APPLIED MATERIALS INC /DE
Form 10-Q
August 22, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 28, 2013
or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 000-06920
Applied Materials, Inc.
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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

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

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

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

Number of shares outstanding of the issuer’s common stock as of July 28, 2013: 1,202,826,487

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	July 28, 2013	July 29, 2012	July 28, 2013	July 29, 2012
	(Unaudited)			
	(In millions, except per share amounts)			
Net sales	$1,975	$2,343	$5,521	$7,073
Cost of products sold	1,169	1,413	3,325	4,347
Gross margin	806	930	2,196	2,726
Operating expenses:				
Research, development and engineering	334	309	982	933
Marketing and selling	111	118	334	374
General and administrative	97	137	348	465
Impairment of goodwill and intangible assets (Note 8)	—	—	278	—
Restructuring charges and asset impairments (Note 10)	14	44	33	44
Total operating expenses	556	608	1,975	1,816
Income from operations	250	322	221	910
Impairments of strategic investments (Notes 3 and 4)	3	—	5	3
Interest and other expenses (Note 9)	23	24	71	72
Interest and other income, net	4	4	11	13
Income before income taxes	228	302	156	848
Provision for income taxes	60	84	83	224
Net income	$168	$218	$73	$624
Earnings per share:				
Basic	$0.14	$0.17	$0.06	$0.49
Diluted	$0.14	$0.17	$0.06	$0.48
Weighted average number of shares:				
Basic	1,203	1,257	1,201	1,282
Diluted	1,220	1,268	1,218	1,292

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended		Nine Months Ended	
	July 28, 2013	July 29, 2012	July 28, 2013	July 29, 2012
	(Unaudited) (In millions)			
Net income	$168	$218	$73	$624
Other comprehensive income (loss), net of tax:				
Change in unrealized net gain on investments	(4)	(9)	3	(6)
Change in unrealized net gain on derivative investments	(2)	(4)	5	(4)
Change in defined benefit plan liability (Note 12)	—	—	(2)	—
Change in cumulative translation adjustments	(1)	1	(6)	(1)
Other comprehensive income (loss), net of tax	(7)	(12)	—	(11)
Comprehensive income	$161	$206	$73	$613

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	July 28, 2013	October 28, 2012
	(In millions)	
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 3 and 4)	$1,745	$1,392
Short-term investments (Notes 3 and 4)	230	545
Accounts receivable, net (Note 6)	1,170	1,220
Inventories (Note 7)	1,358	1,272
Other current assets (Note 7)	734	673
Total current assets	5,237	5,102
Long-term investments (Notes 3 and 4)	1,055	1,055
Property, plant and equipment, net (Note 7)	872	910
Goodwill (Note 8)	3,294	3,518
Purchased technology and other intangible assets, net (Note 8)	1,148	1,355
Deferred income taxes and other assets (Note 13)	145	162
Total assets	$11,751	$12,102
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	$1,446	$1,510
Customer deposits and deferred revenue (Note 7)	756	755
Total current liabilities	2,202	2,265
Long-term debt (Note 9)	1,946	1,946
Other liabilities (Note 7)	649	656
Total liabilities	4,797	4,867
Stockholders' equity (Note 11):		
Common stock	12	12
Additional paid-in capital	6,055	5,863
Retained earnings	12,425	12,700
Treasury stock	(11,477)	(11,279)
Accumulated other comprehensive loss	(61)	(61)
Total stockholders' equity	6,954	7,235
Total liabilities and stockholders' equity	$11,751	$12,102

Amounts as of July 28, 2013 are unaudited. Amounts as of October 28, 2012 are derived from the October 28, 2012 audited consolidated financial statements.
See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC
CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
	(Unaudited) (In millions)							
Balance at October 28, 2012	1,197	$12	$5,863	$12,700	699	$(11,279)	$ (61)	$7,235
Net income	—	—	—	73	—	—	—	73
Other comprehensive income, net of tax	—	—	—	—	—	—	—	—
Dividends	—	—	—	(348)	—	—	—	(348)
Share-based compensation	—	—	121	—	—	—	—	121
Issuance under stock plans, net of a tax benefit of $3 and other	21	—	71	—	—	—	—	71
Common stock repurchases	(15)	—	—	—	15	(198)	—	(198)
Balance at July 28, 2013	1,203	$12	$6,055	$12,425	714	$(11,477)	$ (61)	$6,954

