

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

MARK ONE

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

FOR THE FISCAL YEAR ENDED OCTOBER 26, 1997

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 0-6920

APPLIED MATERIALS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION
OF INCORPORATION OR ORGANIZATION)
3050 BOWERS AVENUE, SANTA CLARA, CALIFORNIA
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

94-1655526
(I.R.S. EMPLOYER
IDENTIFICATION NO.)
95054
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 727-5555

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

TITLE OF CLASS NAME OF EACH EXCHANGE ON WHICH REGISTERED

NONE

NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

COMMON STOCK, \$.01 PAR VALUE

NASDAQ

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 NO .

Indicate by check mark if disclosure of delinquent filers pursuant to Item
405 of Regulation S-K is not contained herein, and will not be contained, to the
best of registrant's knowledge, in definitive proxy or information statements
incorporated by reference in Part III of this Form 10-K or any amendment to this

Aggregate market value of the voting stock held by nonaffiliates of the registrant as of December 26, 1997: \$10,776,331,841

Number of shares outstanding of the issuer's Common Stock, \$.01 par value, as of December 26, 1997: 366,074,967

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Applied Materials 1997 Annual Report for the year ended October 26, 1997 are incorporated by reference into Parts II and IV of this Form 10-K.

Portions of the definitive Proxy Statement for the Company's Annual Meeting of Stockholders to be held on March 17, 1998 are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Organized in 1967, Applied Materials, Inc. (Applied Materials or the Company) develops, manufactures, markets and services semiconductor wafer fabrication equipment and related spare parts for the worldwide semiconductor industry. The Company's customers include semiconductor wafer manufacturers and semiconductor integrated circuit (IC), or "chip," manufacturers. IC manufacturers either use the chips in their own products or sell them to other companies. Applied Materials is also a fifty-percent stockholder in Applied Komatsu Technology, Inc., a joint venture corporation that produces equipment to fabricate thin film transistors on flat panel displays.

ACQUISITIONS

During the first fiscal quarter of 1997, the Company acquired two companies (Opal, Inc. and Orbot Instruments, Ltd.) in separate transactions for approximately \$292.5 million, consisting primarily of cash. Opal, Inc. (Opal) is a supplier of CD-SEM (Critical Dimension-Scanning Electron Microscope) systems for use in semiconductor manufacturing. Orbot Instruments, Ltd. (Orbot) supplies wafer and reticle inspection systems for use in the production of semiconductors. The acquisitions were completed by the early part of January 1997, and have been accounted for using the purchase method of accounting; accordingly, the Company's consolidated results of operations include the operating results of Opal and Orbot subsequent to the acquisition dates.

In connection with the acquisitions, the Company incurred a \$59.5 million non-tax deductible charge for acquired in-process research and development. With the exception of this charge, the Company's results of operations for the year ended October 26, 1997 were not materially affected by the acquisitions. As of October 26, 1997, the Company had approximately \$199.6 million of net intangible assets and \$38.6 million of deferred tax liabilities that resulted from the acquisitions. With the exception of these items, the Company's financial condition as of October 26, 1997 has not been materially affected by the acquisitions.

The Company's pro-forma net sales, income from operations, net income and earnings per share for the fiscal years ended October 26, 1997 and October 27, 1996, assuming the acquisitions occurred at the beginning of such periods, would not have been materially different from the actual amounts reported for such periods.

PRODUCTS

Applied Materials' products are wafer processing and diagnostic systems that use highly sophisticated, state-of-the-art technology in design of their

hardware, process chemistry and software. These systems provide enabling technology, productivity and cost-effective manufacturing to the customer. The Company's products are used to fabricate integrated circuits, or "chips," on a substrate of semiconductor material (usually silicon). A finished IC may consist of millions of microscopic electronic components that interact to perform electrical functions. The fabrication process must control the quality of the film and the preciseness of the individual circuit features to ensure proper device performance while also meeting economic goals such as high yield and throughput. The Company currently manufactures equipment that addresses the following steps in the wafer fabrication process: film deposition, etching, ion implantation, rapid thermal processing (RTP), chemical mechanical polishing (CMP), metrology and wafer/reticle inspection.

Single-wafer, multi-chamber architecture. The trend toward more stringent process requirements and larger wafer sizes prompted Applied Materials to develop its first single-wafer, multi-chamber platform, called the Precision 5000(R) system. The Company introduced the Precision 5000 with dielectric chemical vapor deposition (CVD) processes in 1987, etch processes in 1988 and CVD tungsten processes in 1989. In addition to the process precision and control afforded by single-wafer process chambers, the multi-chamber platform concept provides customers with a significant benefit in processing productivity and integration. Several process chambers can be mounted on a platform, which acts as a central wafer handling system. This architecture provides a closed, controlled environment for the wafer and enables the system to process several wafers simultaneously. In 1990, the Company used its expertise in single-wafer, multi-chamber architecture to

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introduce a second single-wafer, multi-chamber platform, called the Endura(R) PVD (physical vapor deposition) system, featuring a staged, ultra-high vacuum architecture. In September 1992, the Company announced a third single-wafer, multi-chamber platform, the Centura(R) system, to target the high temperature thin film markets and other mainstream process applications with 0.5-micron and below specifications. In 1996, the Company released a fourth single-wafer, multi-chamber platform, called the Optima(TM), which is intended for high-volume CVD applications. Applied Materials' commercialization of the multi-chamber platform concept reached a significant milestone in early 1997 with the Company's shipment of its 5,000th single-wafer, multi-chamber system.

