APPLIED MATERIALS INC /DE
Form 10-Q
February 25, 2016
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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 January 31, 2016
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 January 31, 2016: 1,130,724,579

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(In millions, except per share amounts)

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(Unaudited)	
Net sales	$2,257	$2,359
Cost of products sold	1,341	1,400
Gross profit	916	959
Operating expenses:		
Research, development and engineering	374	351
Marketing and selling	106	111
General and administrative	82	117
Gain on derivatives associated with terminated business combination	—	(78)
Total operating expenses	562	501
Income from operations	354	458
Interest expense	42	23
Interest and other income, net	2	2
Income before income taxes	314	437
Provision for income taxes	28	89
Net income	$286	$348
Earnings per share:		
Basic and diluted	$0.25	$0.28
Weighted average number of shares:		
Basic	1,146	1,224
Diluted	1,154	1,240

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(Unaudited)	
Net income	$286	$348
Other comprehensive loss, net of tax:		
Change in unrealized net gain on investments	1	(1)
Change in unrealized net loss on derivative instruments	(3)	1
Change in cumulative translation adjustments	—	(1)
Other comprehensive loss, net of tax	(2)	(1)
Comprehensive income	$284	$347

See accompanying Notes to Consolidated Condensed Financial Statements.

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

	January 31, 2016	October 25, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$2,962	$4,797
Short-term investments	154	168
Accounts receivable, net of allowance for doubtful accounts of $48 at January 31, 2016 and $49 at October 25, 2015	1,625	1,739
Inventories	1,835	1,833
Other current assets	334	724
Total current assets	6,910	9,261
Long-term investments	996	946
Property, plant and equipment, net	908	892
Goodwill	3,302	3,302
Purchased technology and other intangible assets, net	714	762
Deferred income taxes and other assets	496	145
Total assets	$13,326	$15,308
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$—	$1,200
Accounts payable and accrued expenses	1,457	1,833
Customer deposits and deferred revenue	850	765
Total current liabilities	2,307	3,798
Long-term debt	3,343	3,342
Other liabilities	508	555
Total liabilities	6,158	7,695
Stockholders' equity:		
Common stock	11	11
Additional paid-in capital	6,582	6,575
Retained earnings	14,142	13,967
Treasury stock	(13,473)	(12,848)
Accumulated other comprehensive loss	(94)	(92)
Total stockholders' equity	7,168	7,613
Total liabilities and stockholders' equity	$13,326	$15,308

Amounts as of January 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)

Three Months Ended January 31, 2016	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Income (Loss)	Total
	(Unaudited)							
Balance at October 25, 2015	1,160	$11	$6,575	$13,967	793	$(12,848)	$ (92)	$7,613
Net income	—	—	—	286	—	—	—	286
Other comprehensive loss, net of tax	—	—	—	—	—	—	(2)	(2)
Dividends	—	—	—	(111)	—	—	—	(111)
Share-based compensation	—	—	54	—	—	—	—	54
Issuance under stock plans, net of a tax benefit of $10 and other	6	—	(47)	—	—	—	—	(47)
Common stock repurchases	(35)	—	—	—	35	(625)	—	(625)
Balance at January 31, 2016	1,131	$11	$6,582	$14,142	828	$(13,473)	$ (94)	$7,168

Three Months Ended January 25, 2015	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Income (Loss)	Total
	(Unaudited)							
Balance at October 26, 2014	1,221	$12	$6,384	$13,072	717	$(11,524)	$ (76)	$7,868
Net income	—	—	—	348	—	—	—	348
Other comprehensive loss, net of tax	—	—	—	—	—	—	(1)	(1)
Dividends	—	—	—	(123)	—	—	—	(123)
Share-based compensation	—	—	48	—	—	—	—	48
Issuance under stock plans, net of a tax benefit of $39 and other	8	—	(68)	—	—	—	—	(68)
Balance at January 25, 2015	1,229	$12	$6,364	$13,297	717	$(11,524)	$ (77)	$8,072

See accompanying Notes to Consolidated Condensed Financial Statements.

