



Applied Materials Inc. (AMAT)

Updated August 18th, 2023, by Josh Arnold

Key Metrics

Current Price:	\$138	5 Year CAGR Estimate:	0.4%	Market Cap:	\$116 B
Fair Value Price:	\$120	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	08/23/23
% Fair Value:	115%	5 Year Valuation Multiple Estimate:	-2.8%	Dividend Payment Date:	09/14/23
Dividend Yield:	0.9%	5 Year Price Target	\$132	Years Of Dividend Growth:	6
Dividend Risk Score:	A	Retirement Suitability Score:	D	Rating:	Sell

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 \$116 billion and about \$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 17th, 2023, and results were much better than expected, including terrific guidance for the fourth quarter. Adjusted earnings-per-share came to \$1.90, which was 15 cents ahead of expectations. Revenue was down 1.4% to \$6.43 billion, but was \$250 million ahead of expectations. The company said revenue from foundry and logic accounted for 79% of sales in the quarter, up from 66% a year ago. Revenue from dynamic random access memory and flash accounted for 17% and 4%, compared to 15% and 19%, respectively, in the year-ago period.

Operating margin was 28.3% on an adjusted basis, down 1.7% year-over-year. Cash from operations was \$2.58 billion for the third quarter.

Guidance for the fourth quarter is for \$6.51 billion, plus or minus \$400 million. Adjusted earnings-per-share is expected to be between \$1.82 and \$2.18. These guidance figures are well ahead of expectations from analysts for \$5.88 billion in revenue, and \$1.60 in earnings-per-share.

We've boosted our estimate of earnings to \$7.50 for this year on strong guidance for Q4.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$0.21	\$0.87	\$1.12	\$1.54	\$3.17	\$4.45	\$3.04	\$4.17	\$6.84	\$7.70	\$7.50	\$8.28
DPS	\$0.38	\$0.40	\$0.40	\$0.40	\$0.40	\$0.60	\$0.83	\$0.87	\$0.92	\$1.02	\$1.28	\$2.06
Shares¹	1,204	1,221	1,160	1,078	1,060	980	931	921	898	854	825	725

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 2% annual growth in earnings-per-share in the coming years. The cause for caution is that 2022's earnings base was so high that we see continued, sizable growth as challenging, and early guidance thus far this year supports this view. We note that while the company says its supply chain issues are getting better, the industry is not yet back to pre-pandemic conditions. We previously cut our estimate from the prior 6% projected growth as analysts now forecast lower earnings for 2024.

Two 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

¹ Share count in millions

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businesses are stagnant at best. However, management is extremely bullish on the company's future, and early estimates for 2023 see earnings ahead of 2021 levels.

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 valuation 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	67.7	22.8	18.3	14.5	12.8	11.0	11.3	13.9	17.5	10.6	18.4	16.0
Avg. Yld.	2.7%	2.0%	1.9%	1.8%	1.0%	1.2%	2.0%	1.5%	0.8%	1.2%	0.9%	1.6%

Applied Materials' valuation has risen somewhat since our last update, and shares trade at 18.4 times this year's estimated earnings. That is ahead of 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	181%	46%	36%	26%	13%	13%	27%	21%	13%	13%	17%	25%

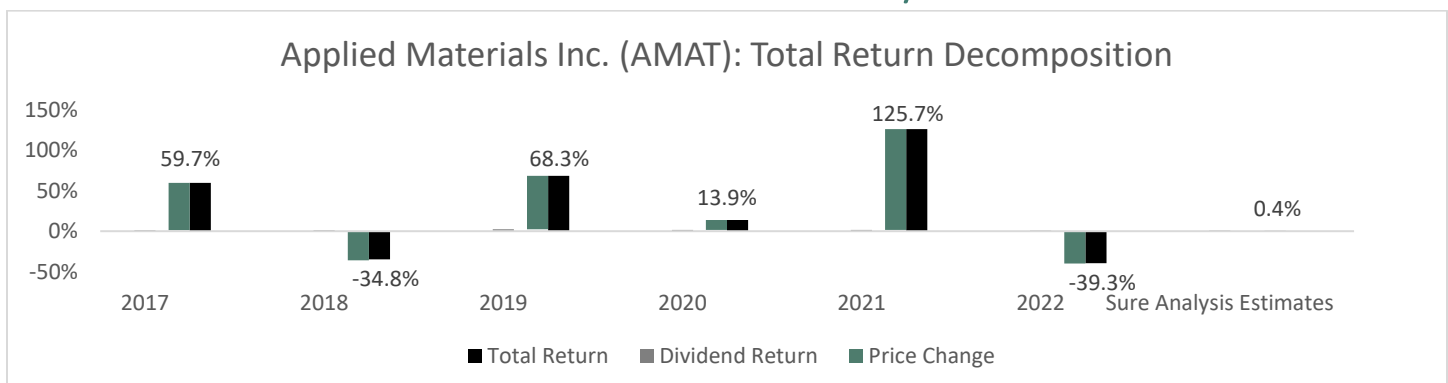
The payout ratio is low, and we expect it will stay that way as Applied Materials continues to return cash to shareholders through share repurchases. Still, maintaining or boosting the payout ratio over time will lead to solid dividend growth.

