APPLIED MATERIALS INC /DE
Form 10-Q
February 19, 2015
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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 25, 2015
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 February 11, 2015: 1,228,696,722

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(Unaudited) (In millions, except per share amounts)	
Net sales	$2,359	$2,190
Cost of products sold	1,400	1,299
Gross profit	959	891
Operating expenses:		
Research, development and engineering	351	356
Marketing and selling	111	109
General and administrative	117	120
Gain on derivatives associated with announced business combination	(78)	(24)
Total operating expenses	501	561
Income from operations	458	330
Interest expense	23	25
Interest and other income, net	2	10
Income before income taxes	437	315
Provision for income taxes	89	62
Net income	$348	$253
Earnings per share:		
Basic and diluted	$0.28	$0.21
Weighted average number of shares:		
Basic	1,224	1,206
Diluted	1,240	1,225

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(Unaudited)	
	(In millions)	
Net income	$348	$253
Other comprehensive income (loss), net of tax:		
Change in unrealized net gain on investments	(1)	(3)
Change in unrealized net gain on derivative investments	1	(1)
Change in cumulative translation adjustments	(1)	(2)
Other comprehensive income (loss), net of tax	(1)	(6)
Comprehensive income	$347	$247

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	January 25, 2015	October 26, 2014
	(In millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	$2,929	$3,002
Short-term investments	158	160
Accounts receivable, net	1,580	1,670
Inventories	1,641	1,567
Other current assets	625	568
Total current assets	6,933	6,967
Long-term investments	930	935
Property, plant and equipment, net	864	861
Goodwill	3,304	3,304
Purchased technology and other intangible assets, net	905	951
Deferred income taxes and other assets	137	156
Total assets	$13,073	$13,174
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$1,737	$1,883
Customer deposits and deferred revenue	784	940
Total current liabilities	2,521	2,823
Long-term debt	1,947	1,947
Other liabilities	533	536
Total liabilities	5,001	5,306
Stockholders' equity:		
Common stock	12	12
Additional paid-in capital	6,364	6,384
Retained earnings	13,297	13,072
Treasury stock	(11,524)	(11,524)
Accumulated other comprehensive loss	(77)	(76)
Total stockholders' equity	8,072	7,868
Total liabilities and stockholders' equity	$13,073	$13,174

Amounts as of January 25, 2015 are unaudited. Amounts as of October 26, 2014 are derived from the October 26, 2014 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

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) (In millions)							
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

Three Months Ended January 26, 2014	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) (In millions)							
Balance at October 27, 2013	1,204	$12	$6,151	$12,487	717	$(11,524)	$ (38)	$7,088
Net income	—	—	—	253	—	—	—	253
Other comprehensive loss, net of tax	—	—	—	—	—	—	(6)	(6)
Dividends	—	—	—	(121)	—	—	—	(121)
Share-based compensation	—	—	46	—	—	—	—	46
Issuance under stock plans, net of a tax benefit of $18 and other	7	—	(19)	—	—	—	—	(19)
Balance at January 26, 2014	1,211	$12	$6,178	$12,619	717	$(11,524)	$ (44)	$7,241

See accompanying Notes to Consolidated Condensed Financial Statements.

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APPLIED MATERIALS, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(Unaudited) (In millions)	
Cash flows from operating activities:		
Net income	$348	$253
Adjustments required to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	92	94
Unrealized gain on derivatives associated with announced business combination	(78)	(24)
Share-based compensation	48	46
Excess tax benefits from share-based compensation	(39)	(18)
Deferred income taxes and other	36	9
Changes in operating assets and liabilities:		
Accounts receivable	90	123
Inventories	(74)	(119)
Other assets	1	37
Accounts payable and accrued expenses	(156)	(106)
Customer deposits and deferred revenue	(156)	107
Income taxes payable	(39)	20
Other liabilities	(13)	(50)
Cash provided by operating activities	60	372
Cash flows from investing activities:		
Capital expenditures	(49)	(48)
Proceeds from sales and maturities of investments	140	364
Purchases of investments	(141)	(163)
Cash provided by (used in) investing activities	(50)	153
Cash flows from financing activities:		
Proceeds from common stock issuances and other	—	10
Excess tax benefits from share-based compensation	39	18
Payments of dividends to stockholders	(122)	(120)
Cash used in financing activities	(83)	(92)
Increase (decrease) in cash and cash equivalents	(73)	433
Cash and cash equivalents — beginning of period	3,002	1,711
Cash and cash equivalents — end of period	$2,929	$2,144
Supplemental cash flow information:		
Cash payments for income taxes	$89	$26
Cash refunds from income taxes	$3	$9
Cash payments for interest	$39	$39

See accompanying Notes to Consolidated Condensed Financial Statements.

