



Applied Materials Inc. (AMAT)

Updated August 29th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$99	5 Year CAGR Estimate:	11.7%	Market Cap:	\$85 B
Fair Value Price:	\$123	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	11/24/22 ¹
% Fair Value:	80%	5 Year Valuation Multiple Estimate:	4.5%	Dividend Payment Date:	12/16/22
Dividend Yield:	1.1%	5 Year Price Target	\$165	Years Of Dividend Growth:	5
Dividend Risk Score:	A	Retirement Suitability Score:	D	Rating:	Buy

Overview & Current Events

Applied Materials began in a small office unit in 1967 and since that time, it has undergone some major, transformative changes. Those changes have afforded it some spectacular rates of growth and today, it has a market capitalization of \$85 billion and more than \$25 billion in annual revenue. Applied Materials has become a major player in the semiconductor market, which makes up the majority of its revenue.

Applied Materials reported third quarter earnings on August 18th, 2022, and results were much better than expected on both the top and bottom lines. Adjusted earnings-per-share came to \$1.94, which was 15 cents ahead of estimates. Revenue was up 5.2% to \$6.52 billion, and was \$250 million ahead of expectations.

Gross margins moved lower year-over-year to 46.1% from 47.9%.

Cash from operations was \$1.47 billion, and returned \$1.23 billion to shareholders via \$1 billion in repurchases, and the balance in cash dividends.

The company guided for \$6.65 billion in fourth quarter revenue, plus or minus \$400 million, which includes ongoing supply chain challenges. Adjusted earnings-per-share is expected in a range of \$1.82 to \$2.18.

We see guidance as robust for the fourth quarter and have added 20 cents to our earnings-per-share estimate for this year, which now stands at \$7.70.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.42	\$0.21	\$0.87	\$1.12	\$1.54	\$3.17	\$4.45	\$3.04	\$4.17	\$6.84	\$7.70	\$10.30
DPS	\$0.34	\$0.38	\$0.40	\$0.40	\$0.40	\$0.40	\$0.60	\$0.83	\$0.87	\$0.92	\$1.04	\$1.67
Shares²	1,197	1,204	1,221	1,160	1,078	1,060	980	931	921	898	878	800

Applied Materials' earnings-per-share history is volatile to say the least, as the company has seen earnings rise and fall very rapidly from year to year in the past decade. Since the bottom in 2013, Applied Materials has managed to see what can only be described as explosive earnings growth. We forecast 6% annual growth in earnings-per-share in the coming years. The cause for caution is that 2022's earnings base is so high that we see continued, sizable growth as challenging, and guidance thus far this year supports this view. We also note that the company is struggling with supply chain issues, and to an extent, lower than expected demand in 2022.

Six percent annual earnings-per-share growth is an achievable goal given that Applied Materials has many levers it can pull to get there. Over time, demand for products like televisions and smartphones drive demand for Applied Materials' products. However, periods of weakness, like the start of 2020, do occur regularly. In particular, the company's memory businesses are stagnant at best. However, management is extremely bullish on the company's future, and guidance for 2022 looks decent.

¹ Estimated date

² Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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The company is also buying back its stock. Management is very serious about spending money when the share price is off its highs, a vote of confidence investors should ignore at their own peril. The company's ample spending on buybacks slowed in 2020, but we think if the share price is low, the company will continue to buy back stock in large quantities.

We see continued growth in the payout, and while the buyback is certainly going to take priority, there is a robust dividend growth story as well. We believe Applied Materials will grow its payout at a significant rate.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	27.3	67.7	22.8	18.3	14.5	12.8	11.0	11.3	13.9	17.5	12.9	16.0
Avg. Yld.	3.0%	2.7%	2.0%	1.9%	1.8%	1.0%	1.2%	2.0%	1.5%	0.8%	1.1%	1.0%

Applied Materials' valuation has pulled back since our last update, and shares trade at 12.9 times this year's estimated earnings. That is below our fair value estimate of 16 times earnings. The yield could move higher over time depending upon the pace of dividend increases. As mentioned, we do see robust dividend growth on the horizon, but the current yield is quite low and unattractive.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	81%	181%	46%	36%	26%	13%	13%	27%	21%	13%	14%	16%

