusted Earnings Per Diluted Share					
Reported earnings per diluted share - GAAP basis <sup>1</sup>	\$0.46	\$0.29	\$0.27	\$0.99	\$0.84
Certain items associated with acquisitions	0.04	0.04	0.03	0.11	0.10
Certain items associated with terminated business combination	—	—	—	—	0.03
Gain on derivative associated with terminated business combination, net	—	—	—	—	(0.05 )
Restructuring, inventory charges and asset impairments	—	—	0.03	—	0.03
Reinstatement of federal R&D tax credit, resolution of prior years' income tax filings and other tax items <sup>1</sup>	—	0.01	(0.02 )	(0.01 )	(0.07 )
Foreign exchange loss due to functional currency change	—	—	0.02	—	0.02
Non-GAAP adjusted earnings per diluted share	0.50	0.34	0.33	1.09	0.90
Weighted average number of diluted shares	1,093	1,119	1,231	1,123	1,238

Amounts for nine months ended July 26, 2015 included an adjustment to decrease the provision for income taxes by \$35 million with a corresponding increase in net income, resulting in an increase in diluted earnings per share of \$0.03. The adjustment was excluded in Applied's non-GAAP adjusted results and was made primarily to correct an error in the recognition of cost of sales in the U.S. related to intercompany sales, which resulted in overstating profitability in the U.S. and the provision for income taxes in immaterial amounts in each year since fiscal 2010.

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

APPLIED MATERIALS, INC.

UNAUDITED RECONCILIATION OF GAAP TO NON-GAAP ADJUSTED RESULTS

(In millions, except percentages)	Three Months Ended			Nine Months Ended	
	July 31, 2016	May 1, 2016	July 26, 2015	July 31, 2016	July 26, 2015
<b>Semiconductor Systems Non-GAAP Adjusted Operating Income</b>					
Reported operating income - GAAP basis	\$511	\$364	\$411	\$1,140	\$1,092
Certain items associated with acquisitions <sup>1</sup>	45	46	44	138	131
Non-GAAP adjusted operating income	\$556	\$410	\$455	\$1,278	\$1,223
Non-GAAP adjusted operating margin	31.1 %	25.8 %	27.8 %	26.9 %	26.4 %
<b>AGS Non-GAAP Adjusted Operating Income</b>					
Reported operating income - GAAP basis	\$175	\$165	\$162	\$489	\$470
Certain items associated with acquisitions <sup>1</sup>	1	—	—	1	1
Inventory charges related to restructuring <sup>2</sup>	—	—	3	\$—	\$3
Non-GAAP adjusted operating income	\$176	\$165	\$165	\$490	\$474
Non-GAAP adjusted operating margin	26.8 %	26.1 %	25.5 %	25.8 %	25.8 %
<b>Display and Adjacent Markets Non-GAAP Adjusted Operating Income</b>					
Reported operating income - GAAP basis	\$63	\$31	\$35	\$142	\$163
Certain items associated with acquisitions <sup>1</sup>	—	—	1	—	3
Non-GAAP adjusted operating income	\$63	\$31	\$36	\$142	\$166
Non-GAAP adjusted operating margin	20.1 %	16.6 %	19.5 %	18.8 %	23.4 %

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

<sup>2</sup> Results for the three and nine months ended July 26, 2015 included \$3 million of inventory charges related to cost reduction in the solar business.

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

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### Item 3: Quantitative and Qualitative Disclosures About Market Risk

Applied is exposed to interest rate risk related to its investment portfolio and debt issuances. Applied's investment portfolio includes fixed-income securities with a fair value of approximately \$1.3 billion at July 31, 2016. These securities are subject to interest rate risk and will decline in value if interest rates increase. Based on Applied's investment portfolio at July 31, 2016, an immediate 100 basis point increase in interest rates would result in a decrease in the fair value of the portfolio of approximately \$18 million. While an increase in interest rates reduces the fair value of the investment portfolio, Applied will not realize the losses in the consolidated statement of operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary. At July 31, 2016, the carrying amount of long-term debt issued by Applied was \$3.3 billion with an estimated fair value of \$3.8 billion. A hypothetical decrease in interest rates of 100 basis points would result in an increase in the fair value of Applied's long-term debt issuances of approximately \$329 million at July 31, 2016.

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

### Item 4. Controls and Procedures

#### Disclosure Controls and Procedures

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

#### Changes in Internal Control Over Financial Reporting

During the third quarter of fiscal 2016, there were no changes in the internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act, that materially affected, or are reasonably likely to materially affect, Applied's internal control over financial reporting.