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	July 28, 2013	July 29, 2012
	(Unaudited) (In millions)	
Cash flows from operating activities:		
Net income	$73	$624
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	312	325
Impairment of goodwill and intangible assets	278	—
Restructuring charges and asset impairments	33	44
Deferred income taxes and other	(102)	144
Share-based compensation	121	138
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	51	183
Inventories	(85)	571
Other assets	18	47
Accounts payable and accrued expenses	(132)	(405)
Customer deposits and deferred revenue	—	(230)
Other liabilities	37	(1)
Cash provided by operating activities	604	1,440
Cash flows from investing activities:		
Capital expenditures, net	(140)	(121)
Cash paid for acquisitions, net of cash acquired	(1)	(4,189)
Proceeds from sales and maturities of investments	737	765
Purchases of investments	(438)	(1,152)
Cash provided by (used in) investing activities	158	(4,697)
Cash flows from financing activities:		
Proceeds from common stock issuances and others, net	125	51
Common stock repurchases	(198)	(900)
Payments of dividends to stockholders	(336)	(323)
Cash used in financing activities	(409)	(1,172)
Effect of exchange rate changes on cash and cash equivalents	—	(2)
Increase (decrease) in cash and cash equivalents	353	(4,431)
Cash and cash equivalents — beginning of year	1,392	5,960
Cash and cash equivalents — end of year	$1,745	$1,529
Supplemental cash flow information:		
Cash payments for income taxes	$184	$233
Cash refunds from income taxes	$67	$5
Cash payments for interest	$85	$87

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 28, 2012 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 28, 2012 (2012 Form 10-K). Applied’s results of operations for the three and nine months ended July 28, 2013 are not necessarily indicative of future operating results. Applied’s fiscal year ends on the last Sunday in October of each year. Fiscal 2013 and 2012 each contain 52 weeks, and the first nine months of fiscal 2013 and 2012 each contained 39 weeks.

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, Applied recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer technical acceptance; (3) for transactions where legal title does not pass at shipment, revenue is recognized when legal title passes to the customer, which is generally at customer technical acceptance; 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.

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 July 2013, the Financial Accounting Standards Board (FASB) issued authoritative guidance that will require an unrecognized tax benefit to be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward, with certain exceptions. The authoritative guidance becomes effective for Applied in the first quarter of fiscal 2015, with early adoption permitted. The guidance is not expected to have an impact on Applied's financial position or results of operations.

In February 2013, the FASB issued authoritative guidance that will require a public entity to present in its annual and interim financial statements information about reclassification adjustments from accumulated other comprehensive income in a single note or on the face of the financial statements. The authoritative guidance becomes effective for Applied in the first quarter of fiscal 2014, with early adoption permitted, and is not expected to have an impact on Applied's financial position or results of operations.

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 plans shares) outstanding during the period. Net income has not been adjusted for any period presented for purposes of computing basic or diluted earnings per share as Applied has a non-complex capital structure.

	Three Months Ended		Nine Months Ended	
	July 28, 2013	July 29, 2012	July 28, 2013	July 29, 2012
	(In millions, except per share amounts)			
Numerator:				
Net income	$168	$218	$73	$624
Denominator:				
Weighted average common shares outstanding	1,203	1,257	1,201	1,282
Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	17	11	17	10
Denominator for diluted earnings per share	1,220	1,268	1,218	1,292
Basic earnings per share	$0.14	$0.17	$0.06	$0.49
Diluted earnings per share	$0.14	$0.17	$0.06	$0.48
Potentially dilutive securities	1	11	1	12

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.