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

Note 1 Basis of Presentation

Basis of Presentation

In the opinion of management, the unaudited interim consolidated condensed financial statements of Applied Materials, Inc. and its subsidiaries (Applied or the Company) included herein have been prepared on a basis consistent with the October 26, 2014 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 26, 2014 (2014 Form 10-K). Applied’s results of operations for the three months ended January 25, 2015 are not necessarily indicative of future operating results. Applied’s fiscal year ends on the last Sunday in October of each year. Fiscal 2015 and 2014 each contain 52 weeks, and the first three months of fiscal 2015 and 2014 each contained 13 weeks.

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

Use of Estimates

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

Revenue Recognition

Applied recognizes revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; seller’s price to buyer is fixed or determinable; and collectability is probable. Applied’s shipping terms are customarily FOB Applied shipping point or equivalent terms. Applied’s revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment 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 May 2014, the Financial Accounting Standards Board (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. The guidance becomes effective for Applied in the first quarter of fiscal 2018, and can be applied either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Early adoption is prohibited. 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 2014, the FASB issued authoritative guidance that raises the threshold for a disposal transaction to qualify as a discontinued operation and requires additional disclosures about discontinued operations and disposals of individually significant components that do not qualify as discontinued operations. The authoritative guidance becomes effective prospectively for Applied in the first quarter of fiscal 2016. Early adoption is permitted, but only for disposals that have not been reported in financial statements previously issued.

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 25, 2015	January 26, 2014
	(In millions, except per share amounts)	
Numerator:		
Net income	$ 348	$ 253
Denominator:		
Weighted average common shares outstanding	1,224	1,206
Effect of dilutive stock options, restricted stock units and employee stock purchase plan shares	16	19
Denominator for diluted earnings per share	1,240	1,225
Basic and diluted earnings per share	$ 0.28	$ 0.21
Potentially dilutive securities	1	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.

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

Note 3 Cash, Cash Equivalents and Investments
Summary of Cash, Cash Equivalents and Investments
The following tables summarize Applied's cash, cash equivalents and investments by security type:

January 25, 2015	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$491	$—	$—	$491
Cash equivalents:				
Money market funds	2,438	—	—	2,438
Total Cash equivalents	2,438	—	—	2,438
Total Cash and Cash equivalents	$2,929	$—	$—	$2,929
Short-term and long-term investments:				
U.S. Treasury and agency securities	$79	$—	$—	$79
Non-U.S. government securities*	12	—	—	12
Municipal securities	374	2	—	376
Commercial paper, corporate bonds and medium-term notes	221	1	—	222
Asset-backed and mortgage-backed securities	284	1	2	283
Total fixed income securities	970	4	2	972
Publicly traded equity securities	19	30	—	49
Equity investments in privately-held companies	67	—	—	67
Total short-term and long-term investments	$1,056	$34	$2	$1,088
Total Cash, Cash equivalents and Investments	$3,985	$34	$2	$4,017

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

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

October 26, 2014	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Cash	$508	$—	$—	$508
Cash equivalents:				
Money market funds	2,494	—	—	2,494
Total Cash equivalents	2,494	—	—	2,494
Total Cash and Cash equivalents	$3,002	$—	$—	$3,002
Short-term and long-term investments:				
U.S. Treasury and agency securities	$62	$—	$—	$62
Non-U.S. government securities	14	—	—	14
Municipal securities	391	2	—	393
Commercial paper, corporate bonds and medium-term notes	223	1	—	224
Asset-backed and mortgage-backed securities	287	1	2	286
Total fixed income securities	977	4	2	979
Publicly traded equity securities	19	31	—	50
Equity investments in privately-held companies	66	—	—	66
Total short-term and long-term investments	$1,062	$35	$2	$1,095
Total Cash, Cash equivalents and Investments	$4,064	$35	$2	$4,097

Maturities of Investments
The following table summarizes the contractual maturities of Applied's investments at January 25, 2015:

	Cost	Estimated Fair Value
	(In millions)	
Due in one year or less	$149	$149
Due after one through five years	537	539
No single maturity date**	370	400
	$1,056	$1,088

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

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

Gains and Losses on Investments

During the three months ended January 25, 2015, gross realized gains and losses on investments were not material. During the three months ended January 26, 2014, gross realized gains on investments were $12 million and gross realized losses on investments were not material.

At January 25, 2015 and October 26, 2014, 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 25, 2015 and January 26, 2014 were temporary in nature and therefore it did not recognize any impairment of its marketable securities during the three months ended January 25, 2015 or January 26, 2014. Impairment charges on equity investments in privately-held companies during the three months ended January 25, 2015 and January 26, 2014 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 25, 2015, substantially all of Applied’s available-for-sale, short-term and long-term investments were recognized at fair value that was determined based upon observable inputs.