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

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(Unaudited)	
Cash flows from operating activities:		
Net income	$286	$348
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	96	92
Share-based compensation	54	48
Excess tax benefits from share-based compensation	(10)	(39)
Deferred income taxes	15	28
Other	10	8
Changes in operating assets and liabilities:		
Accounts receivable	113	90
Inventories	(2)	(74)
Other current and non-current assets	(14)	(77)
Accounts payable and accrued expenses	(423)	(156)
Customer deposits and deferred revenue	85	(156)
Income taxes payable	5	(39)
Other liabilities	(8)	(13)
Cash provided by operating activities	207	60
Cash flows from investing activities:		
Capital expenditures	(68)	(49)
Proceeds from sales and maturities of investments	241	140
Purchases of investments	(282)	(141)
Cash used in investing activities	(109)	(50)
Cash flows from financing activities:		
Debt repayments	(1,205)	—
Proceeds from common stock issuances and other	2	—
Common stock repurchases	(625)	—
Excess tax benefits from share-based compensation	10	39
Payments of dividends to stockholders	(115)	(122)
Cash used in financing activities	(1,933)	(83)
Decrease in cash and cash equivalents	(1,835)	(73)
Cash and cash equivalents — beginning of period	4,797	3,002
Cash and cash equivalents — end of period	$2,962	$2,929
Supplemental cash flow information:		
Cash payments for income taxes	$44	$89
Cash refunds from income taxes	$5	$3
Cash payments for interest	$34	$39

See accompanying Notes to Consolidated Condensed Financial Statements.

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

Note 1 Basis of Presentation

Basis of Presentation

In the opinion of management, the unaudited interim consolidated condensed financial statements of Applied Materials, Inc. and its subsidiaries (Applied or the Company) included herein have been prepared on a basis consistent with the October 25, 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 months ended January 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 three months of fiscal 2016 and 2015 contained 14 weeks and 13 weeks, respectively.

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.

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 January 2016, the Financial Accounting Standards Board (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.

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. The guidance becomes effective for Applied in the first quarter of fiscal 2017 and may be adopted either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. Early adoption is permitted. 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.

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. 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.

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

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	
	January 31, 2016	January 25, 2015
	(In millions, except per share amounts)	
Numerator:		
Net income	$ 286	$ 348
Denominator:		
Weighted average common shares outstanding	1,146	1,224
Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	8	16
Denominator for diluted earnings per share	1,154	1,240
Basic and diluted earnings per share	$ 0.25	$ 0.28
Potentially dilutive securities	2	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.

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:

January 31, 2016	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$1,861	$—	$—	$1,861
Cash equivalents:				
Money market funds	856	—	—	856
Non-U.S. government securities*	10	—	—	10
Municipal securities	71	—	—	71
Commercial paper, corporate bonds and medium-term notes	164	—	—	164
Total Cash equivalents	1,101	—	—	1,101
Total Cash and Cash equivalents	$2,962	$—	$—	$2,962
Short-term and long-term investments:				
U.S. Treasury and agency securities	$101	$—	$—	$101
Non-U.S. government securities*	9	—	—	9
Municipal securities	408	2	—	410
Commercial paper, corporate bonds and medium-term notes	248	—	1	247
Asset-backed and mortgage-backed securities	274	—	—	274
Total fixed income securities	1,040	2	1	1,041
Publicly traded equity securities	33	19	1	51
Equity investments in privately-held companies	58	—	—	58
Total short-term and long-term investments	$1,131	$21	$2	$1,150
Total Cash, Cash equivalents and Investments	$4,093	$21	$2	$4,112

* 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 January 31, 2016:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$135	$135
Due after one through five years	631	632
No single maturity date**	365	383
	$1,131	$1,150

** 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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Gains and Losses on Investments

During the three months ended January 31, 2016 and January 25, 2015, gross realized gains and losses on investments were not material.

At January 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 January 31, 2016 and January 25, 2015 were temporary in nature and therefore it did not recognize any impairment of its marketable securities during the three months ended January 31, 2016 or January 25, 2015. Impairment charges on equity investments in privately-held companies during the three months ended January 31, 2016 and January 25, 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 January 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:

	January 31, 2016			October 25, 2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(In millions)					
Assets:						
Money market funds	$856	$—	$856	$3,272	$—	$3,272
U.S. Treasury and agency securities	83	18	101	72	12	84
Non-U.S. government securities	—	19	19	—	69	69
Municipal securities	—	481	481	—	459	459
Commercial paper, corporate bonds and medium-term notes	—	411	411	—	632	632
Asset-backed and mortgage-backed securities	—	274	274	—	262	262
Publicly traded equity securities	51	—	51	45	—	45
Total	$990	$1,203	$2,193	$3,389	$1,434	$4,823

There were no transfers between Level 1 and Level 2 fair value measurements during the three months ended January 31, 2016 or January 25, 2015. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of January 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 January 31, 2016, equity investments in privately-held companies totaled $58 million, of which $50 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. 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 months ended January 31, 2016 and January 25, 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 January 31, 2016 and 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 8 of the Notes to the Consolidated Condensed Financial Statements for further detail of existing debt.