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

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A: Risk Factors

The risk factors set forth below include any material changes to, and supersede the description of, the risk factors disclosed in Part I, Item 1A of Applied’s 2015 Form 10-K. These factors could materially and adversely affect Applied’s business, financial condition or results of operations and cause reputational harm, and they should be carefully considered in evaluating the Company and its business, in addition to other information presented elsewhere in this report.

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

As a supplier to the global semiconductor and display 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’ requirements for new manufacturing capacity and advanced technology, which depend in part on customers’ capacity utilization, production volumes, access to affordable capital, end-use demand, consumer buying patterns, and inventory levels relative to demand, as well as the rate of technology transitions and general economic conditions. 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. In particular, the amount and mix of capital equipment spending between foundry, memory and logic customers can have a significant impact on the results of operations of our Semiconductor Systems segment, which is the largest contributor to Applied’s consolidated net sales and total new orders.

To meet rapidly changing demand in the industries it serves, Applied must accurately forecast demand and effectively manage its resources and production capacity for each of its segments as well as across multiple segments, and may incur unexpected or additional costs to align its business operations. During periods of increasing demand for its products, Applied must have sufficient manufacturing capacity and inventory to meet customer demand; effectively manage its supply chain; attract, retain and motivate a sufficient number of qualified employees; and continue to control costs. During periods of decreasing demand, Applied must reduce costs and align its cost structure with prevailing market conditions; effectively manage its supply chain; and motivate and retain key employees. Even with effective management of costs, during periods of decreasing demand, Applied’s gross margins and earnings may be adversely impacted.

Applied is exposed to risks associated with the uncertain global economy.

Uncertain global economic conditions along with uncertainties in the financial markets, national debt and fiscal concerns in various regions, and government austerity measures, are posing challenges to the industries in which Applied operates. The markets for semiconductors and displays in particular depend largely on consumer spending. Economic uncertainty and related factors exacerbate negative trends in business and consumer spending and may cause certain Applied customers to push out, cancel, or refrain from placing orders for equipment or services, which may in turn reduce Applied’s net sales, reduce backlog, and affect Applied’s ability to convert backlog to sales. Uncertain market conditions, difficulties in obtaining capital, or reduced profitability may also cause some customers to scale back operations, exit businesses, merge with other manufacturers, or file for bankruptcy protection and potentially cease operations, which can also result in lower sales and/or additional inventory or bad debt expense for Applied. These conditions may 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 and prioritize the risks that may affect its businesses, sources and uses of cash, financial condition and results of operations. Applied may be required to implement additional cost

reduction efforts, including restructuring activities, which may adversely affect Applied's ability to capitalize on opportunities. 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, as well as returns on pension assets, could be negatively impacted and lead to impairment charges. Applied also maintains cash balances in various bank accounts globally in order to fund normal operations. If any of these financial institutions becomes insolvent, it could limit Applied's ability to access cash in the affected accounts.

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

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

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

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

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

- the increasing cost of research and development due to many factors, including: decreasing linewidths on a chip, the use of new materials, new and more complex device structures, more applications and process steps, increasing chip design costs, and the increasing cost and complexity of integrated manufacturing processes;
- the need to reduce product development time, despite the increasing difficulty of technical challenges;
- the growing number of types and varieties of semiconductors and number of applications across multiple substrate sizes;
- 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;
- challenges in generating organic growth given semiconductor manufacturers' levels of capital expenditures and the allocation of capital investment to market segments that Applied does not serve, such as lithography, or segments where Applied's products have lower relative market presence;
- the importance of increasing market positions in under-penetrated segments, such as etch and inspection;
- semiconductor manufacturer's ability to reconfigure and re-use equipment, and the resulting effect on their need to purchase new equipment and services;



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- the increasing frequency and complexity of technology transitions and inflections, such as 3-D transistors and advanced interconnects, and Applied's ability to timely and effectively anticipate and adapt to these changes; shorter cycle times between order placements by customers and product shipment require greater reliance on forecasting of customer investment, which may lead to inventory write-offs and manufacturing inefficiencies that decrease gross margin;

- competitive factors that make it difficult to enhance position, including challenges in securing development-tool-of-record (DTOR) and production-tool-of-record (PTOR) positions with customers; consolidation in the semiconductor industry, including among semiconductor manufacturers and among manufacturing equipment suppliers;

- shifts in sourcing strategies by computer and electronics companies that impact the equipment requirements of Applied's foundry customers;

- the concentration of new wafer starts in Korea and Taiwan, where Applied's service penetration and service-revenue-per-wafer-start have been lower than in other regions;

- the potential increasing investment in semiconductor manufacturing capabilities in China, and its effect on the demand for semiconductor manufacturing equipment; and

- the increasing fragmentation of semiconductor markets, leading certain markets to become too small to support the cost of a new fabrication plant, while others require less technologically advanced products.