With many customers in the planning process for 300mm wafer fabs, Applied Materials has been actively developing a complete line of 300mm systems in its core process technologies covering more than 60 applications. In order to perform many types of process measurements and testing, without the need to send processed wafers to outside companies or back to customers, Applied Materials built the industry's first complete in-house metrology lab for 300mm wafers. In March 1997, Applied Materials shipped the industry's first 300mm system, a 300mm RTP system, to a customer. Several other 300mm systems, including epitaxial (epi) and CVD systems, were sent to customers and to industry consortia at various locations during the year. All of the Company's mainstream process technologies are in development for 300mm wafer sizes.

Partially to support this 300mm program, the Company announced, in July 1997, its plans to invest \$430 million in research and product development facilities in Santa Clara, California. During the same time period, another stage of the Company's Austin, Texas manufacturing center expansion was completed. A new 310,000-square-foot building was also begun in Austin as part of a master plan to build a manufacturing infrastructure ultimately capable of supporting at least \$10 billion in annual revenues. Additional plans were announced, in 1997, to build the industry's first equipment process pilot line, which would replicate many of the functions of an operating fab and enable Applied Materials to perform higher levels of integration among its various technologies in simulated "real world" conditions. This facility, also to be built in Santa Clara, will contain advanced photolithography related tools and a spectrum of metrology and device testing equipment.

PROCESS TECHNOLOGIES

Deposition. Deposition is a fundamental step in fabricating an integrated circuit. During deposition, a layer of either electrically insulating (dielectric) or electrically conductive material is deposited or grown on a wafer. Applied Materials currently provides equipment to perform two main types of deposition: CVD and PVD. The Company also offers certain types of dielectric deposition processes using its RTP system. In 1997, Applied Materials introduced several of these processes as new applications for its industry-leading RTP XE Centura product. These processes provide a more accurate and controllable method of fabricating advanced device structures than traditional furnace technology.

CVD. Chemical vapor deposition is a process frequently used in semiconductor fabrication in which thin films (insulators, conductors and semiconductors) are deposited or grown from gaseous sources. The Company produces several different types of CVD systems.

Dielectric CVD. Dielectric films are used to electrically isolate certain areas of an integrated circuit. In 1987, the Company introduced the Precision 5000 CVD system which performs a broad range of deposition processes utilizing up to four individual chambers on a single system. During the 1990s, a variety of dielectric plasma-enhanced CVD process applications were released on the Precision 5000 and Centura platforms to address customers' specific device requirements. In April 1994, the Company released its sub-atmospheric (SA) process technology, which today addresses device geometries to 0.18 micron and below. The Company has continued to refine the SACVD technology and address customers' requirements for high productivity. In April 1997, Applied Materials released the Giga-Fill(TM) SACVD Centura system, a leapfrog advancement in pre-metal dielectric CVD technology for 0.18-micron device designs. This new Giga-Fill system combines the SACVD BPSG (borophosphosilicate glass) process with a new, high-throughput, cost-efficient xZ-series chamber to offer customers higher levels of economic performance as well as leading-edge technology.

In February 1996, the Company introduced a first generation system using a new type of CVD technology, known as high-density plasma (HDP), for the most advanced CVD applications. Later that year,

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a second generation system, the Ultima HDP-CVD(TM) Centura system, was announced, offering the industry's first production-ready HDP-CVD system for multiple processes and applications, including deposition of fluorinated silicate glass (FSG) for emerging low dielectric constant (low k) applications. The Ultima system also introduced the industry's first Remote Plasma Clean technology that virtually eliminates "global warming" emissions from the CVD chamber cleaning process. This "soft" clean process also reduces consumables used by the chamber. Remote Plasma Clean technology is now being extended for use on many other Applied Materials CVD systems.

Metal CVD. Metal films are used in specific areas of an integrated circuit to form pathways for electrical current. In 1989, the Company entered the market for metal chemical vapor deposition with the introduction of a new system for depositing blanket tungsten (W) film, the Precision 5000 WCVD. In 1991, the Company introduced CVD tungsten silicide capabilities; in 1993, CVD titanium nitride; and in 1996, aluminum CVD. In December 1996, the Company expanded its highly successful Endura HP Metal product line with new system options for depositing titanium (Ti) and titanium nitride (TiN) liner/barrier films in sub-0.25-micron, high aspect ratio contact and via structures. Each of these products provides customers with new technology, as well as systems that have been optimized for high throughput, productivity and low cost of ownership. Processes for depositing copper-based films by CVD are currently in advanced stages of development for chipmakers requiring those technologies. Most of the Company's metal CVD process chambers are now being shipped on the Centura and Endura platforms.

Epitaxial deposition. Epi deposition, a process used for some types of ICs,

involves growing a layer of pure crystal silicon to form a high quality base for the subsequent device circuitry. Applied Materials' experience in epi dates from the Company's inception. The Company currently offers two epi systems. The Precision 7700 Epi(TM) system, introduced in 1989, extends the capabilities of batch-type, radiantly-heated barrel technology and incorporates fully automated wafer handling. The Epi Centura, introduced in 1993, is a single-wafer, multi-chamber epi system for wafers up to 200mm (8 inches) in diameter.

Polysilicon deposition. Polysilicon is a material typically used to form portions of the transistor structure on the wafer. In September 1992, the Company announced the Poly Centura, a single-wafer, multi-chamber system targeted at the deposition of thin polysilicon films at high temperatures on wafers up to 200mm in diameter. The Polycide Centura, launched in December 1993, integrated a polysilicon chamber and tungsten silicide chamber on a single platform (Centura), to offer customers a single solution to forming polycide structures in advanced devices. Using a variant of the technology used for polysilicon deposition, in early 1997 Applied Materials launched a new process for depositing high-temperature, single-wafer silicon nitride, a film previously deposited almost exclusively in batch furnaces. The superior process control of the single-wafer approach results in films of greater uniformity and precision, which is increasingly important as transistor structures shrink to smaller dimensions.