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 January 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 months ended January 31, 2016 and January 25, 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. During the three months ended January 25, 2015, Applied recorded an unrealized gain of $78 million 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. Due to the termination of the proposed business combination with TEL on April 26, 2015, these foreign exchange option contracts were sold during the third quarter of fiscal 2015.

Other than the foreign exchange option contracts discussed in the preceding paragraph, the fair values of other foreign exchange derivative instruments at January 31, 2016 and October 25, 2015 were not material.

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

		Three Months Ended January 31, 2016			January 25, 2015		
		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	$(6)	$ 1	$ —	$5	$ 8	$ (1)
Foreign exchange contracts	General and administrative	—	(1)	(1)	—	(4)	—
Interest rate swaps	Interest expense	—	(1)	—	—	—	—
Total		$(6)	$ (1)	$ (1)	$5	$ 4	$ (1)

	Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Recognized in Income Three Months Ended January 31, 2016	January 25, 2015
		(In millions)	
Derivatives Not Designated as Hedging Instruments			
Foreign exchange contracts	Gain on derivatives associated with terminated business combination	$—	$ 78
Foreign exchange contracts	General and administrative	(4)	21
Total		$ (4)	$ 99

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 January 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 Balance Sheet Detail

	January 31, 2016	October 25, 2015
	(In millions)	
Inventories		
Customer service spares	$391	$382
Raw materials	512	438
Work-in-process	259	294
Finished goods	673	719
	$1,835	$1,833

Included in finished goods inventory are $115 million at January 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 $189 million and $185 million of evaluation inventory at January 31, 2016 and October 25, 2015, respectively.

	January 31, 2016	October 25, 2015
	(In millions)	
Other Current Assets		
Deferred income taxes, net[1]	$—	$403
Prepaid income taxes and income taxes receivable	155	127
Prepaid expenses and other	179	194
	$334	$724

[1] January 31, 2016 balance reflects the effects of the prospective 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.

	Useful Life	January 31, 2016	October 25, 2015
	(In years)	(In millions)	
Property, Plant and Equipment, Net			
Land and improvements		$157	$157
Buildings and improvements	3-30	1,249	1,247
Demonstration and manufacturing equipment	3-5	927	920
Furniture, fixtures and other equipment	3-15	586	574
Construction in progress		59	48
Gross property, plant and equipment		2,978	2,946
Accumulated depreciation		(2,070)	(2,054)
		$908	$892

	January 31, 2016	October 25, 2015
	(In millions)	
Accounts Payable and Accrued Expenses		
Accounts payable	$549	$658
Compensation and employee benefits	299	509
Warranty	119	126
Dividends payable	113	116
Income taxes payable	49	60
Other accrued taxes	42	58
Interest payable	36	36
Other	250	270
	$1,457	$1,833

	January 31, 2016	October 25, 2015
	(In millions)	
Customer Deposits and Deferred Revenue		
Customer deposits	$212	$132
Deferred revenue	638	633
	$850	$765

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

	January 31, 2016	October 25, 2015
	(In millions)	
Other Liabilities		
Deferred income taxes	$14	$56
Income taxes payable	232	227
Defined and postretirement benefit plans	180	187
Other	82	85
	$508	$555

Note 7 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 January 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 Silicon Systems reporting segment, Applied Global Services, Display and Energy and Environmental Solutions.