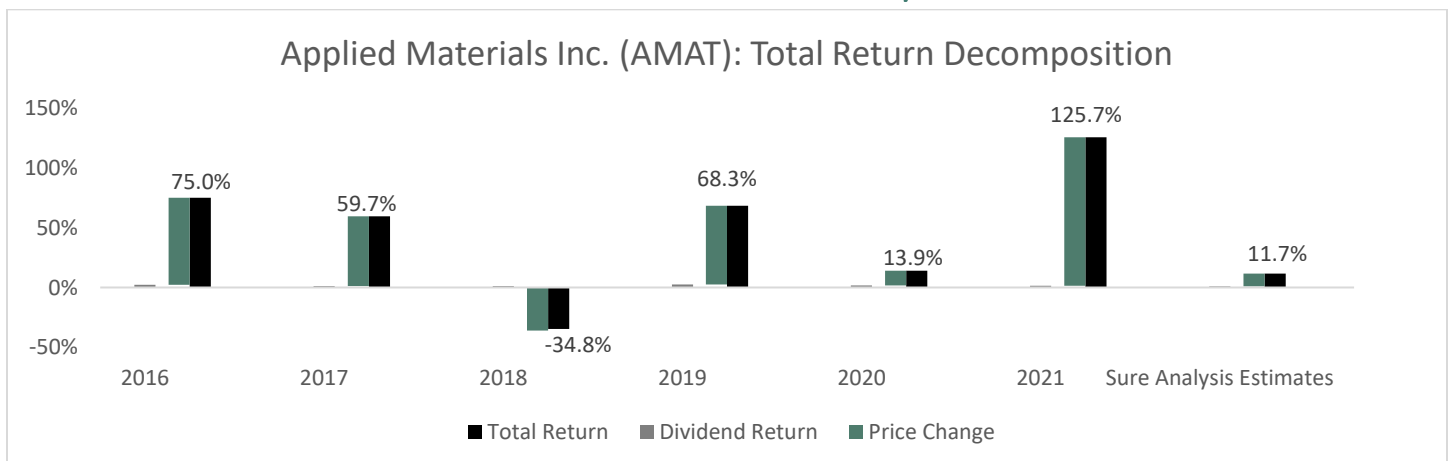
The payout ratio is low, and we expect it will stay that way as Applied Materials continues to return cash to shareholders through share repurchases. Still, maintaining or boosting the payout ratio over time will lead to solid dividend growth.

Applied Materials suffered during the last recession but produced enormous growth during the 2020 recession. Applied Materials' long history of solving complex engineering problems and its entrenched customers should help see it through. The company has created high switching costs for its customers with its excellent products, which we think is a long-term competitive advantage in a very competitive field. It is also seeing high rates of growth in its subscription business, which is well over half of revenue now.

Final Thoughts & Recommendation

With the share price having pulled back sharply since our last update, we see Applied Materials as undervalued, and with higher expected earnings. With expected growth still decent, and the valuation in a much better spot, we are upgrading the stock from hold to buy. We see 6% earnings growth, a 1.1% yield, and a 4.5% tailwind from the valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	8,719	7,509	9,072	9,659	10,825	14,698	16,705	14,608	17,202	23,063
Gross Profit	3,313	2,991	3,843	3,952	4,511	6,612	7,517	6,386	7,692	10,914
Gross Margin	38.0%	39.8%	42.4%	40.9%	41.7%	45.0%	45.0%	43.7%	44.7%	47.3%
SG&A Exp.	1,076	891	925	897	819	895	1,004	982	1,093	1,229
D&A Exp.	422	410	375	371	389	407	457	363	376	394
Operating Profit	1,000	780	1,490	1,604	2,152	3,936	4,491	3,350	4,365	7,200
Operating Margin	11.5%	10.4%	16.4%	16.6%	19.9%	26.8%	26.9%	22.9%	25.4%	31.2%
Net Profit	109	256	1,072	1,377	1,721	3,519	3,038	2,706	3,619	5,888
Net Margin	1.3%	3.4%	11.8%	14.3%	15.9%	23.9%	18.2%	18.5%	21.0%	25.5%
Free Cash Flow	1,689	426	1,559	948	2,313	3,444	3,165	2,806	3,382	4,774
Income Tax	207	94	376	221	292	297	1,358	563	547	883

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	12,102	12,043	13,174	15,308	14,570	19,419	17,633	19,024	22,353	25,825
Cash & Equivalents	1,392	1,711	3,002	4,797	3,406	5,010	3,440	3,129	5,351	4,995
Accounts Receivable	1,220	1,633	1,670	1,739	2,279	2,338	2,323	2,533	2,963	4,953
Inventories	1,272	1,413	1,567	1,833	2,050	2,930	3,721	3,474	3,904	4,309
Goodwill & Int. Ass.	4,873	4,397	4,255	4,064	3,891	3,780	3,581	3,555	3,619	3,583
Total Liabilities	4,867	4,955	5,306	7,695	7,353	10,070	10,788	10,810	11,775	13,578
Accounts Payable	396	582	613	658	813	945	996	958	1,124	---
Long-Term Debt	1,946	1,946	1,947	4,542	3,325	5,304	5,309	5,313	5,448	5,452
Shareholder's Equity	7,235	7,088	7,868	7,613	7,217	9,349	6,845	8,214	10,578	12,247
LTD/E Ratio	0.27	0.27	0.25	0.60	0.46	0.57	0.78	0.65	0.52	0.45

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.8%	2.1%	8.5%	9.7%	11.5%	20.7%	16.4%	14.8%	17.5%	24.4%
Return on Equity	1.4%	3.6%	14.3%	17.8%	23.2%	42.5%	37.5%	35.9%	38.5%	51.6%
ROIC	1.1%	2.8%	11.4%	12.5%	15.2%	27.9%	22.7%	21.1%	24.5%	34.9%
Shares Out.	1,197	1,204	1,221	1,160	1,078	1,060	980	931	921	898
Revenue/Share	6.83	6.16	7.37	7.88	9.70	13.56	16.28	15.46	18.64	25.10
FCF/Share	1.32	0.35	1.27	0.77	2.07	3.18	3.08	2.97	3.66	5.19

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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