PVD. Physical vapor deposition is another method used to deposit metal films. Unlike CVD, in which gases are used, the deposited materials come from solid sources called targets. Applied Materials entered the PVD market in April 1990 with the Endura PVD system. This system offers a modular, two-stage, single-wafer, multi-chamber platform that accommodates both ultra-high vacuum processes like PVD and conventional high vacuum processes like CVD and etch. In 1993 and 1994, the Company introduced enhanced versions of the Endura system, called the Endura HP (High Productivity) and Endura VHP(TM) (Very High Productivity) PVD systems. A variety of process advancements have also been continually introduced to keep pace with customers' changing technology requirements. For highly advanced metallization applications, the Company now offers several integrated combinations of metal CVD and PVD processes on the Endura platform. In December 1996, Applied Materials announced an integrated CVD/PVD process, called Cool Al(TM), which provides aluminum fill of interconnect structures below 380 degrees(c). The low temperature of the process is compatible with the low k dielectric films that are being used to make high speed, multilevel devices at or below 0.25-micron design geometries. Processes for building copper interconnect structures using PVD and integrated CVD/PVD technologies are in development for announcement in fiscal 1998.

Etch. Films are selectively removed from a wafer during etching. Before etch processing begins, a wafer is coated with photoresist and exposed to a circuit pattern during photolithography. Etching removes material

only from areas dictated by the photoresist pattern. Applied Materials entered the etch market in 1981 with the introduction of the AME 8100 etch system, which utilized a batch process technology for dry plasma etching. Applied Materials' first single-wafer, multi-chamber system for the dry etch market was the Precision 5000 Etch, introduced in 1988 for silicon etching. In 1989 and 1990, the Company introduced dielectric and metal etch systems based on the Precision 5000 architecture. In 1993, the Company introduced dielectric etching technology on its next-generation Centura platform, the HDP Dielectric Etch Centura, designed for applications requiring sub-0.5 micron design rules. Since 1993, the Company has launched a series of MxP(TM) process chambers for metal, dielectric and silicon etching, available on both the Precision 5000 and Centura platforms. In mid-1997, the capabilities of the MxP design were further extended with the introduction of the eMxP+(TM) chamber for dielectric etching. This reactive ion etch (RIE) technology has proven capable of remarkable development, with this latest chamber type already in use for 0.25-micron designs. The MxP chambers are known for high reliability and low operating costs in high-volume production environments.

Beginning in 1996, the Company introduced a new series of high-density plasma etch systems for the most advanced etch applications. The 1996 introductions of the Metal Etch DPS(TM) (Decoupled Plasma Source) Centura system and the Silicon Etch DPS(TM) Centura system targeted 0.35-micron and below device designs for metal and silicon applications, respectively. In July 1997, a second-generation chamber design was introduced for the DPS Metal Etch system, employing several key engineering enhancements to the system. In April 1997, the Company launched its most advanced, high-density plasma system for etching dielectric films, called the Dielectric Etch IPS(TM) Centura. With these three systems, Applied Materials now addresses all of the main dry etch market segments for sub-0.35-micron design geometries, with the systems' most advanced process capabilities aimed at feature sizes of 0.18-micron and below.

Ion Implantation. During ion implantation, silicon wafers are bombarded by a high velocity beam of electrically charged ions. These ions penetrate film material at selected sites, changing its electrical properties. Applied Materials entered the high-current portion of the implant market in 1985 with the Precision Implant 9000 and introduced the Precision Implant 9200 in 1988. In November 1992, the Company introduced a new high-current ion implantation system, the Precision Implant 9500, for the production of high-density semiconductor devices, such as 16Mb and 64Mb memory devices and advanced microprocessors. In 1996, the Company introduced a new series of small footprint implant systems with the Implant xR80(TM), quickly expanding the line to include the Implant xR120(TM), the Implant xR LEAP(TM) (Low Energy Advanced Processing) and Implant xR200(TM), all with different energy ranges to suit diverse customer needs. These systems were enhanced in 1997 with an "S" series, offering significantly increased system throughput and lower cost of ownership.

Rapid Thermal Processing. RTP is a heat treatment process in which high-intensity light energy is directed to a wafer for a short period of time, usually less than 15 seconds. This heat pulse activates and controls the movement of atoms in the already-deposited film to modify its electrical properties. Applied Materials entered the fast-growing RTP market in 1995 with the RTP Centura, which utilizes proprietary, leading-edge advances in thermal measurement, control and calibration. Moving rapidly in 1997 to further enhance its market leading position, the Company launched its first major system enhancement, called the RTP XE Centura, which reduced operating costs for customers while further elevating the reliability of several major components and sub-systems. The RTP group also began moving beyond its core heat treatment applications with the introduction of a Nitric Oxide process, which deposits the critical (50A degrees) gate dielectric layers required for the most advanced logic, DRAM and flash memory devices. Compared to traditional batch-type furnaces, this single-wafer technology incorporates nitrogen into the gate oxide with a reduced thermal budget, thereby enabling the accurate and repeatable results necessary for deep submicron transistor formation.

Chemical Mechanical Processing. CMP is a material removal process in which uneven topography on a wafer surface is removed until a flat (planarized) surface is created. This allows subsequent photolithography processing to take place with greater accuracy, and enables film layers to be built up with minimal height variations. The Company announced its entry into the CMP market with the Mirra(R) CMP in December 1995. The Mirra CMP system features a unique three-station, four polishing head design that permits continuous processing of several wafers simultaneously, yet with the precision afforded by single-head process control.