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 January 31, 2016 and October 25, 2015 were as follows:

	Goodwill	Other Intangible Assets	Total
	(In millions)		
Silicon Systems	$2,151	$—	$2,151
Applied Global Services	1,027	5	1,032
Display	124	18	142
Energy and Environmental Solutions	—	2	2
Carrying amount	$3,302	$25	$3,327

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

	January 31, 2016	October 25, 2015
	(In millions)	
Purchased technology, net	$532	$575
Intangible assets - finite-lived, net	157	162
Intangible assets - indefinite-lived	25	25
Total	$714	$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:

	January 31, 2016			October 25, 2015		
	Purchased Technology	Other Intangible Assets	Total	Purchased Technology	Other Intangible Assets	Total
	(In millions)					
Gross carrying amount:						
Silicon Systems	$1,449	$252	$1,701	$1,449	$252	$1,701
Applied Global Services	28	44	72	28	44	72
Display	110	33	143	110	33	143
Energy and Environmental Solutions	4	12	16	4	12	16
Gross carrying amount	$1,591	$341	$1,932	$1,591	$341	$1,932
Accumulated amortization:						
Silicon Systems	$(919)	$(99)	$(1,018)	$(876)	$(95)	$(971)

Applied Global Services	(26)	(44)	(70)	(26)	(44)	(70)
Display	(110)	(33)	(143)	(110)	(33)	(143)
Energy and Environmental Solutions	(4)	(8)	(12)	(4)	(7)	(11)
Accumulated amortization	$(1,059)	$(184)	$(1,243)	$(1,016)	$(179)	$(1,195)
Carrying amount	$532	$157	$689	$575	$162	$737

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

Details of amortization expense by segment were as follows:

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(In millions)	
Silicon Systems	$47	$ 43
Applied Global Services	—	1
Display	—	1
Energy and Environmental Solutions	1	1
Total	$48	$ 46

Amortization expense was charged to the following categories:

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(In millions)	
Cost of products sold	$43	$ 40
Marketing and selling	5	5
General and administrative	—	1
Total	$48	$ 46

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

	Amortization Expense (In millions)
2016 (remaining 9 months)	$ 141
2017	186
2018	185
2019	44
2020	39
Thereafter	94
Total	$ 689

Note 8 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 $67 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 January 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, Applied repaid the $800 million aggregated principal amount of the loan.

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

	Principal Amount			
	January 31, 2016	October 25, 2015	Effective Interest Rate	Interest Pay Dates
	(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 15
	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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Note 9 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 on Investments, Net	Unrealized Gain (Loss) on 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	1	(3)	—	—	(2)
Amounts reclassified out of AOCI	—	—	—	—	—
Other comprehensive income (loss), net of tax	1	(3)	—	—	(2)
Balance at January 31, 2016	$15	$(18)	$ (105)	$ 14	$(94)

	Unrealized Gain on Investments, Net	Unrealized Gain (Loss) on 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	(1)	3	—	(1)	1
Amounts reclassified out of AOCI	—	(2)	—	—	(2)
Other comprehensive income (loss), net of tax	(1)	1	—	(1)	(1)
Balance at January 25, 2015	$23	$1	$ (105)	$ 4	$(77)

The effects on net income of amounts reclassified from AOCI for the three months ended January 31, 2016 and January 25, 2015 were not material.
Stock Repurchase Program

On April 26, 2015, Applied's Board of Directors approved a common stock repurchase program authorizing up to $3.0 billion in repurchases over the three years ending April 2018. At January 31, 2016, $1.1 billion remained available for future stock repurchases under this repurchase program.

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The following table summarizes Applied’s stock repurchases for the three months ended January 31, 2016:

	Three Months Ended January 31, 2016
	(In millions, except per share amounts)
Shares of common stock repurchased	35
Cost of stock repurchased	$625
Average price paid per share	$17.64

Applied did not purchase any shares of its common stock during the three months ended January 25, 2015.

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 December 2015, Applied's Board of Directors declared a quarterly cash dividend in the amount of $0.10 per share. Dividends paid during the three months ended January 31, 2016 and January 25, 2015 totaled $115 million and $122 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 beginning in March 2012 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 months ended January 31, 2016 and January 25, 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	
	January 31, 2016	January 25, 2015
	(In millions)	
Cost of products sold	$17	$15
Research, development, and engineering	20	18
Marketing and selling	7	6

General and administrative	10	9
Total share-based compensation	$54	$48

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.

At January 31, 2016, Applied had $366 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 2.9 years. At January 31, 2016, there were 107 million shares available for grants of share-based awards under the Employee Stock Incentive Plan, and an additional 29 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 three months ended January 31, 2016 is presented below:

	Shares	Weighted Average Grant Date Fair Value
	(In millions, except per share amounts)	
Non-vested restricted stock units, restricted stock, performance shares and performance units at October 25, 2015	27	$16.41
Granted	10	$18.24
Vested	(9)	$14.07
Canceled	(1)	$17.47
Non-vested restricted stock units, restricted stock, performance shares and performance units at January 31, 2016	27	$17.90

At January 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 targeted levels 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.