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

Assets Measured at Fair Value on a Recurring Basis

Financial assets (excluding cash balances) measured at fair value on a recurring basis are summarized below as of January 25, 2015 and October 26, 2014:

	January 25, 2015			October 26, 2014		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(In millions)					
Assets:						
Money market funds	$2,438	$—	$2,438	$2,494	$—	$2,494
U.S. Treasury and agency securities	56	23	79	43	19	62
Non-U.S. government securities	—	12	12	—	14	14
Municipal securities	—	376	376	—	393	393
Commercial paper, corporate bonds and medium-term notes	—	222	222	—	224	224
Asset-backed and mortgage-backed securities	—	283	283	—	286	286
Publicly traded equity securities	49	—	49	50	—	50
Foreign exchange derivative assets	—	131	131	—	52	52
Total	$2,543	$1,047	$3,590	$2,587	$988	$3,575

There were no transfers between Level 1 and Level 2 fair value measurements during the three months ended January 25, 2015 or January 26, 2014. Applied did not have any financial assets measured at fair value on a recurring basis within Level 3 fair value measurements as of January 25, 2015 or October 26, 2014.

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 25, 2015, equity investments in privately-held companies totaled $67 million, of which $58 million of investments were accounted for under the cost method of accounting and $9 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 26, 2014, equity investments in privately-held companies totaled $66 million, of which $57 million of investments were accounted for under the cost method of accounting and $9 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 25, 2015 and January 26, 2014 were not material.

Other

The carrying amounts of Applied’s financial instruments, including cash and cash equivalents, accounts receivable, notes payable, and accounts payable and accrued expenses, approximate fair value due to their short maturities. At January 25, 2015 and October 26, 2014, the carrying amount of long-term debt was $1.9 billion and the estimated fair value was $2.2 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.

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

Note 5 Derivative Instruments and Hedging Activities

Derivative Financial Instruments

Applied conducts business in a number of foreign countries, with certain transactions denominated in local currencies, such as the Japanese yen, euro, Israeli shekel, Taiwanese dollar and Swiss franc. Applied uses derivative financial instruments, such as forward exchange contracts and currency option contracts, to hedge certain forecasted foreign currency denominated transactions expected to occur typically 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. Applied does not use derivative financial instruments for trading or speculative purposes.

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

Hedges related to anticipated transactions are designated and documented at the inception of the hedge as cash flow hedges and are typically entered into once per month. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of accumulated other comprehensive income or loss (AOCI) in stockholders' equity and is reclassified into earnings when the hedged transaction affects earnings. The majority of the after-tax net income or loss related to derivative instruments included in AOCI at January 25, 2015 is expected to be reclassified into earnings within 12 months. Changes in the fair value of currency forward exchange and option contracts due to changes in time value are excluded from the assessment of effectiveness. Both ineffective hedge amounts and hedge components excluded from the assessment of effectiveness are recognized in earnings. If the transaction being hedged is no longer probable to occur, or if a portion of any derivative is deemed to be ineffective, Applied promptly recognizes the gain or loss on the associated financial instrument in general and administrative expenses. The amount recognized due to discontinuance of cash flow hedges that were probable not to occur by the end of the originally specified time period was not significant for the three months ended January 25, 2015 and January 26, 2014.

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.

During the fourth quarters of fiscal 2014 and 2013, Applied purchased foreign exchange option contracts to limit its foreign exchange risk associated with the announced business combination with Tokyo Electron Limited (TEL). The derivatives used to hedge currency exposure did not qualify for hedge accounting treatment. These derivatives are marked to market at the end of each reporting period with gains and losses recorded as part of operating expenses. At January 25, 2015 and October 26, 2014, the fair value of these foreign exchange option contracts was approximately $130 million and $52 million, respectively. Applied recorded unrealized gains of $78 million and $24 million during the three months ended January 25, 2015 and January 26, 2014, respectively, related to such contracts. The cash flow impact of these derivatives has been classified as operating cash flows in the Consolidated Condensed Statements of Cash Flows. To further mitigate credit exposure in connection with these foreign exchange option contracts, Applied entered into security arrangements with certain counterparties, which require the counterparties to post collateral amounting to the approximate fair value of the derivative contracts. The cash collateral is included in cash and cash equivalents in the Consolidated Condensed Statements of Financial Position, with the corresponding liability included in accounts payable and accrued expenses.

Other than the foreign exchange option contracts discussed in the preceding paragraph, the fair values of other derivative instruments at January 25, 2015 and October 26, 2014 were not material.

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

The effects of derivative instruments on the Consolidated Condensed Statements of Operations for the three months ended January 25, 2015 and January 26, 2014 were as follows:

		Three Months Ended January 25, 2015			Three Months Ended January 26, 2014		
		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	$5	$ 8	$ (1)	$5	$ 3	$ —
Foreign exchange contracts	General and administrative	—	(4)	—	—	3	(1)
Total		$5	$ 4	$ (1)	$5	$ 6	$ (1)

	Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Recognized in Income Three Months Ended	
		January 25, 2015	January 26, 2014
		(In millions)	
Derivatives Not Designated as Hedging Instruments			
Foreign exchange contracts	General and administrative	$ 99	$ 39
Total		$ 99	$ 39

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 25, 2015.