Applied Materials continued its production ramp of the Mirra CMP system in 1997 with steady penetration into a number of key accounts. In June 1997, the Company announced a significant enhancement to the Mirra system's fundamental component, the polishing head, called the Titan Head. This proprietary head design overcomes several shortcomings of traditional polishing heads by minimizing effects at the edge of the wafer, thus allowing better uniformity and a higher degree of planarity.

Metrology and Wafer/Reticle Inspection. The Company acquired two Israeli companies, Opal, Inc. and Orbot Instruments, Ltd., in January 1997. Opal produces CD-SEM systems that measure the accuracy of circuitry dimensions to ensure that manufacturing processes are operating within specifications. Building on the proven technology of the earlier 7830-series systems, the Opal 7830Si was introduced in 1997, adding improvements in optics, imaging and software. Orbot makes two types of inspection tools. One tool detects and classifies defects in semiconductor wafers and the other tool performs defect detection on reticles (also called masks) used by photolithography systems to pattern wafers. For reticle inspection, the Orbot RT 8000 was also upgraded in 1997 with a variety of new features that improved its capability to inspect reticles used in 0.25-micron and below device geometries.

CUSTOMER SERVICE AND SUPPORT

The Company installs equipment and provides warranty service worldwide through offices located in the United States, Europe (including Israel), Japan, Korea, Taiwan and Asia-Pacific (China and Southeast Asia). The Company maintains approximately 84 sales and service offices worldwide, with 26 offices located in the United States, 16 in Europe, 27 in Japan, 7 in Korea, 2 in Taiwan and 6 in Asia-Pacific. The Company offers a variety of service contracts to customers for the maintenance of installed equipment and provides a comprehensive training program for all customers.

BACKLOG

At October 26, 1997, the Company's backlog totaled \$1.7 billion, compared to \$1.4 billion at October 27, 1996. The Company schedules production of its systems based upon order backlog and customer commitments. The backlog includes only orders for which written authorizations have been accepted and shipment dates within 12 months have been assigned. Due to possible changes in customer delivery schedules and cancellations of orders, the Company's backlog at any particular date is not necessarily indicative of actual sales for any succeeding period.

MANUFACTURING, RAW MATERIALS AND SUPPLIES

The Company's manufacturing activities consist primarily of assembling various commercial and proprietary components into finished systems, principally in the United States, with additional operations in England, Israel, Japan, Korea and Taiwan. Production requires some raw materials and a wide variety of mechanical and electrical components, which are manufactured to the Company's specifications. Multiple commercial sources are available for most components. The Company has consolidated the number of sources for several key purchased items for purposes of improving its position with suppliers, resulting in improved on-time delivery, lower inventory levels and better pricing to the Company. There have been no significant delays in receiving components from sole source suppliers; however, the unavailability of any of these components in the future could disrupt scheduled deliveries to customers.

The Company has commenced, for all of its information systems, a year 2000 date conversion project to address all necessary changes, testing and implementation. The "Year 2000 Issue" creates risk for the Company from unforeseen problems in its own computer systems and from third parties with whom the Company deals on financial transactions worldwide. Such failures of the Company's and/or third parties' computer systems could have a material impact on the Company's ability to conduct its business, and especially to process and account for the transfer of funds electronically. Management is currently assessing the Year 2000 compliance expense and related potential effect on the Company's earnings.

MARKETING AND SALES

Because of the highly technical nature of its products, the Company markets its products worldwide through a direct sales force, with sales, service and spare parts offices in the United States, Europe, Japan, Korea, Taiwan and Asia-Pacific. For the fiscal year ended October 26, 1997, net sales to customers in North America (primarily the United States), Europe, Japan, Korea, Taiwan and Asia-Pacific were approximately 37%, 15%, 18%, 8%, 17% and 5%, respectively, of the Company's total net sales. For the fiscal year ended October 27, 1996, net sales to customers in North America (primarily the United States), Europe, Japan, Korea, Taiwan and Asia-Pacific were approximately 31%, 16%, 24%, 14%, 10% and 5%, respectively, of the Company's total net sales. The Company's business is not seasonal in nature, but it is cyclical based on the capital equipment investment expenditures of major semiconductor manufacturers. These expenditure patterns are based on many factors, including anticipated market demand for integrated circuits, the development of new technologies and global economic conditions.

The Company sells systems and provides services to customers located throughout the world. Managing global operations and sites located throughout the world presents challenges associated with cultural diversities and organizational alignment. Moreover, each region in the global semiconductor equipment market exhibits unique characteristics that can cause capital equipment investment patterns to vary significantly from period to period. Although international markets provide the Company with significant growth opportunities, periodic economic downturns, trade balance issues, political instability and fluctuations in interest and foreign currency exchange rates are all risks that could affect global product and service demand. Many Pacific Rim countries are currently experiencing banking and currency difficulties that could lead to economic recession in those countries. Specifically, the decline in value of the Korean currency, together with difficulties obtaining credit, could result in a decline in the purchasing power of the Company's Korean customers. This in turn could result in the cancellation or delay of orders for the Company's products from Korean customers, thus adversely affecting the Company's results of operations. In addition, if Japan's economy weakens further, investments by Japanese customers may be negatively affected and it is possible that economic recovery in other Pacific Rim countries could be delayed. The Company actively manages its exposure to changes in foreign currency exchange rates, but there can be no assurance that future changes in foreign currency exchange rates will not have a material effect on its results of operations or financial condition.