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 28, 2013	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$600	$—	$—	$600
Cash equivalents:				
Money market funds	1,145	—	—	1,145
Total Cash equivalents	1,145	—	—	1,145
Total Cash and Cash equivalents	$1,745	$—	$—	$1,745
Short-term and long-term investments:				
U.S. Treasury and agency securities	$229	$1	$1	$229
Non-U.S. government securities*	11	—	—	11
Municipal securities	378	1	1	378
Commercial paper, corporate bonds and medium-term notes	257	2	1	258
Asset-backed and mortgage-backed securities	281	2	2	281
Total fixed income securities	1,156	6	5	1,157
Publicly traded equity securities	30	27	—	57
Equity investments in privately-held companies	71	—	—	71
Total short-term and long-term investments	$1,257	$33	$5	$1,285
Total Cash, Cash equivalents and Investments	$3,002	$33	$5	$3,030

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

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

October 28, 2012	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$876	$—	$—	$876
Cash equivalents:				
Money market funds	483	—	—	483
Municipal securities	33	—	—	33
Total Cash equivalents	516	—	—	516
Total Cash and Cash equivalents	$1,392	$—	$—	$1,392
Short-term and long-term investments:				
U.S. Treasury and agency securities	$373	$1	$—	$374
Non-U.S. government securities	29	—	—	29
Municipal securities	396	2	—	398
Commercial paper, corporate bonds and medium-term notes	381	3	—	384
Asset-backed and mortgage-backed securities	294	4	—	298
Total fixed income securities	1,473	10	—	1,483
Publicly traded equity securities	32	15	—	47
Equity investments in privately-held companies	70	—	—	70
Total short-term and long-term investments	$1,575	$25	$—	$1,600
Total Cash, Cash equivalents and Investments	$2,967	$25	$—	$2,992

Maturities of Investments

The following table summarizes the contractual maturities of Applied's investments at July 28, 2013:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$195	$195
Due after one through five years	681	682
No single maturity date**	381	408
	$1,257	$1,285

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

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Gains and Losses on Investments

At July 28, 2013 and October 28, 2012, 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 was 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 28, 2013 and July 29, 2012 were temporary in nature and therefore it did not recognize any impairment of its marketable securities during the three and nine months ended July 28, 2013 or July 29, 2012. Applied recognized $3 million and $5 million of impairment charges on its equity investments in privately-held companies during the three and nine months ended July 28, 2013, respectively, and $3 million of impairment charges during the nine months ended July 29, 2012.
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 are comprised 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 28, 2013, 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.

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Financial assets and liabilities (excluding cash balances) measured at fair value on a recurring basis are summarized below as of July 28, 2013 and October 28, 2012:

	July 28, 2013			October 28, 2012		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(In millions)					
Assets:						
Money market funds	$1,145	$—	$1,145	$483	$—	$483
U.S. Treasury and agency securities	105	124	229	128	246	374
Non-U.S. government securities	—	11	11	—	29	29
Municipal securities	—	378	378	—	431	431
Commercial paper, corporate bonds and medium-term notes	—	258	258	—	384	384
Asset-backed and mortgage-backed securities	—	281	281	—	298	298
Publicly traded equity securities	57	—	57	47	—	47
Total	$1,307	$1,052	$2,359	$658	$1,388	$2,046

There were no transfers between Level 1 and Level 2 fair value measurements during the three and nine months ended July 28, 2013 or July 29, 2012. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of July 28, 2013 or October 28, 2012.

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 28, 2013, equity investments in privately-held companies totaled $71 million, of which $61 million of investments were accounted for under the cost method of accounting and $10 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 28, 2012, equity investments in privately-held companies totaled $70 million, of which $57 million of investments were accounted for under the cost method of accounting and $13 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. Applied recognized $3 million and $5 million of impairment charges on its equity investments in privately-held companies during the three and nine months ended July 28, 2013, respectively, and $3 million of impairment charges during the nine months ended July 29, 2012.

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Other
The carrying amounts of Applied's financial instruments, including cash and cash equivalents, accounts receivable, notes payable, and accounts payable and accrued expenses, approximate fair value due to their short maturities. At July 28, 2013, the carrying amount of long-term debt was $1.9 billion and the estimated fair value was $2.1 billion. At October 28, 2012, the carrying amount of long-term debt was $1.9 billion and the estimated fair value was $2.3 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.