Applied must accurately forecast, and allocate appropriate resources and investment towards addressing, key technology changes and inflections in order to enable opportunities for gains.

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

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

- the importance of new types of display technologies, such as organic light-emitting diode (OLED), low temperature polysilicon (LTPS), flexible displays and metal oxide, and new touch panel films;

- the timing and extent of an expansion of manufacturing facilities in China, which may be affected by changes in economic conditions in China;

- the rate of transition to larger substrate sizes for TVs and to new display technologies for TVs and mobile

- applications, and the resulting effect on capital intensity in the industry and on Applied's product differentiation, gross margin and return on investment; and

- uncertainty with respect to future display technology end-use applications and growth drivers.

Applied must continually innovate, commercialize its products, and adapt its business and product offerings to respond to competition and rapid technological changes.

As Applied operates in a highly competitive environment in which innovation is critical, its future success depends on many factors, including the effective commercialization and customer acceptance of its equipment, services and related products. In addition, Applied must successfully execute its growth strategy, including enhancing its presence 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 collaborative, geographically diverse, open and varied competitive environments have grown more complex and expensive over time. Furthermore, new or improved products may entail higher costs and reduced profits. Applied's performance may be adversely affected if it does not timely, cost-effectively and successfully:

- identify and address technology inflections, market changes, new applications, customer requirements and end-use demand;

- develop new products and disruptive technologies, 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;

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- differentiate its products from those of competitors and any disruptive technologies, meet customers' performance specifications, appropriately price products, and achieve market acceptance;
- maintain operating flexibility to enable different responses to different markets, customers and applications;
  - enhance its worldwide operations across all business segments to reduce cycle time, enable continuous quality improvement, reduce costs, and enhance design for manufacturability and serviceability;
- focus on product development and sales and marketing strategies that address customers' high value problems and foster strong customer relationships;
- 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;
- improve the productivity of capital invested in R&D activities;
- accurately forecast demand, work with suppliers and meet production schedules for its products;
- improve its manufacturing processes and achieve cost efficiencies across product offerings;
- adapt to changes in value offered by companies in different parts of the supply chain;
- qualify products for evaluation and, in turn, volume manufacturing with its customers; and
- 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.

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

Applied's semiconductor customer base historically has been, and is becoming even more, highly concentrated as a result of economic and industry conditions. In the first nine months of fiscal 2016, four semiconductor manufacturers accounted for approximately 58 percent of the Semiconductor Systems segment's net sales and four customers accounted for 49 percent of Applied's consolidated net sales. Applied's display customer base is also highly concentrated. Applied's customer base is also geographically-concentrated. See Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," for tabular presentations of net sales by geographic region. In addition, certain customers have experienced significant ownership or management changes, consolidated with other manufacturers, outsourced manufacturing activities, or engaged in collaboration or cooperation arrangements with other manufacturers. 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. Also, certain customers are making an increasingly greater percentage of their respective industry's capital equipment investments. Further, claims or litigation involving key industry participants have resulted and may continue to result in changes in their sourcing strategies and other outcomes. In this environment, contracts or orders from a relatively limited number of manufacturers have accounted for, and are expected to continue to account for, a substantial portion of Applied's business. The mix and type of customers, and sales to any single customer, may vary significantly from quarter to quarter and from year to year. As Applied's products are configured to customer specifications, changing, rescheduling or canceling orders may result in significant, non-recoverable costs. If customers do not place orders, or they substantially reduce, delay or cancel orders, Applied may not be able to replace the business. The concentration of our customer base may increase our risks related to the financial condition of our customers, and the failure of a single customer to perform its obligations could have a material adverse effect on the Company's results of operations. Major customers may also seek, and on occasion receive, pricing, payment, intellectual property-related, or other commercial terms that are less favorable to Applied.