RESEARCH AND DEVELOPMENT

The markets served by the Company are characterized by rapid technological change. The Company's research and development efforts are global in nature. Engineering organizations are located in the United States, England, Israel and Japan, with process support and customer demonstration laboratories in the United States, England, Israel, Japan, Korea and Taiwan. Since 1984, the Company has operated a large-scale technology center in Narita, Japan, which has been expanded several times to meet the requirements of the Japanese customer base. In 1996, the Company completed construction of new technology centers in Korea and Taiwan. The Company also operates a technology center in Israel, which is being used to develop controller configuration and software tools for its semiconductor processing systems; additionally, research, development and engineering activities are performed in Israel for metrology and wafer/recticle inspection products. The Company's research and development activities are primarily directed toward the development of new wafer processing, metrology and wafer/recticle inspection systems as well as new process applications for existing products. The Company works closely with its global customers to design systems to meet its customers' planned technical and production requirements. During fiscal 1997, 1996, and 1995, research, development, and engineering expenses were \$567,612,000, \$481,394,000, and \$329,676,000, respectively.

COMPETITION

The global semiconductor equipment industry is highly competitive and characterized by increasingly rapid technological advancements and demanding worldwide service requirements. Each of the Company's products competes in markets defined by the particular wafer fabrication process it performs. There

are several companies that compete with Applied Materials in each of these markets. Competition is based on many factors, primarily technological advancements, productivity and cost-effectiveness, customer support, contami-

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nation control and overall product quality. Management believes that the Company's competitive advantage in each of its served markets is based on the ability of its products and services to address customer requirements as they relate to these competitive factors.

Applied Materials is a principal supplier in each of its served markets. The Company faces strong competition throughout the world from other semiconductor equipment manufacturers, as well as semiconductor manufacturers that design and produce fabrication equipment for their own internal uses and, in some cases, for resale. Management believes that the Company is a strong competitor with respect to its products, services and resources. However, new products, pricing pressures and other competitive actions from both new and existing competitors could adversely affect the Company's market position.

JOINT VENTURE

In September 1991, the Company announced its plans to develop thin film transistor (TFT) manufacturing systems for Active-Matrix Liquid Crystal Displays (AMLCDs). The AMLCD market currently includes screens for laptop, notebook and palmtop computers, desktop monitors, digital/video cameras, portable televisions and instrument displays and may eventually include High Definition Television (HDTV). In September 1993, the Company and Komatsu, Ltd. of Japan formed a joint venture corporation, Applied Komatsu Technology, Inc. (AKT), to target this equipment market. The Company and Komatsu, Ltd. each own 50% of AKT, and the Company accounts for the joint venture using the equity method. The Company has granted AKT an exclusive license to use the Company's intellectual property to develop, manufacture and sell products for the production of flat panel displays, in exchange for royalties in respect thereof.

PATENTS AND LICENSES

Management believes that the Company's competitive position is primarily dependent upon skills in engineering, production, and marketing, rather than its patent position. However, protection of the Company's technology assets by obtaining and enforcing patents is important. Consequently, the Company has an active program to file applications in the United States and other countries for inventions that the Company considers to be significant. The Company has a number of patents in the United States and other countries and additional applications are pending for new developments in its equipment and processes. In addition to patents, the Company also possesses other proprietary intellectual property, including trademarks, know-how, trade secrets and copyrights.

The Company enters into patent and technology licensing agreements with other companies when management determines it is in the Company's best interest to do so. The Company pays royalties under existing patent license agreements for the use, in several of its products, of certain patents that are licensed to the Company for the life of the patents.

In the normal course of business, the Company from time to time receives and makes inquiries with regard to possible patent infringement. In dealing with such inquiries, it may become necessary or useful for the Company to obtain and grant licenses or other rights. However, there can be no assurance that such license rights will be available to the Company on commercially reasonable terms. Although there can be no assurance about the outcome of such inquiries, the Company believes that it is unlikely that their resolution will have a material adverse effect on its results of operations or financial condition.

ENVIRONMENTAL MATTERS

Although one of the Company's locations has been designated as a Superfund

site by the United States Environmental Protection Agency, neither compliance with Federal, State and local provisions regulating discharge of materials into the environment, nor remedial agreements or other actions relating to the environment, has had, or is expected to have, a material effect on the Company's capital expenditures, results of operations, financial condition or competitive position. The Company has been designated a "Potentially Responsible Party" by the U.S. Environmental Protection Agency with respect to its Superfund site.

EMPLOYEES

At October 26, 1997, the Company employed approximately 13,924 regular full-time employees. In the high technology industry, competition for highly skilled employees is intense. The Company believes that a great part of its future success depends on its continued ability to attract and retain qualified employees. None of the Company's employees are represented by a trade union. Management considers its relations with its employees to be good.

ITEM 2. PROPERTIES

Certain information concerning the Company's principal properties at October 26, 1997 is set forth below:

LOCATION	TYPE	PRINCIPAL USE	SQUARE FOOTAGE	OWNERSHIP
Santa Clara, CA	Office, plant & warehouse	Headquarters, Marketing, Manufacturing, Research and Engineering	968,000 1,813,000	owned leased
Austin, TX	Office, plant & warehouse	Manufacturing	824,000 300,000	owned leased
Horsham, England	Office, plant & warehouse	Manufacturing, Research and Engineering	81,000	leased
Narita, Japan	Office, plant & warehouse	Manufacturing, Research and Engineering	222,000	owned*
Chun-An, Korea	Office, plant & warehouse	Manufacturing, Research and Engineering	107,000	owned
Hsin-Chu, Taiwan	Office, plant & warehouse	Manufacturing, Research and Engineering	268,000 21,000	owned leased
Tel Aviv, Israel	Office	Research and Engineering	21,000	leased
Nes Ziona, Israel	Office, plant & warehouse	Manufacturing, Research and Engineering	60,000	leased
Yavne, Israel	Office, plant & warehouse	Manufacturing, Research and Engineering	55,000	leased

* Subject to loans of \$50.0 million, secured by property and equipment having an approximate net book value of \$66.3 million at October 26, 1997.