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

We continue to see the valuation as ahead of fair value, despite rising earnings estimates. With expected growth still decent, and the valuation ahead of fair value, we rate the stock a sell. We see 2% earnings growth, a 0.9% yield, and a 2.8% headwind from the valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	7,509	9,072	9,659	10,825	14,698	16,705	14,608	17,202	23,063	25,785
Gross Profit	2,991	3,843	3,952	4,511	6,612	7,517	6,386	7,692	10,914	11,993
Gross Margin	39.8%	42.4%	40.9%	41.7%	45.0%	45.0%	43.7%	44.7%	47.3%	46.5%
SG&A Exp.	891	925	897	819	895	1,004	982	1,093	1,229	1,438
D&A Exp.	410	375	371	389	407	457	363	376	394	444
Operating Profit	780	1,490	1,604	2,152	3,936	4,491	3,350	4,365	7,200	7,784
Operating Margin	10.4%	16.4%	16.6%	19.9%	26.8%	26.9%	22.9%	25.4%	31.2%	30.2%
Net Profit	256	1,072	1,377	1,721	3,519	3,038	2,706	3,619	5,888	6,525
Net Margin	3.4%	11.8%	14.3%	15.9%	23.9%	18.2%	18.5%	21.0%	25.5%	25.3%
Free Cash Flow	426	1,559	948	2,313	3,444	3,165	2,806	3,382	4,774	4,612
Income Tax	94	376	221	292	297	1,358	563	547	883	1,074

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	12,043	13,174	15,308	14,570	19,419	17,633	19,024	22,353	25,825	26,726
Cash & Equivalents	1,711	3,002	4,797	3,406	5,010	3,440	3,129	5,351	4,995	1,995
Accounts Receivable	1,633	1,670	1,739	2,279	2,338	2,323	2,533	2,963	4,953	6,068
Inventories	1,413	1,567	1,833	2,050	2,930	3,721	3,474	3,904	4,309	5,932
Goodwill & Int. Ass.	4,397	4,255	4,064	3,891	3,780	3,581	3,555	3,619	3,583	4,039
Total Liabilities	4,955	5,306	7,695	7,353	10,070	10,788	10,810	11,775	13,578	14,532
Accounts Payable	582	613	658	813	945	996	958	1,124	1,472	1,755
Long-Term Debt	1,946	1,947	4,542	3,325	5,304	5,309	5,313	5,448	5,452	5,457
Shareholder's Equity	7,088	7,868	7,613	7,217	9,349	6,845	8,214	10,578	12,247	12,194
LTD/E Ratio	0.27	0.25	0.60	0.46	0.57	0.78	0.65	0.52	0.45	0.45

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.1%	8.5%	9.7%	11.5%	20.7%	16.4%	14.8%	17.5%	24.4%	24.8%
Return on Equity	3.6%	14.3%	17.8%	23.2%	42.5%	37.5%	35.9%	38.5%	51.6%	53.4%
ROIC	2.8%	11.4%	12.5%	15.2%	27.9%	22.7%	21.1%	24.5%	34.9%	36.9%
Shares Out.	1,204	1,221	1,160	1,078	1,060	980	931	921	919	877
Revenue/Share	6.16	7.37	7.88	9.70	13.56	16.28	15.46	18.64	25.10	29.40
FCF/Share	0.35	1.27	0.77	2.07	3.18	3.08	2.97	3.66	5.19	5.26

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

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