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

Note 6 Accounts Receivable, Net

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

Applied did not factor any accounts receivable during the three months ended January 25, 2015 and factored accounts receivable of $45 million during the three months ended January 26, 2014. Applied did not discount promissory notes or utilize programs to discount letters of credit issued by customers during the three months ended January 25, 2015 or January 26, 2014. Financing charges on the sale of receivables and discounting of letters of credit are included in interest expense in the accompanying Consolidated Condensed Statements of Operations and were not material for all periods presented.

Accounts receivable are presented net of allowance for doubtful accounts of $58 million at both January 25, 2015 and October 26, 2014. Applied sells its products principally to manufacturers within the semiconductor, display and solar industries. While Applied believes that its allowance for doubtful accounts is adequate and represents its best estimate as of January 25, 2015, it continues to closely monitor customer liquidity and industry and economic conditions, which may result in changes to Applied’s estimates regarding collectability.

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

Note 7 Balance Sheet Detail

	January 25, 2015	October 26, 2014
	(In millions)	
Inventories		
Customer service spares	$318	$316
Raw materials	411	405
Work-in-process	341	316
Finished goods	571	530
	$1,641	$1,567

Included in finished goods inventory are $116 million at January 25, 2015, and $104 million at October 26, 2014, 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 $202 million and $164 million of evaluation inventory at January 25, 2015 and October 26, 2014, respectively.

	January 25, 2015	October 26, 2014
	(In millions)	
Other Current Assets		
Deferred income taxes, net	$216	$232
Prepaid income taxes and income taxes receivable	82	79
Prepaid expenses and other	327	257
	$625	$568

	Useful Life	January 25, 2015	October 26, 2014
	(In years)	(In millions)	
Property, Plant and Equipment, Net			
Land and improvements		$161	$156
Buildings and improvements	3-30	1,268	1,227
Demonstration and manufacturing equipment	3-5	867	829
Furniture, fixtures and other equipment	3-15	588	575
Construction in progress		43	61
Gross property, plant and equipment		2,927	2,848
Accumulated depreciation		(2,063)	(1,987)
		$864	$861

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

	January 25, 2015	October 26, 2014
	(In millions)	
Accounts Payable and Accrued Expenses		
Accounts payable	$650	$613
Compensation and employee benefits	356	524
Warranty	119	113
Dividends payable	123	122
Income taxes payable	44	142
Other accrued taxes	47	51
Interest payable	14	30
Other	384	288
	$1,737	$1,883

	January 25, 2015	October 26, 2014
	(In millions)	
Customer Deposits and Deferred Revenue		
Customer deposits	$180	$286
Deferred revenue	604	654
	$784	$940

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 25, 2015	October 26, 2014
	(In millions)	
Other Liabilities		
Deferred income taxes	$23	$32
Income taxes payable	244	225
Defined and postretirement benefit plans	198	208
Other	68	71
	$533	$536

Note 8 Business Combination

On September 24, 2013, Applied and Tokyo Electron Limited (TEL) entered into a Business Combination Agreement, which was amended on February 14, 2014, to effect a strategic combination of their respective businesses into a new combined company. TEL, a Japanese corporation, is a global supplier of semiconductor and flat panel display production equipment, and a provider of technical support and services for semiconductor, flat panel display and photovoltaic panel production equipment. Under the terms of the Business Combination Agreement, TEL shareholders will receive 3.25 shares of the new combined company for every TEL share held. Applied shareholders will receive one share of the new combined company for every Applied share held. Based on the number of shares of Applied common stock and shares of TEL common stock expected to be issued and outstanding immediately prior to the closing of the transaction, it is anticipated that, immediately following the transaction, former Applied stockholders and former TEL shareholders will own approximately 68% and 32%, respectively, of the new combined company.

The new combined company, Eteris N.V., will have dual headquarters in Tokyo and Santa Clara and dual listing of its shares on the Tokyo Stock Exchange and NASDAQ, and will be incorporated in the Netherlands. In June 2014, the shareholders of Applied and TEL approved the proposed business combination. The closing of the transaction remains subject to customary conditions, including regulatory approvals. It is expected that the combined company will commence a $3.0 billion stock repurchase program targeted to be executed within 12 months following the closing of the transaction.

The Business Combination Agreement contains mutual pre-closing covenants, including the obligation of Applied and TEL to conduct their businesses in the ordinary course consistent in all material respects with past practices, and certain termination rights.

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

Note 9 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. Applied's reporting units are consistent with the reportable segments identified in Note 15, Industry Segment Operations, which are based on the manner in which Applied operates its business and the nature of those operations.
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 25, 2015 and October 26, 2014 were as follows :

	Goodwill	Other Intangible Assets	Total
	(In millions)		
Silicon Systems Group	$2,151	$103	$2,254
Applied Global Services	1,027	6	1,033
Display	126	18	144
Carrying amount	$3,304	$127	$3,431

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.