The Company also leases office space for 84 sales and service offices throughout the world: 26 offices are located in the United States, 16 in Europe, 27 in Japan, 7 in Korea, 2 in Taiwan and 6 in Asia-Pacific.

The Company currently owns 266,000 square feet of manufacturing and other operating facilities in California that have not yet been completed and placed in service. In addition, the Company is currently constructing 310,000 square feet of manufacturing facilities in Texas.

The Company also owns 99 acres of buildable land in Austin, Texas and 43 acres of buildable land in Santa Clara, California. The Austin and Santa Clara land can accommodate approximately 976,000 and 1,340,000 square feet, respectively, of additional building space to help satisfy the Company's current and future needs.

Management considers the above facilities suitable and adequate to meet the Company's requirements.

ITEM 3. LEGAL PROCEEDINGS

Subsequent to the end of fiscal 1997, the Company resolved all outstanding legal disputes with Advanced Semiconductor Materials International N.V., Epsilon Technology Inc. (doing business as ASM Epitaxy) and Advanced Semiconductor Materials America Inc. (collectively ASM). The settlement included ASM's payment of \$80 million, a cross license of certain patented technologies held by Applied Materials and ASM, an ongoing royalty payable by ASM on semiconductor systems for epitaxial and plasma TEOS technologies

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and a dismissal with prejudice of all pending litigation between the companies. The settlement also included certain covenants not to sue for potential patent infringement of existing commercially available semiconductor systems and processes offered by each company. ASM's payment of \$80 million was in the form of a convertible note, against which the Company received a \$15 million payment in November 1997. Royalties from ASM are not expected to have a material effect on the Company's results of operations.

On or about October 23, 1997, the Company entered into an agreement with General Signal Corporation (GSC), pursuant to which the Company acquired the rights to five "cluster tool" architecture patents and corresponding continuations, divisionals and foreign counterparts, formerly belonging to Drytek Systems, for a payment of \$11 million. The agreement also resolved all pending patent litigation between the Company and GSC in the United States District Court, District of Delaware, which was dismissed with prejudice.

During the third fiscal quarter of 1997, the Company settled certain outstanding patent litigation with Novellus Systems, Inc. (Novellus) concerning plasma TEOS and tungsten CVD technology. The settlement included a payment of \$80 million from Novellus, a cross license of certain patented technology held by Applied Materials and Novellus, and payment by Novellus of ongoing royalties for certain system shipments subsequent to the date of the settlement. These royalties have not had, and are not expected to have, a material effect on the Company's results of operations.

In April 1997, the Company filed suit against AST Elektronik GmbH and AST Elektronik USA Inc. (collectively AST), and AG Associates, Inc. (AG) in the United States District Court for the Northern District of California (case no. C-97-20375RWM), alleging infringement of several of the Company's patents relating to RTP. In October 1997, AST and AG each brought counterclaims alleging that the Company infringed patents concerning related technology. Discovery is commencing and trial has been set for March 1999.

As a result of the Company's acquisition of Orbot, the Company is a defendant in a lawsuit captioned KLA Instruments Corporation (KLA) v. Orbot Instruments, Ltd. (case no. C-93-20886-JW), in the United States District Court for the Northern District of California. KLA alleges that the Company infringes one patent regarding equipment for the inspection of masks and reticles, and seeks an injunction, damages and such other relief as the Court may find appropriate. There has been some discovery, but no trial date has been scheduled.

On June 13, 1997, the Company filed a patent infringement lawsuit against Varian Associates, Inc. captioned Applied Materials, Inc. v. Varian Associates, Inc. (Varian) (case no. C-97-20523-RMW), alleging infringement of several of the Company's patents concerning PVD technology. The complaint was later amended on July 7, 1997 to include Novellus as a defendant as a result of Novellus' acquisition of the Varian thin film PVD business unit. The Company seeks damages for past infringement, a permanent injunction, treble damages for willful infringement, pre-judgment interest and attorneys fees. Varian answered the complaint by denying all allegations, counterclaiming for declaratory judgment of invalidity and unenforceability and alleging conduct by Applied Materials violative of the antitrust laws. On June 23, 1997, Novellus filed a separate

patent infringement lawsuit against the Company captioned Novellus Systems, Inc. v. Applied Materials, Inc. (case no. C-97-20551-EAI), alleging infringement by the Company of three patents concerning PVD technology which were formerly owned by Varian. On July 8, 1997, Varian filed a separate lawsuit against the Company captioned Varian Associates, Inc. v. Applied Materials, Inc. (case no. C-97-20597-PVT), alleging a broad range of conduct in violation of the federal antitrust law and state unfair competition and business practice statutes. Discovery has commenced in these actions. No trial dates have been set.