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

In the third quarter of fiscal 2016, approximately 90 percent of Applied's net sales were to customers in regions outside the United States. Moreover, China now represents the largest market for various electronic products, such as TVs, PCs, and smartphones. Certain of Applied's R&D and manufacturing facilities, as well as suppliers to Applied, are also located outside the United States, including in Singapore, Taiwan, China, Korea, Israel, Germany and Italy. Applied is also expanding its business and operations in new countries. The global nature of Applied's business and operations, combined with the need to continually improve the Company's operating cost structure, 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;
- customer- or government-supported efforts to influence Applied to conduct more of its operations and sourcing in a particular country, such as Korea and China;
- variations among, and changes in, local, regional, national or international laws and regulations (including intellectual property, labor, tax, and import/export laws), 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, as well as international trade disputes;
- positions taken by governmental agencies regarding possible national commercial and/or security issues posed by international business operations;
- fluctuating raw material, commodity, energy and shipping costs or shipping delays;
- challenges associated with managing more geographically diverse operations and projects, which require an effective organizational structure and appropriate business processes, procedures and controls;
- a more diverse workforce with different experience levels, cultures, customs, business practices and worker expectations;
- variations in the ability to develop relationships with local customers, suppliers and governments;
- fluctuations in interest rates and currency exchange rates, including the relative strength or weakness of the U.S. dollar against the Japanese yen, euro, Taiwanese dollar, Israeli shekel or Chinese yuan;
- the need to provide sufficient levels of technical support in different locations around the world;
- political instability, natural disasters (such as earthquakes, floods or storms), pandemics, social unrest, terrorism or acts of war in locations where Applied has operations, suppliers or sales, or that may influence the value chain of the industries that Applied serves;
- the need for an effective business continuity plan if a disaster or other event occurs that could disrupt business operations;
- the need to regularly reassess the size, capability and location of global infrastructure and make appropriate changes;
- cultural and language differences;
- difficulties and uncertainties associated with the entry into new countries;
- hiring and integration of an increasing number of new workers, including in countries such as India and China;
- the increasing need for the workforce to be more mobile and work in or travel to different regions;
- uncertainties with respect to economic growth rates in various countries; and
- uncertainties with respect to growth rates for the manufacture and sale of semiconductors and displays in the developing economies of certain countries.

Many of these challenges are present in China and Korea, which are experiencing significant growth of customers, suppliers and competitors to Applied. Applied further believes that China and Korea present large potential markets for its products and opportunity for growth over the long term, although at lower projected levels of profitability and margins for certain products than historically have been achieved in other regions.



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

Applied has made, and in the future may make, acquisitions of or investments in companies, technologies or products in existing, related or new markets for Applied. Business combinations, acquisitions and investments involve numerous risks that vary depending on their scale and nature, including but not limited to:

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

Applied also makes strategic investments in other companies, including companies formed as joint ventures, which may decline in value 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.

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

Applied has \$3.35 billion in aggregate principal amount of senior unsecured notes outstanding. Under the indenture governing the senior unsecured notes, it may be required to offer to repurchase the notes at a price equal to 101% of the principal amount, plus accrued and unpaid interest, upon a change of control of Applied and a contemporaneous downgrade of the notes below investment grade. Applied also has in place a \$1.5 billion committed revolving credit agreement. While no amounts were outstanding under this credit agreement at July 31, 2016, Applied may borrow amounts in the future under the agreement. Applied may also enter into new financing arrangements. Applied's ability to satisfy its debt obligations is dependent upon the results of its business operations and other risks discussed in this section. Significant changes in Applied's credit rating or changes in the interest rate environment could have a material adverse consequence on Applied's access to and cost of capital for future financings, and financial condition. If Applied fails to satisfy its debt obligations, or comply with financial and other debt covenants, it may be in default and any borrowings may become immediately due and payable, and such default may also constitute a default under other of Applied's obligations. There can be no assurance that Applied would have sufficient financial resources or be able to arrange financing to repay any borrowings at such time.

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

As part of its growth strategy, Applied must successfully expand into related or new markets and industries, either with its existing products or with new products developed internally or 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;
- the need to develop new sales and technical marketing strategies, cultivate relationships with new customers and meet different customer service requirements;
- differing rates of profitability and growth among multiple businesses;
- Applied's ability to anticipate demand, capitalize on opportunities, and avoid or minimize risks;
- the complexity of managing multiple businesses with variations in production planning, execution, supply chain management and logistics;
- the adoption of new business models, business processes and systems;
- Applied's ability to rapidly expand or reduce its operations to meet increased or decreased demand, respectively, 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, or has limited, operations;
- new or different competitors with potentially more financial or other resources, industry experience and/or established customer relationships;
- entry into new industries and countries, with differing levels of government involvement, laws and regulations, and business, employment and safety practices;
- third parties' intellectual property rights; and
- the need to comply with, or work to establish, industry standards and practices.