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

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

	January 25, 2015	October 26, 2014
	(In millions)	
Purchased technology, net	$595	$636
Intangible assets - finite-lived, net	183	188
Intangible assets - indefinite-lived	127	127
Total	$905	$951

Finite-Lived Purchased Intangible Assets

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

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

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

Details of finite-lived intangible assets were as follows as of January 25, 2015 and October 26, 2014:

	January 25, 2015			October 26, 2014		
	Purchased Technology	Other Intangible Assets	Total	Purchased Technology	Other Intangible Assets	Total
	(In millions)					
Gross carrying amount:						
Silicon Systems Group	$1,346	$252	$1,598	$1,346	$252	$1,598
Applied Global Services	28	44	72	28	44	72
Display	110	33	143	110	33	143
Energy and Environmental Solutions	5	17	22	5	17	22
Gross carrying amount	$1,489	$346	$1,835	$1,489	$346	$1,835
Accumulated amortization:						
Silicon Systems Group	$(755)	$(81)	$(836)	$(716)	$(77)	$(793)

Applied Global Services	(25)	(44)	(69)	(24)	(44)	(68)
Display	(110)	(32)	(142)	(110)	(31)	(141)
Energy and Environmental Solutions	(4)	(6)	(10)	(3)	(6)	(9)
Accumulated amortization	$(894)	$(163)	$(1,057)	$(853)	$(158)	$(1,011)
Carrying amount	$595	$183	$778	$636	$188	$824

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

Details of amortization expense by segment for the three months ended January 25, 2015 and January 26, 2014 were as follows:

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(In millions)	
Silicon Systems Group	$43	$42
Applied Global Services	1	1
Display	1	1
Energy and Environmental Solutions	1	2
Total	$46	$46

For the three months ended January 25, 2015 and January 26, 2014, amortization expense was charged to the following categories:

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(In millions)	
Cost of products sold	$40	$40
Marketing and selling	5	5
General and administrative	1	1
Total	$46	$46

As of January 25, 2015, future estimated amortization expense is expected to be as follows:

	Amortization Expense (In millions)
2015	135
2016	175
2017	172
2018	171
2019	29
Thereafter	96
Total	$778

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

Note 10 Borrowing Facilities and Long-Term 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 May 2017. This agreement provides for borrowings in United States dollars at interest rates keyed to one of the two rates selected by Applied for each advance and includes financial and other covenants. Remaining credit facilities in the amount of approximately $68 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 25, 2015 and October 26, 2014, and Applied has not utilized these credit facilities.

In December 2014, the undrawn $1.5 billion unsecured revolving credit agreement was amended. The amendment provides for waiver of certain defaults to the extent arising from the transactions contemplated by the proposed business combination with TEL. In addition, effective on the date of the completion of the proposed business combination, the amendment permits certain exclusions from the calculation of the financial covenant and modifies the termination date of the agreement to the earlier of the one-year anniversary of the completion of the business combination, or May 2017.

Long-term debt outstanding as of January 25, 2015 and October 26, 2014 was as follows:

	Principal Amount (In millions)	Effective Interest Rate	Interest Pay Dates
2.650% Senior Notes Due 2016	$400	2.666%	June 15, December 15
7.125% Senior Notes Due 2017	200	7.190%	April 15, October 15
4.300% Senior Notes Due 2021	750	4.326%	June 15, December 15
5.850% Senior Notes Due 2041	600	5.879%	June 15, December 15
	1,950		
Total unamortized discount	(3)		
Total long-term debt	$1,947		

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

Note 11 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 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 25, 2015 and January 26, 2014 were not material.
Stock Repurchase Program

On March 5, 2012, Applied's Board of Directors approved a stock repurchase program authorizing up to $3.0 billion in repurchases over the next three years ending in March 2015. Under this authorization, Applied purchases shares of its common stock on the open market. Applied did not purchase any shares of its common stock during the three months ended January 25, 2015 and January 26, 2014. At January 25, 2015, $1.6 billion remained available for future stock repurchases under this repurchase program.

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.

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

Dividends

In December 2014, Applied's Board of Directors declared quarterly cash dividends in the amount of $0.10 per share. Dividends declared during the three months ended January 25, 2015 and January 26, 2014 totaled $123 million and $121 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 25, 2015 and January 26, 2014, 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 25, 2015	January 26, 2014
	(In millions)	
Cost of products sold	$15	$14
Research, development, and engineering	18	17
Marketing and selling	6	6
General and administrative	9	9
Total share-based compensation	$48	$46

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 25, 2015, Applied had $350 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 25, 2015, there were 167 million shares available for grants of share-based awards under the Employee Stock Incentive Plan, and an additional 34 million shares available for issuance under the ESPP.

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

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 25, 2015 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 26, 2014	33	$12.59
Granted	9	$23.58
Vested	(12)	$11.71
Canceled	—	$13.80
Non-vested restricted stock units, restricted stock, performance shares and performance units at January 25, 2015	30	$16.31

With respect to the performance-based awards granted in fiscal 2013 and 2012, as of October 26, 2014, all performance goals had been fully achieved, but such awards remained subject to time-based vesting.