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Note 10 Employee Benefit Plans

Applied sponsors a number of employee benefit plans, including defined benefit plans of certain foreign subsidiaries, and a plan that provides certain medical and vision benefits to eligible retirees. A summary of the components of net periodic benefit costs of these defined and postretirement benefit plans for the three months ended January 31, 2016 and January 25, 2015 is presented below:

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(In millions)	
Service cost	$3	$3
Interest cost	4	4
Expected return on plan assets	(4)	(4)
Amortization of actuarial loss	1	2
Curtailment and settlement gain	(4)	(1)
Net periodic benefit cost	$—	$4

Note 11 Income Taxes

Applied’s effective tax rates for the first quarters of fiscal 2016 and 2015 were 8.9 percent and 20.4 percent, respectively. The effective tax rate for the first quarter of fiscal 2016 was lower than in the same period in the prior year primarily due to changes in the geographical composition of income and changes related to income tax liabilities for prior years. The effective tax rates for the first quarters of fiscal 2016 and 2015 both included the benefit of 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 $16 million as a result of the expiration of statutes of limitation.

Note 12 Warranty, Guarantees and Contingencies

Warranty

Changes in the warranty reserves are presented below:

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(In millions)	
Beginning balance	$126	$113
Provisions for warranty	26	37
Releases of reserves related to preexisting warranty	(11)	(1)
Consumption of reserves	(22)	(30)
Ending balance	$119	$119

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 January 31, 2016, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately $56 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 January 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.

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 13 Industry Segment Operations

Applied’s four reportable segments are: Silicon Systems, Applied Global Services, Display, and Energy and Environmental Solutions. 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 January 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.

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. Applied does not allocate to its reportable segments certain operating expenses that it manages separately at the corporate level, which 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 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.

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

The Display segment includes products for manufacturing liquid crystal displays (LCDs), organic light-emitting diodes (OLEDs), and other display technologies for TVs, personal computers, tablets, smart phones, and other consumer-oriented devices.

The Energy and Environmental Solutions segment includes products for fabricating solar photovoltaic cells and modules, as well as high throughput roll-to-roll deposition equipment for flexible electronics and other applications.

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

	Three Months Ended	
	Net Sales	Operating Income (Loss)
	(In millions)	
January 31, 2016:		
Silicon Systems	$1,373	$265
Applied Global Services	626	156
Display	213	38
Energy and Environmental Solutions	45	6
Total Segment	$2,257	$465
January 25, 2015:		
Silicon Systems	$1,446	$307
Applied Global Services	583	153
Display	275	72
Energy and Environmental Solutions	55	(4)
Total Segment	$2,359	$528

Reconciliations of total segment operating results to Applied consolidated totals were as follows:

	Three Months Ended	
	January 31, 2016	January 25, 2015
	(In millions)	
Total segment operating income	$465	$528
Corporate and unallocated costs	(111)	(128)
Certain items associated with terminated business combination	—	(20)
Gain on derivatives associated with terminated business combination	—	78
Income from operations	$354	$458

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

	Percentage of Net Sales
Taiwan Semiconductor Manufacturing Company Limited	13%
Micron Technology, Inc.	11%
Samsung Electronics Co., Ltd.	10%

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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 January 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, solar photovoltaic (PV) and related industries. Applied’s customers include manufacturers of semiconductor wafers and chips, liquid crystal and other displays, solar PV cells and modules, 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 four reportable segments: Silicon Systems, Applied Global Services, Display, and Energy and Environmental Solutions. A summary of financial information for each reportable segment is found in Note 13 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, solar PVs 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	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except per share amounts and percentages)				
New orders	$2,275	$2,424	$2,273	$(149)	$2
Net sales	$2,257	$2,368	$2,359	$(111)	$(102)
Gross profit	$916	$959	$959	$(43)	$(43)
Gross margin	40.6 %	40.5 %	40.7 %	0.1 points	(0.1) points
Operating income	$354	$423	$458	$(69)	$(104)
Operating margin	15.7 %	17.9 %	19.4 %	(2.2) points	(3.7) points
Net income	$286	$336	$348	$(50)	$(62)
Earnings per diluted share	$0.25	$0.28	$0.28	$(0.03)	$(0.03)
Non-GAAP Adjusted Results					
Non-GAAP adjusted gross profit	$957	$1,000	$999	$(43)	$(42)
Non-GAAP adjusted gross margin	42.4 %	42.2 %	42.3 %	0.2 points	0.1 points
Non-GAAP adjusted operating income	$401	$456	$447	$(55)	$(46)
Non-GAAP adjusted operating margin	17.8 %	19.3 %	18.9 %	(1.5) points	(1.1) points
Non-GAAP adjusted net income	$302	$347	$338	$(45)	$(36)
Non-GAAP adjusted earnings per diluted share	$0.26	$0.29	$0.27	$(0.03)	$(0.01)