In the normal course of business, the Company from time to time receives and makes inquiries regarding possible patent infringement. Management believes that it has meritorious claims and defenses and intends to pursue these matters vigorously.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS IN FOURTH QUARTER OF FISCAL 1997

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table and notes thereto identify and set forth information about the Company's five executive officers:

NAME OF INDIVIDUAL	CAPACITIES IN WHICH SERVED
James C. Morgan(1)	Chairman of the Board of Directors and Chief Executive Officer
Dan Maydan(2)	President of the Company and Chairman of Applied Komatsu Technology, Inc.
Joseph R. Bronson(3)	Senior Vice President, Chief Financial Officer and Chief Administrative Officer
Sasson Somekh(4)	Senior Vice President
David N.K. Wang(5)	Senior Vice President

(1) Mr. Morgan, age 59, has been Chief Executive Officer since 1977 and Chairman of the Board of Directors since 1987. Mr. Morgan also served as President of the Company from 1976 to 1987.

(2) Dr. Maydan, age 62, was appointed President of the Company in December 1993. Dr. Maydan served as Executive Vice President from 1990 to December 1993. Prior to that, Dr. Maydan had been Group Vice President since February 1989. Dr. Maydan joined Applied Materials in 1980 as a Director of Technology.

(3) Mr. Bronson, age 49, was appointed Senior Vice President, Chief Financial Officer and Chief Administrative Officer in January 1998, upon the retirement of Mr. Gerald F. Taylor, who had most recently served as Senior Vice President and Chief Financial Officer of the Company and who will continue to serve as a senior advisor to the Company. Mr. Bronson served as Group Vice President from April 1994 to January 1998. Prior to that, Mr. Bronson had been Vice President since November 1990. Mr. Bronson joined Applied Materials in September 1984 as Corporate Controller.

(4) Dr. Somekh, age 51, was appointed Senior Vice President of the Company in December 1993. Dr. Somekh served as Group Vice President from 1990 to 1993. Prior to that, Dr. Somekh had been a divisional Vice President. Dr. Somekh joined Applied Materials in 1980 as a Project Manager.

(5) Dr. Wang, age 51, was appointed Senior Vice President of the Company in

December 1993. Dr. Wang served as Group Vice President from 1990 to 1993. Prior to that, Dr. Wang had been a divisional Vice President. Dr. Wang joined Applied Materials in 1980 as a Manager, Process Engineering and Applications.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

"Stock Price History" on page 52 of the Applied Materials 1997 Annual Report is incorporated herein by reference.

The Company's common stock is traded on the Nasdaq over-the-counter market. As of December 26, 1997, there were approximately 4,703 holders of record of the common stock.

To date, the Company has paid no cash dividends to its stockholders. The Company has no plans to pay cash dividends in the near future.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

"Selected Consolidated Financial Data" on page 24 of the Applied Materials 1997 Annual Report is incorporated herein by reference.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Management's Discussion and Analysis" on pages 25 through 31 of the Applied Materials 1997 Annual Report is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

"Market Risk Disclosure" on page 31 of the Applied Materials 1997 Annual Report is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements, together with the report thereon of Price Waterhouse LLP, Independent Accountants, dated November 19, 1997 and appearing on pages 32 through 50, and page 52 of the Applied Materials 1997 Annual Report, are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

Pursuant to Paragraph G(3) of the General Instructions to Form 10-K, portions of the information required by Part III of Form 10-K are incorporated by reference from the Company's Proxy Statement to be filed with the Commission in connection with the 1998 Annual Meeting of Stockholders ("the Proxy Statement").

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

(a) Information concerning directors of the Company appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.

(b) For information with respect to Executive Officers, see Part I of this Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

Information concerning executive compensation appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors," and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information concerning the security ownership of certain beneficial owners and management appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors," and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information concerning certain relationships and related transactions appears in the Company's Proxy Statement, under Item 1 -- "Election of Directors," and is incorporated herein by reference.

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PART IV

ITEM 14: EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(A) 1. FINANCIAL STATEMENTS

The consolidated financial statements listed in the accompanying index to financial statements and financial statement schedule are filed or incorporated by reference as part of this annual report on Form 10-K.

2. FINANCIAL STATEMENT SCHEDULE

The financial statement schedule listed in the accompanying index to financial statements and financial statement schedule is filed as part of this annual report on Form 10-K.

3. EXHIBITS

The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this annual report on Form 10-K.

(B) Report on Form 8-K was filed on August 12, 1997. The report contains the Company's financial statements for the three and nine months ended July 27, 1997, as attached to its press release dated August 12, 1997.

INDEX TO FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE
(ITEM 14(A))

	ANNUAL REPORT PAGE NUMBER

(1) Financial Statements	
Consolidated Statements of Operations for the Fiscal Years Ended October 26, 1997, October 27, 1996, and October 29, 1995.....	32
Consolidated Balance Sheets at October 26, 1997 and October 27, 1996.....	33
Consolidated Statements of Cash Flows for the Fiscal Years Ended October 26, 1997, October 27, 1996 and October 29, 1995.....	34
Notes to Consolidated Financial Statements.....	35 - 50
Report of Independent Accountants.....	52

(2) Financial Statement Schedule	
Report of Independent Accountants on Financial Statement Schedule...	18
Schedule II -- Valuation and Qualifying Accounts.....	19

Schedules not listed above have been omitted because they are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or Notes to Consolidated Financial Statements.

The consolidated financial statements listed in the above index and included in the Company's Annual Report to Stockholders are hereby incorporated by reference. With the exception of the pages listed in the above index and the portion of such report referred to in items 5, 6, 7, 7a and 8 of this Form 10-K, the 1997 Annual Report to Stockholders is not to be deemed filed as part of this report.