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, Taiwanese dollar and Swiss franc. 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 up to 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. Applied does not use derivative financial instruments for trading or speculative purposes.
Derivative instruments and hedging activities, including foreign currency exchange contracts, are recognized on the balance sheet at fair value. Changes in the fair value of derivatives that do not qualify for hedge treatment, as well as the ineffective portion of any hedges, are recognized currently in earnings. All of Applied's derivative financial instruments are recorded at their fair value in other current assets or 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 are typically entered into once per month. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of accumulated other comprehensive income or loss (AOCI) in stockholders' equity and is reclassified into earnings when the hedged transaction affects earnings. The majority of the after-tax net income or loss related to derivative instruments included in AOCI at July 28, 2013 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 general and administrative expenses. The amount recognized due to discontinuance of cash flow hedges that were probable not to occur by the end of the originally specified time period was not significant for the three and nine months ended July 28, 2013 and July 29, 2012.
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.
The fair values of derivative instruments at July 28, 2013 and October 28, 2012 were not material.

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

The effect of derivative instruments on the Consolidated Condensed Statements of Operations for the three and nine months ended July 28, 2013 and July 29, 2012 was as follows:

		Three Months Ended July 28, 2013			Three Months Ended July 29, 2012		
		Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness Testing	Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness Testing
	Location of Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income
		(In millions)					
Derivatives in Cash Flow Hedging Relationships							
Foreign exchange contracts	Cost of products sold	$7	$ 7	$ (1)	$(8)	$ —	$ (1)
Foreign exchange contracts	General and administrative	—	3	(1)	—	(2)	—
Total		$7	$ 10	$ (2)	$(8)	$ (2)	$ (1)

		Nine Months Ended July 28, 2013			Nine Months Ended July 29, 2012		
		Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness Testing	Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness Testing
	Location of Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income	Gain or (Loss) Recognized in AOCI	Gain or (Loss) Reclassified from AOCI into Income	Gain or (Loss) Recognized in Income
		(In millions)					
Derivatives in Cash Flow Hedging Relationships							
Foreign exchange contracts	Cost of products sold	$29	$ 16	$ (2)	$(3)	$ 5	$ (1)
Foreign exchange contracts	General and administrative	—	6	(1)	—	(3)	(1)
Total		$29	$ 22	$ (3)	$(3)	$ 2	$ (2)

	Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Recognized in Income Three Months Ended		Nine Months Ended	
		July 28, 2013	July 29, 2012	July 28, 2013	July 29, 2012
		(In millions)			
Derivatives Not Designated as Hedging Instruments					
Foreign exchange contracts	General and administrative	$2	$(11)	$31	$3
Total		$2	$(11)	$31	$3

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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 28, 2013.

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

Note 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.

There was no factoring of accounts receivable or discounting of promissory notes during the three and nine months ended July 28, 2013 or the three months ended July 29, 2012. Applied factored accounts receivable and discounted promissory notes of $70 million during the nine months ended July 29, 2012. Applied did not utilize programs to discount letters of credit issued by customers during the three and nine months ended July 28, 2013 and July 29, 2012. 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 $82 million at July 28, 2013 and $87 million at October 28, 2012. Applied sells principally to manufacturers within the semiconductor, display and solar industries. While Applied believes that its allowance for doubtful accounts is adequate and represents Applied's best estimate as of July 28, 2013, Applied continues to closely monitor customer liquidity and other economic conditions, which may result in changes to Applied's estimates regarding collectability.

Note 7 Balance Sheet Detail

	July 28, 2013	October 28, 2012
	(In millions)	
Inventories		
Customer service spares	$270	$312
Raw materials	311	331
Work-in-process	267	234
Finished goods	510	395
	$1,358	$1,272

Included in finished goods inventory are $128 million at July 28, 2013, and $60 million at October 28, 2012, 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 $175 million and $176 million of evaluation inventory at July 28, 2013 and October 28, 2012, respectively.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

	July 28, 2013	October 28, 2012
	(In millions)	
Other Current Assets		
Deferred income taxes, net	$431	$369
Prepaid expenses	127	101
Income taxes receivable	30	87
Other	146	116
	$734	$673