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

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

Applied's business depends on its timely supply of equipment, services and related products that meet the rapidly changing technical and volume requirements of its customers, which depends in part on the timely delivery of parts, components and subassemblies (collectively, parts) from suppliers, including contract manufacturers. Some key parts are 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 countries where Applied conducts its manufacturing, including China and Korea. Cyclical industry conditions and the volatility of demand for manufacturing equipment increase capital, technical, operational and other risks for Applied and for companies throughout its supply chain. Further, these conditions may cause some suppliers to scale back operations, exit businesses, merge with other companies, or file for bankruptcy protection and possibly cease operations. Applied may also experience significant interruptions of its manufacturing operations, delays in its ability to deliver products or services, increased costs or customer order cancellations as a result of:

• the failure or inability of suppliers to timely deliver sufficient quantities of quality parts on a cost-effective basis;

• volatility in the availability and cost of materials, including rare earth elements;

• difficulties or delays in obtaining required import or export approvals;

• information technology or infrastructure failures; and

natural disasters or other events beyond Applied's control (such as earthquakes, floods or storms, regional economic downturns, pandemics, social unrest, political instability, terrorism, or acts of war), particularly where it conducts manufacturing.

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

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

Applied's success, competitiveness and ability to execute on its global strategies and maintain a culture of innovation depend in large part on its ability to attract, retain and motivate key employees, especially in critical positions.

Achieving this objective may be difficult due to many factors, including fluctuations in global economic and industry conditions, management changes, Applied's organizational structure, hiring practices of competitors and other companies, cost reduction activities (including workforce reductions and unpaid shutdowns), availability of career development opportunities, the ability to obtain necessary authorizations for workers to provide services outside their home countries, and the effectiveness of Applied's compensation and benefit programs, including its share-based programs. Restructuring programs present particular challenges to the extent they involve the departure of knowledgeable and experienced employees and the resulting need to identify and train existing or new workers to perform necessary functions, which may result in unexpected costs, reduced productivity, and/or difficulties with respect to internal processes and controls.

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

Applied's success depends in significant part on the protection of its 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. Policing any unauthorized use of intellectual property is difficult and costly and Applied cannot be certain that the measures it has implemented will prevent misuse. Applied's 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 or obtain necessary licenses on commercially reasonable terms. 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 adequately protect Applied's rights. In addition, changes in intellectual property laws or their interpretation, such as recent changes in U.S. patent laws, may impact Applied's ability to protect and assert its intellectual property rights, increase costs and uncertainties in the prosecution of patent applications and enforcement or defense of issued patents, and diminish the value of Applied's intellectual property.



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

In the conduct of its business, Applied collects, uses, transmits and stores data on information technology systems. This data includes confidential information belonging to Applied or its customers or other business partners, as well as personally-identifiable information of individuals. Applied has experienced, and expects to continue to be subject to, cybersecurity threats and incidents, ranging from employee error or misuse to individual attempts to gain unauthorized access to information systems to sophisticated and targeted measures known as advanced persistent threats, none of which have been material to the Company to date. Applied devotes significant resources to network security, data encryption and other measures to protect its systems and data from unauthorized access or misuse. However, depending on their nature and scope, cybersecurity incidents could result in business disruption; the misappropriation, corruption or loss of confidential information and critical data (Applied's and that of third parties); reputational damage; litigation with third parties; diminution in the value of Applied's investment in research, development and engineering; data privacy issues; and increased cybersecurity protection and remediation costs.

Applied is exposed to various risks related to legal proceedings.

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

Legal proceedings and claims, whether with or without merit, and associated internal investigations, may (1) be time-consuming and expensive to prosecute, defend or conduct; (2) divert management's attention and other Applied resources; (3) inhibit Applied's ability to sell its products; (4) result in adverse judgments for damages, injunctive relief, penalties and fines; and/or (5) negatively affect Applied's business. There can be no assurance regarding the outcome of current or future legal proceedings, claims or investigations.