During the first quarter of fiscal 2015, 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 three or four years, provided that the grantee remains employed by Applied through each scheduled vesting date. If the performance goals are not met, 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.

Note 12 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 25, 2015 and January 26, 2014 is presented below:

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(In millions)	
Service cost	$3	$4
Interest cost	4	4
Expected return on plan assets	(4)	(3)
Amortization of actuarial loss	2	1
Settlement gain	(1)	—
Net periodic benefit cost	$4	$6

Note 13 Income Taxes

Applied's effective tax rates for the first quarters of fiscal 2015 and 2014 were 20.4 percent and 19.7 percent, respectively. The effective tax rate for the first quarter of fiscal 2015 was slightly higher than in the same period in the prior year primarily due to resolutions and changes related to income tax liabilities for prior years, partially offset by the benefit from the reinstatement of the U.S. federal research and development tax credit during the first quarter of fiscal 2015 which was retroactive to its expiration in December 2013.

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

Note 14 Warranty, Guarantees and Contingencies

Warranty

Changes in the warranty reserves during the three months ended January 25, 2015 and January 26, 2014 were as follows:

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(In millions)	
Beginning balance	$113	$102
Provisions for warranty	36	27
Consumption of reserves	(30)	(23)
Ending balance	$119	$106

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 25, 2015, the maximum potential amount of future payments that Applied could be required to make under these guarantee agreements was approximately $49 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 25, 2015, Applied has provided parent guarantees to banks for approximately $102 million to cover these arrangements.

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

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 15 Industry Segment Operations

Applied's four reportable segments are: Silicon Systems Group, 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 25, 2015 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to Applied's reportable segments.

Each reportable 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 Group 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.

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

Net sales and operating income (loss) for each reportable segment for the three months ended January 25, 2015 and January 26, 2014 were as follows:

	Three Months Ended	
	Net Sales	Operating Income (Loss)
	(In millions)	
January 25, 2015:		
Silicon Systems Group	$1,446	$307
Applied Global Services	583	153
Display	275	72
Energy and Environmental Solutions	55	(4)
Total Segment	$2,359	$528
January 26, 2014:		
Silicon Systems Group	$1,484	$314
Applied Global Services	507	125
Display	159	26
Energy and Environmental Solutions	40	(11)
Total Segment	$2,190	$454

Reconciliations of total segment operating results to Applied consolidated totals for the three months ended January 25, 2015 and January 26, 2014 were as follows:

	Three Months Ended	
	January 25, 2015	January 26, 2014
	(In millions)	
Total segment operating income	$528	$454
Corporate and unallocated costs	(128)	(137)
Certain items associated with announced business combination	(20)	(11)
Gain on derivatives associated with announced business combination	78	24
Income from operations	$458	$330

The following customers accounted for at least 10 percent of Applied's net sales for the three months ended January 25, 2015, which were for products in multiple reportable segments.

	Percentage of Net Sales
Samsung Electronics Co., Ltd.	23%
Taiwan Semiconductor Manufacturing Company Limited	14%

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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 25, 2015 should be read in conjunction with the financial statements for the fiscal year ended October 26, 2014 contained in the Company's Form 10-K filed December 17, 2014.

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, the proposed business combination with Tokyo Electron Limited, 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 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, flat panel display, solar photovoltaic (PV) and related industries. Applied’s customers include manufacturers of semiconductor wafers and chips, flat panel 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 Group, Applied Global Services, Display, and Energy and Environmental Solutions. A summary of financial information for each reportable segment is found in Note 15 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 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 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except per share amounts and percentages)				
New orders	$2,273	$2,255	$2,285	$18	$(12)
Net sales	$2,359	$2,264	$2,190	$95	$169
Gross profit	$959	$959	$891	$—	$68
Gross margin	40.7 %	42.4 %	40.7 %	(1.7) points	—
Operating income	$458	$412	$330	$46	$128
Operating margin	19.4 %	18.2 %	15.1 %	1.2 point	4.3 points
Net income	$348	$256	$253	$92	$95
Earnings per diluted share	$0.28	$0.21	$0.21	$0.07	$0.07
Non-GAAP Adjusted Results					
Non-GAAP adjusted gross profit	$999	$1,001	$930	$(2)	$69
Non-GAAP adjusted gross margin	42.3 %	44.2 %	42.5 %	(1.9) points	(0.2) point
Non-GAAP adjusted operating income	$447	$442	$380	$5	$67
Non-GAAP adjusted operating margin	18.9 %	19.5 %	17.4 %	(0.6) point	1.5 points
Non-GAAP adjusted net income	$338	$338	$279	$—	$59
Non-GAAP adjusted earnings per diluted share	$0.27	$0.27	$0.23	$—	$0.04

Reconciliations of non-GAAP adjusted measures are presented below under "Non-GAAP Adjusted Results." Fiscal 2015 and 2014 each contain 52 weeks, and the first three months of fiscal years 2015 and 2014 each contained 13 weeks.
Mobility, and the increasing technological functionality of mobile devices, continues to be the largest drivers of semiconductor industry spending. The first three months of fiscal 2015 were characterized by improved demand for semiconductor equipment by memory customers as manufacturers invested in technology upgrades, and continued demand from foundry customers, driven by demand for advanced mobile chips. 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.