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 three months of fiscal 2016 and 2015 contained 14 weeks and 13 weeks, respectively.

Mobility, and the increasing technological functionality of mobile devices, continues to be a strong driver of semiconductor industry spending. During the first three months of fiscal 2016, memory manufacturers invested in technology upgrades and additional capacity while foundry customers invested to meet demand for advanced mobile chips. For the remainder of the year, Applied anticipates 3D NAND and foundry advanced node spending to drive our semiconductor business. Mobility represents a significant driver of display industry spending, which has resulted in continued manufacturing capacity expansion for mobile applications. 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. Investment in solar equipment remained low due to ongoing excess manufacturing capacity in the industry.

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Results of Operations

New Orders

New orders by reportable segment for the periods indicated were as follows:

	Three Months Ended						Change	
	January 31, 2016		October 25, 2015		January 25, 2015		Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)							
Silicon Systems	$1,275	56%	$1,444	60%	$1,426	63%	(12)%	(11)%
Applied Global Services	773	34%	761	31%	690	30%	2%	12%
Display	183	8%	195	8%	107	5%	(6)%	71%
Energy and Environmental Solutions	44	2%	24	1%	50	2%	83%	(12)%
Total	$2,275	100%	$2,424	100%	$2,273	100%	(6)%	—%

New orders for the first quarter of fiscal 2016 decreased compared to the prior quarter primarily due to lower orders for semiconductor equipment. New orders for the first quarter of fiscal 2016 were essentially flat compared to the same period in the prior year. New orders for Silicon Systems and Applied Global Services continued to comprise the majority of Applied's consolidated total new orders.

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

	Three Months Ended						Change	
	January 31, 2016		October 25, 2015		January 25, 2015		Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)							
Taiwan	$574	25%	$846	35%	$545	24%	(32)%	5%
China	462	20%	382	16%	296	13%	21%	56%
Korea	373	17%	207	8%	546	24%	80%	(32)%
Japan	109	5%	452	19%	242	11%	(76)%	(55)%
Southeast Asia	232	10%	100	4%	85	4%	132%	173%
Asia Pacific	1,750	77%	1,987	82%	1,714	76%	(12)%	2%
United States	369	16%	282	12%	411	18%	31%	(10)%
Europe	156	7%	155	6%	148	6%	1%	5%
Total	$2,275	100%	$2,424	100%	$2,273	100%	(6)%	—%

The changes in new orders from customers in Japan, Taiwan, Southeast Asia and China in the first quarter of fiscal 2016 compared to the prior quarter primarily reflected changes in customer mix for semiconductor equipment. The decrease in new orders from customers in Taiwan also reflected lower demand for display equipment, while the increase in new orders from customers in Korea was primarily due to higher demand for semiconductor and display equipment in this region.

The changes in new orders from customers in Korea, Southeast Asia, China and Japan in the first quarter of fiscal 2016 compared to the same period in the prior year primarily reflected changes in customer mix for semiconductor equipment. The decrease in new orders from customers in Korea was partially offset by higher demand for display equipment.

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Changes in backlog during the three months ended January 31, 2016 were as follows:

	January 31, 2016
	(In millions)
Beginning balance	$3,142
New orders	2,275
Net sales	(2,257)
Net adjustments	(51)
Ending balance	$3,109

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 73 percent of backlog as of the end of the first quarter of fiscal 2016 is anticipated to be shipped within the next two quarters. Backlog adjustments were negative during the first three months of fiscal 2016 and totaled $51 million, primarily consisting of order cancellations, unfavorable foreign currency impacts and other adjustments.