	Useful Life	July 28, 2013	October 28, 2012
	(In years)	(In millions)	
Property, Plant and Equipment, Net			
Land and improvements		$167	$169
Buildings and improvements	3-30	1,210	1,196
Demonstration and manufacturing equipment	3-5	787	760
Furniture, fixtures and other equipment	3-15	607	734
Construction in progress		55	58
Gross property, plant and equipment		2,826	2,917
Accumulated depreciation		(1,954)	(2,007)
		$872	$910

	July 28, 2013	October 28, 2012
	(In millions)	
Accounts Payable and Accrued Expenses		
Accounts payable	$515	$396
Compensation and employee benefits	394	426
Warranty	100	119
Dividends payable	120	108
Income taxes payable	44	74
Other accrued taxes	28	18
Interest payable	14	30
Restructuring reserve	17	133
Other	214	206
	$1,446	$1,510

APPLIED MATERIALS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

	July 28, 2013	October 28, 2012
	(In millions)	
Customer Deposits and Deferred Revenue		
Customer deposits	$145	$143
Deferred revenue	611	612
	$756	$755

Applied typically receives deposits on future deliverables from customers in the Display and Energy and Environmental Solutions segments. In certain instances, customer deposits may be received from customers in the Applied Global Services segment.

	July 28, 2013	October 28, 2012
	(In millions)	
Other Liabilities		
Deferred income taxes	$146	$201
Income taxes payable	153	140
Defined benefit pension plan liability	190	184
Other	160	131
	$649	$656

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 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. Applied’s reporting units are consistent with the reportable segments identified in Note 15, Industry Segment Operations, which are based on the manner in which Applied operates its business and the nature of those operations.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

During the second quarter of fiscal 2013, the solar industry experienced further deterioration of market conditions associated with continued manufacturing overcapacity and weaker operating performance and outlook, resulting in increased uncertainties regarding the timing and nature of a recovery in solar capital equipment expenditures. Taking these factors into account, Applied reassessed its financial outlook for the Energy and Environmental Solutions reporting unit and consequently reevaluated the recoverability of this reporting unit's goodwill. Applied performed the two-step impairment test and concluded that the Energy and Environmental Solutions reporting unit's carrying value exceeded its fair value. Based on Applied's analyses, the implied fair value of goodwill was substantially lower than the carrying value of goodwill for the reporting unit. As a result, in the second quarter of fiscal 2013, Applied recorded a goodwill impairment charge of $224 million, representing all of the remaining goodwill for this reporting unit. Applied also performed an impairment test for long-lived assets associated with the reporting unit and determined that the majority of intangible assets were impaired mostly due to the lower long-term revenue and profitability outlook associated with products related to these intangible assets. Accordingly, during the second quarter of fiscal 2013, Applied recorded an impairment charge of $54 million related to these intangible assets, which was the amount by which the carrying value of these intangible assets exceeded their estimated fair value, based on discounted projected cash flows.
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 28, 2013 and October 28, 2012 were as follows :

	July 28, 2013			October 28, 2012		
	Goodwill	Other Intangible Assets	Total	Goodwill	Other Intangible Assets	Total
	(In millions)					
Silicon Systems Group	$2,151	$142	$2,293	$2,151	$142	$2,293
Applied Global Services	1,027	—	1,027	1,027	—	1,027
Display	116	—	116	116	—	116
Energy and Environmental Solutions	—	—	—	224	—	224
Carrying amount	$3,294	$142	$3,436	$3,518	$142	$3,660

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.

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

	July 28, 2013	October 28, 2012
	(In millions)	

Purchased technology, net	$786	$945
Intangible assets - finite-lived, net	220	268
Intangible assets - indefinite-lived	142	142
Total	$1,148	$1,355

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

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 as of July 28, 2013 and October 28, 2012:

	July 28, 2013			October 28, 2012		
	Purchased Technology	Other Intangible Assets	Total	Purchased Technology	Other Intangible Assets	Total
	(In millions)					
Gross carrying amount:						
Silicon Systems Group	$1,301	$252	$1,553	$1,300	$252	$1,552
Applied Global Services	28	44	72	28	44	72
Display	110	33	143	110	33	143
Energy and Environmental Solutions	5	15	20	105	232	337
Gross carrying amount						