On September 24, 2013, Applied announced an agreement with Tokyo Electron Limited (TEL), a Japanese corporation and global supplier of semiconductor, and flat panel display production equipment, and provider of technical support and services for semiconductor, flat panel display and PV panel production equipment, to effect a combination of their respective businesses into a new combined company. The combination is expected to bring together leading technologies and products and create an expanded set of capabilities in precision materials engineering and patterning. In June 2014, the shareholders of Applied and TEL approved the proposed business combination. Under the agreement, which was amended February 14, 2014, the closing of the transaction is subject to customary conditions, including regulatory approvals.

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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 25, 2015		October 26, 2014		January 26, 2014		Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except percentages)							
Silicon Systems Group	$1,426	63%	$1,334	59%	$1,569	69%	7%	(9)%
Applied Global Services	690	30%	747	33%	597	26%	(8)%	16%
Display	107	5%	130	6%	79	3%	(18)%	35%
Energy and Environmental Solutions	50	2%	44	2%	40	2%	14%	25%
Total	$2,273	100%	$2,255	100%	$2,285	100%	1%	(1)%

New orders for the first quarter of fiscal 2015 increased slightly compared to the prior quarter primarily due to higher orders for semiconductor equipment, offset by lower demand for semiconductor services, 200mm equipment and display equipment. New orders for the first quarter of fiscal 2015 were essentially flat compared to the same period in fiscal 2014. The Silicon Systems Group's proportion of total new orders relative to other segments increased compared to the prior quarter and continues to constitute the majority of 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 25, 2015		October 26, 2014		January 26, 2014		Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except percentages)							
Taiwan	$545	24%	$599	27%	$984	43%	(9)%	(45)%
China	296	13%	211	9%	326	14%	40%	(9)%
Korea	546	24%	251	11%	240	11%	118%	128%
Japan	242	11%	287	13%	163	7%	(16)%	48%
Southeast Asia	85	4%	113	5%	50	2%	(25)%	70%
Asia Pacific	1,714	76%	1,461	65%	1,763	77%	17%	(3)%
United States	411	18%	596	26%	403	18%	(31)%	2%
Europe	148	6%	198	9%	119	5%	(25)%	24%
Total	$2,273	100%	$2,255	100%	$2,285	100%	1%	(1)%

The increase in new orders from customers in Korea in the first quarter of fiscal 2015 compared to the prior quarter primarily reflected higher orders for semiconductor equipment, partially offset by lower demand for display equipment. The changes in new orders from customers in the United States and China in the first quarter of fiscal 2015 compared to the prior quarter was primarily due to changes in customer mix for semiconductor equipment. The changes in new orders from customers in Korea, Taiwan, Southeast Asia and Japan in the first quarter of fiscal 2015 compared to the same periods in the prior year primarily reflected changes in customer mix for semiconductor equipment.

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Changes in backlog during the three months ended January 25, 2015 were as follows:

	January 25, 2015 (In millions)
Beginning balance	$2,917
New orders	2,273
Net sales	(2,359)
Net adjustments	(53)
Ending balance	$2,778

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 76 percent of backlog as of the end of the first quarter of fiscal 2015 is anticipated to be shipped within the next two quarters. Backlog adjustments were negative during the first quarter of fiscal 2015 and totaled $53 million, primarily consisting of unfavorable foreign currency impacts.
Backlog by reportable segment as of the end of the most recent three fiscal quarters was as follows:

	January 25, 2015		October 26, 2014		July 27, 2014		Q1 2015 over Q4 2014	Q1 2015 over Q3 2014
	(In millions, except percentages)							
Silicon Systems Group	$1,369	49%	$1,400	48%	$1,514	51%	(2)%	(10)%
Applied Global Services	837	30%	775	27%	648	22%	8%	29%
Display	418	15%	593	20%	651	22%	(30)%	(36)%
Energy and Environmental Solutions	154	6%	149	5%	155	5%	3%	(1)%
Total	$2,778	100%	$2,917	100%	$2,968	100%	(5)%	(6)%

Total backlog decreased in the first quarter of fiscal 2015 compared to the prior quarter primarily due to lower orders for display equipment. In the first quarter of fiscal 2015, approximately 66 percent of net sales in the Silicon Systems Group, Applied's largest business segment, were for orders received and shipped within the quarter, up from 44 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 25, 2015		October 26, 2014		January 26, 2014		Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except percentages)							
Silicon Systems Group	$1,446	61%	$1,434	63%	$1,484	68%	1%	(3)%
Applied Global Services	583	25%	592	26%	507	23%	(2)%	15%
Display	275	12%	190	9%	159	7%	45%	73%
Energy and Environmental Solutions	55	2%	48	2%	40	2%	15%	38%
Total	$2,359	100%	$2,264	100%	$2,190	100%	4%	8%

Net sales for the first quarter of fiscal 2015 increased compared to the prior quarter led by higher customer spending on display equipment. The Silicon Systems Group’s relative share of total net sales decreased slightly compared to the prior quarter but remains the largest contributor of net sales.