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

	January 31, 2016		October 25, 2015		July 26, 2015		Q1 2016 over Q4 2015	Q1 2016 over Q3 2015
	(In millions, except percentages)							
Silicon Systems	$1,602	51%	$1,720	55%	$1,763	57%	(7)%	(9)%
Applied Global Services	928	30%	812	26%	691	22%	14%	34%
Display	495	16%	525	16%	524	17%	(6)%	(6)%
Energy and Environmental Solutions	84	3%	85	3%	122	4%	(1)%	(31)%
Total	$3,109	100%	$3,142	100%	$3,100	100%	(1)%	—%

Total backlog in the first quarter of fiscal 2016 compared to the prior quarter was almost flat. In the first quarter of fiscal 2016, approximately 60 percent of net sales in the Silicon Systems segment, Applied's largest business segment, were for orders received and shipped within the quarter, up from 55 percent in the prior quarter.

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Net Sales

Net sales by reportable segment for the periods indicated were as follows:

	Three Months Ended						Change	
	January 31, 2016		October 25, 2015		January 25, 2015		Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)							
Silicon Systems	$1,373	61%	$1,494	63%	$1,446	61%	(8)%	(5)%
Applied Global Services	626	28%	637	27%	583	25%	(2)%	7%
Display	213	9%	191	8%	275	12%	12%	(23)%
Energy and Environmental Solutions	45	2%	46	2%	55	2%	(2)%	(18)%
Total	$2,257	100%	$2,368	100%	$2,359	100%	(5)%	(4)%

Net sales for the first quarter of fiscal 2016 decreased compared to the prior quarter led by lower customer spending on semiconductor equipment, partially offset by higher customer spending on display equipment. The Silicon 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.

For the first quarter of fiscal 2016 compared to the same period in the prior year, net sales decreased primarily due to lower customer spending on semiconductor and display equipment, partially offset by higher customer spending on semiconductor spares and services.

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

	Three Months Ended						Change	
	January 31, 2016		October 25, 2015		January 25, 2015		Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)							
Taiwan	$637	28%	$758	32%	$556	24%	(16)%	15%
China	497	22%	477	20%	410	17%	4%	21%
Korea	268	12%	239	10%	536	23%	12%	(50)%
Japan	334	15%	278	12%	243	10%	20%	37%
Southeast Asia	90	4%	143	6%	92	4%	(37)%	(2)%
Asia Pacific	1,826	81%	1,895	80%	1,837	78%	(4)%	(1)%
United States	293	13%	301	13%	369	16%	(3)%	(21)%
Europe	138	6%	172	7%	153	6%	(20)%	(10)%
Total	$2,257	100%	$2,368	100%	$2,359	100%	(5)%	(4)%

The changes in net sales from customers in Taiwan, Japan and Southeast Asia in the first quarter of fiscal 2016 compared to the prior quarter primarily reflected lower investments in semiconductor equipment and changes in customer mix. The changes in net sales from customers in Korea, China, Taiwan, Japan and the United States in the first quarter of fiscal 2016 compared to the same period in the prior year primarily reflected changes in customer mix for semiconductor equipment.

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Gross Margin

Gross margins for the periods indicated were as follows:

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)				
Gross profit	$916	$959	$959	$(43)	$(43)
Gross margin	40.6 %	40.5 %	40.7 %	0.1 points	(0.1) points
Non-GAAP Adjusted Results					
Non-GAAP adjusted gross profit	$957	$1,000	$999	$(43)	$(42)
Non-GAAP adjusted gross margin	42.4 %	42.2 %	42.3 %	0.2 points	0.1 points

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

Gross profit and non-GAAP adjusted gross profit in the first quarter of fiscal 2016 decreased compared to the prior quarter, primarily reflecting lower net sales, but slightly increased as a percentage of net sales primarily due to favorable product mix. Gross profit and non-GAAP adjusted gross profit in the first quarter of fiscal 2016 decreased compared to the same period in the prior year, primarily due to lower net sales.

Gross profit and non-GAAP adjusted gross profit during each of the three months ended January 31, 2016, October 25, 2015 and January 25, 2015 included $17 million, $14 million and $15 million, respectively, of share-based compensation expense.