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

To better align its costs with market conditions, locate closer to customers, enhance productivity, and improve efficiencies, Applied conducts certain engineering, software development, manufacturing, sourcing and other operations in regions outside the United States, including India, Taiwan, China, and Korea. Applied has implemented a distributed manufacturing model, under which certain manufacturing and supply chain activities are conducted in various countries, including Germany, Israel, Italy, Singapore, Taiwan, the United States and other countries in Asia, and assembly of some systems is completed at customer sites. In addition, Applied outsources certain functions to third parties, including companies in the United States, India, China, Korea, Malaysia and other countries. Outsourced functions include contract manufacturing, engineering, 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 the intellectual property of Applied and its customers, suppliers and other partners. If Applied does not accurately forecast the amount, timing and mix of demand for products, or if contract manufacturers or other outsource providers fail to perform in a timely manner or at satisfactory quality levels, Applied's ability to meet customer requirements could suffer, particularly during a market upturn.

In addition, Applied must regularly implement or update comprehensive programs and processes to better align its global organizations, including initiatives to enhance its supply chain and improve back office and information technology infrastructure for more efficient transaction processing. The implementation of new processes and additional functionality to the existing systems 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. During transitions Applied must continue to rely on legacy information systems, which may be costly or inefficient, while the

implementation of new initiatives may not achieve the anticipated benefits and may divert management's attention from other operational activities, or have other unintended consequences.

If Applied does not effectively develop and implement its outsourcing and relocation 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, reputational harm, increased product time-to-market, and/or inefficient allocation of human resources.

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

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

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

Applied is subject to taxation in the United States and various other jurisdictions. Significant judgment is required to determine and estimate worldwide tax liabilities. Applied's future provision for income taxes and effective tax rates could be affected by numerous factors, including changes in: (1) applicable tax laws; (2) amount and composition of pre-tax income in jurisdictions with differing tax rates; (3) plans to indefinitely reinvest certain funds held outside of the U.S.; and (4) valuation of deferred tax assets and liabilities. As of July 31, 2016, Applied intends to indefinitely reinvest approximately \$2.8 billion of cash, cash equivalents and marketable securities held by non-U.S. subsidiaries and does not plan to repatriate these funds. Applied would need to accrue and pay U.S. taxes if these funds were repatriated.

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

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

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.

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

Applied is subject to various risks related to: (1) new, different, inconsistent or conflicting laws, rules and regulations that may be enacted by executive order, legislative bodies 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. As a public company with global operations, Applied is subject to the laws of multiple jurisdictions and the rules and regulations of various governing bodies,

including those related to financial and other disclosures, corporate governance, privacy, and anti-corruption. Changes and ambiguities in laws, regulations and standards create uncertainty and challenges regarding compliance matters. Efforts to comply with new and changing regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

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

## Issuer Purchases of Equity Securities

The following table provides information as of July 31, 2016 with respect to the shares of common stock repurchased by Applied during the third quarter of fiscal 2016.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Aggregate Price Paid	Total Number of Shares Purchased as Part of Publicly Announced Program*	Maximum Dollar Value of Shares That May Yet be Purchased Under the Program*
(In millions, except per share amounts)					
Month #1 (May 2, 2016 to May 29, 2016)	5.9	\$ 20.60	\$ 120	5.9	\$ 30
Month #2 (May 30, 2016 to June 26, 2016)	1.2	\$ 24.32	29	1.2	\$ 2,000
Month #3 (June 27, 2016 to July 31, 2016)	1.9	\$ 24.29	47	1.9	\$ 1,953
Total	9.0	\$ 21.88	\$ 196	9.0	

On June 9, 2016, Applied's Board of Directors approved a new \$2.0 billion common stock repurchase program \*authorizing up to \$2.0 billion in repurchases, which followed the completion of a \$3.0 billion common stock repurchase program approved on April 26, 2015.

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Item 6. Exhibits

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

Exhibit No.	Description	Incorporated by Reference		
		Form No.	File No.	Filing Date
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†			
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†			
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002‡			
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002‡			
101.INS	XBRL Instance Document‡			
101.SCH	XBRL Taxonomy Extension Schema Document‡			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document‡			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document‡			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document‡			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document‡			

† Filed herewith.

‡ Furnished herewith.

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SIGNATURES

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

APPLIED MATERIALS, INC.

By: /s/ ROBERT J. HALLIDAY

Robert J. Halliday  
Senior Vice President,  
Chief Financial Officer  
(Principal Financial Officer)

August 25, 2016

By: /s/ CHARLES W. READ

Charles W. Read  
Corporate Vice President,  
Corporate Controller  
and Chief Accounting Officer  
(Principal Accounting Officer)

August 25, 2016