For the first quarter of fiscal 2015 compared to the same period in the prior year, net sales increased primarily due to greater customer investments in semiconductor spares and services, 200mm and display equipment.

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 25, 2015		October 26, 2014		January 26, 2014		Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except percentages)							
Taiwan	$519	22%	$618	27%	$705	32%	(16)%	(26)%
China	388	16%	303	14%	589	27%	28%	(34)%
Korea	464	20%	187	8%	201	9%	148%	131%
Japan	231	10%	209	9%	164	8%	11%	41%
Southeast Asia	85	4%	136	6%	87	4%	(38)%	(2)%
Asia Pacific	1,687	72%	1,453	64%	1,746	80%	16%	(3)%
United States	529	22%	633	28%	280	13%	(16)%	89%
Europe	143	6%	178	8%	164	7%	(20)%	(13)%
Total	$2,359	100%	$2,264	100%	$2,190	100%	4%	8%

The changes in net sales from customers in Korea, the United States, Taiwan and China in the first quarter of fiscal 2015 compared to the prior quarter and the same period in fiscal 2014 primarily reflected changes in customer mix. In addition, higher customer spending on display equipment contributed to the change in net sales from customers in China in the first quarter of fiscal 2015 compared to the prior quarter and the same period in fiscal 2014.

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Gross Margin

Gross margins for the periods indicated were as follows:

	Three Months Ended			Change	
	January 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions, except percentages)				
Gross profit	$959	$959	$891	$—	$68
Gross margin	40.7 %	42.4 %	40.7 %	(1.7) points	—
Non-GAAP Adjusted Results					
Non-GAAP adjusted gross profit	$999	$1,001	$930	$(2)	$69
Non-GAAP adjusted gross margin	42.3 %	44.2 %	42.5 %	(1.9) points	(0.2) point

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

Gross profit, non-GAAP adjusted gross profit, gross margin and non-GAAP adjusted gross margin in the first quarter of fiscal 2015 decreased compared to the prior quarter, despite higher net sales, primarily due to unfavorable changes in product and customer mix. Gross profit and non-GAAP adjusted gross profit for the first quarter of fiscal 2015 increased compared to the same period in the prior year, primarily reflecting higher net sales, but were flat as a percentage of net sales primarily due to unfavorable changes in product mix. Gross profit and non-GAAP adjusted gross profit during each of the three months ended January 25, 2015, October 26, 2014 and January 26, 2014 included $15 million, $13 million and $14 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 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions)				
Research, development and engineering	$351	$ 360	$ 356	$(9)	$(5)

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 decreased slightly during the first quarter of fiscal 2015 compared to the prior quarter and compared to the same period in the prior year, but continue to reflect ongoing investment in product development initiatives. RD&E expenses during the three months ended January 25, 2015, October 26, 2014 and January 26, 2014 included $18 million, $17 million and $17 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 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions)				
Marketing and selling	$111	$ 99	$ 109	$12	$2

Marketing and selling expenses for the first quarter of fiscal 2015 increased compared to the prior quarter primarily due to the reversal of provisions for bad debts recorded in the prior quarter, while marketing and selling expenses remained essentially flat compared to the same period in fiscal 2014. Marketing and selling expenses during the three months ended January 25, 2015, October 26, 2014 and January 26, 2014 each included $6 million 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 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions)				
General and administrative	$117	$ 127	$ 120	$(10)	$(3)

G&A expenses for the first quarter of fiscal 2015 decreased compared to the prior quarter primarily due to holiday shutdown savings, while G&A expenses for the first quarter of fiscal 2015 remained almost flat compared to the same period of the prior year. G&A expenses during the three months ended January 25, 2015, October 26, 2014 and January 26, 2014 each included $9 million of share-based compensation expense.

Gain on Derivatives Associated with Announced Business Combination

Gain on derivatives associated with announced business combination amounted to $78 million, $39 million and $24 million during the three months ended January 25, 2015, October 26, 2014 and January 26, 2014, respectively. Changes in gain on derivatives result from exchange rate fluctuations. For further details, see Note 5 of Notes to Consolidated Condensed Financial Statements.

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 25, 2015	October 26, 2014	January 26, 2014	Q1 2015 over Q4 2014	Q1 2015 over Q1 2014
	(In millions)				
Interest expense	$23	$ 23			