Research, Development and Engineering

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

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions)				
Research, development and engineering	$374	$ 363	$ 351	$11	$23

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 slightly increased during the first quarter of fiscal 2016 compared to the prior quarter and the same period in the prior year, reflecting ongoing investment in product development initiatives. RD&E expenses during the three months ended January 31, 2016, October 25, 2015 and January 25, 2015 included $20 million, $17 million and $18 million, respectively, of share-based compensation expense.

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Marketing and Selling

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

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions)				
Marketing and selling	$106	$96	$111	$10	$(5)

Marketing and selling expenses slightly increased in the first quarter of fiscal 2016 compared to the prior quarter, primarily due to the reversal of provisions for bad debt recorded in the prior quarter, while marketing and selling expense slightly decreased compared to the same period in fiscal 2015 due to continued cost management efforts. Marketing and selling expenses during the three months ended January 31, 2016, October 25, 2015 and January 25, 2015 included $7 million, $6 million and $6 million, respectively, of share-based compensation expense.

General and Administrative

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

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions)				
General and administrative	$82	$77	$117	$5	$(35)

G&A expenses for the first quarter of fiscal 2016 increased compared to the prior quarter primarily due to an additional week during the quarter. G&A expenses for the first quarter of fiscal 2016 decreased compared to the same period in the prior year primarily due to lower acquisition-related and integration costs related to the terminated business combination with Tokyo Electron Limited (TEL) and lower variable compensation.

G&A expenses during the three months ended January 31, 2016, October 25, 2015 and January 25, 2015 included $10 million, $8 million and $9 million of share-based compensation expense, respectively.

Gain on Derivatives Associated with Terminated Business Combination

During the three months ended January 25, 2015, Applied recorded an unrealized gain of $78 million 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.

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Interest Expense and Interest and Other Income, net

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

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions)				
Interest expense	$42	$ 32	$ 23	$10	$19
Interest and other income, net	$2	$ 6	$ 2	$(4)	$—

Interest expenses incurred were primarily associated with the senior unsecured notes issued in June 2011 and September 2015. Interest expense increased in the first quarter of fiscal 2016 compared to the prior quarter and to the same period in fiscal 2015 due to the issuance of senior unsecured notes in September 2015.

Interest and other income, net in the first quarter of fiscal 2016 compared to the prior quarter and to the same period in the prior year remained relatively flat. Interest and other income, net in the first quarter of fiscal 2016 included a $5 million loss from redemption of $400 million in principal amount of senior unsecured notes.

Income Taxes

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

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages)				
Provision for income taxes	$28	$61	$89	$(33)	$(61)
Effective tax rate	8.9 %	15.4 %	20.4 %	(6.5) points	(11.5) points

Applied’s provision for income taxes and effective tax rate are affected by the geographical composition of 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 first quarter of fiscal 2016 was lower than in the prior quarter primarily due to reinstatement of the U.S. federal research and development (U.S. R&D) tax credit during the first quarter of fiscal 2016 which was retroactive to its expiration in December 2014 and changes in the geographical composition of income, partially offset by changes related to income tax liabilities for prior years.

The effective tax rate for the first quarter of fiscal 2016 was lower than in the same period in the prior year primarily due to changes in the geographical composition of income and changes related to income tax liabilities for prior years. The effective tax rates for the first quarters of fiscal 2016 and 2015 both included the benefit of the reinstatement of the U.S. R&D tax credit during these periods retroactive to its expiration in December of the prior years. The effective tax rates for subsequent quarters are not expected to benefit from the retroactive reinstatement of the U.S. R&D tax credit.

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Segment Information

Applied reports financial results in four segments: Silicon Systems, Applied Global Services, Display, and Energy and Environmental Solutions. A description of the products and services, as well as financial data, for each reportable segment can be found in Note 13 of Notes to Consolidated Condensed Financial Statements. Applied does not allocate to its reportable segments certain operating expenses that it manages separately at the corporate level. These unallocated costs include 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.

Silicon Systems Segment

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

The competitive environment for Silicon Systems in the first three months of fiscal 2016 reflected steady investment by semiconductor manufacturers. Memory manufacturers invested in technology upgrades and additional capacity. Foundry customers invested to meet demand for advanced mobile chips.

Certain significant measures for the periods indicated were as follows:

	Three Months Ended			Change	
	January 31, 2016	October 25, 2015	January 25, 2015	Q1 2016 over Q4 2015	Q1 2016 over Q1 2015
	(In millions, except percentages and ratios)				
New orders	$1,275	$1,444	$1,426	$(169	