INDEX TO EXHIBITS

These Exhibits are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K:

EXHIBIT NO.	DESCRIPTION
-----	-----
2.1	Agreement and Plan of Merger, by and among Applied Materials, Inc., Orion Corp. I, and Opal, Inc. dated as of November 24, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
2.2	Stock Purchase Agreement dated as of November 24, 1996 by and among Applied Materials, Inc., Orbot Instruments, Ltd. and the Stockholders of Orbot Instruments, Ltd., previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
3(i)	Certificate of Incorporation of Applied Materials, Inc., a Delaware corporation, as amended to March 18, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
3(ii)	Bylaws of Applied Materials, Inc., as amended to December 13, 1996, previously filed with the Company's Annual Report on Form 10-K for the year ended October 27, 1996, and incorporated herein by reference.
4.1	Rights Agreement, dated as of June 14, 1989, between Applied Materials, Inc. and Bank of America NT&SA, as Rights Agent, including Form of Rights Certificate and Form of Summary of Rights to Purchase Common Stock, previously filed with the Company's report on Form 8-K dated June 14, 1989, and incorporated herein by reference.
4.2	Form of Indenture (including form of debt security) dated as of August 24, 1994 between Applied Materials, Inc. and Harris Trust Company of California, as Trustee, previously filed with the Company's Form 8-K on August 17, 1994, and incorporated herein by reference.
10.1	The 1976 Management Stock Option Plan, as amended to October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
10.2	Applied Materials, Inc., Supplemental Income Plan, as amended, including Participation Agreements with James C. Morgan, Walter Benzing, and Robert Graham, previously filed with the Company's Form 10-K for fiscal year 1981, and incorporated herein by reference.
10.3	Amendment to Supplemental Income Plan, dated July 20, 1984, previously filed with the Company's Form 10-K for fiscal year 1984, and incorporated herein by reference.
10.4	The Applied Materials Employee Financial Assistance Plan, previously filed with the Company's definitive Proxy Statement in connection with the Annual Meeting of Shareholders held on March 5, 1981, and incorporated herein by reference.
10.5	The 1985 Stock Option Plan for Non-Employee Directors, previously filed with the Company's Form 10-K for fiscal year 1985, and incorporated herein by reference.
10.6	Amendment 1 to the 1985 Stock Option Plan for Non-Employee Directors dated June 14, 1989, previously filed with the Company's Form 10-K for fiscal year 1989, and incorporated herein by reference.
10.7	Applied Materials, Inc. Supplemental Income Plan as amended to December 15, 1988,

including the Participation Agreement with James C. Morgan, previously filed with the Company's Form 10-K for fiscal year 1988, and incorporated herein by reference.

- 10.8 License Agreement dated January 1, 1992 between the Company and Varian Associates, Inc., previously filed with the Company's Form 10-K for fiscal year 1992, and incorporated herein by reference.
- 10.9 Amendment dated December 9, 1992 to Applied Materials, Inc. Supplemental Income Plan dated June 4, 1981 (as amended to December 15, 1988), previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.

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EXHIBIT NO.	DESCRIPTION
10.10	The Applied Materials, Inc. Executive Deferred Compensation Plan dated July 1, 1993 and as amended on September 2, 1993, previously filed with the Company's Form 10-Q for the quarter ended August 1, 1993, and incorporated herein by reference.
10.11	Joint Venture Agreement between Applied Materials, Inc. and Komatsu, Ltd. dated September 14, 1993 and exhibits thereto, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference. (Confidential treatment has been requested for certain portions of the agreement.)
10.12	\$125,000,000 Credit Agreement dated as of September 8, 1994 between Applied Materials and a group of seven banks, previously filed with the Company's Form 10-K for fiscal year 1994, and incorporated herein by reference.
10.13	Amendment No. 2 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated September 10, 1992, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
10.14	Amendment No. 3 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated October 5, 1993, previously filed with the Company's Form 10-K for fiscal year 1993, and incorporated herein by reference.
10.15	Amendment No. 2 to the Applied Materials, Inc. Executive Deferred Compensation Plan, dated May 9, 1994, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
10.16	Amendment No. 4 to Applied Materials, Inc. 1985 Stock Option Plan for Non-Employee Directors, dated December 8, 1993, previously filed with the Company's Form 10-Q for the quarter ended May 1, 1994, and incorporated herein by reference.
10.17	Applied Komatsu Technology, Inc. 1994 Executive Incentive Stock Purchase Plan, together with forms of Promissory Note, 1994 Executive Incentive Stock Purchase Agreement, and Loan and Security Agreement, previously filed with the Company's Form 10-Q for the quarter ended July 31, 1994, and incorporated herein by reference.
10.18	The Applied Materials, Inc. 1995 Equity Incentive Plan, dated April 5, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
10.19	The Applied Materials, Inc. Senior Executive Bonus Plan, dated September 23, 1994, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
10.20	The Applied Materials, Inc. Executive Deferred Compensation Plan, as amended and restated on April 1, 1995, previously filed with the Company's Form 10-Q for the quarter ended April 30, 1995, and incorporated herein by reference.
10.21	Applied Materials, Inc. Medium-Term Notes, Series A Distribution Agreement, dated August 24, 1995, and incorporated herein by reference.
10.22	Amendment No. 1 to Credit Agreement, dated February 12, 1996, previously filed with the Company's Form 10-K for fiscal year 1996, and incorporated herein by reference.
10.23	Amended and Restated Credit Agreement, dated April 4, 1997 among Applied Materials, Inc., the Banks party hereto, and Morgan Guaranty Trust Company of New York, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
10.24	Amendment No. 1 to Amended and Restated Credit Agreement, dated May 7, 1997, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.

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EXHIBIT NO.	DESCRIPTION
10.25	Resolution pertaining to the Amendment of the Applied Materials, Inc. 1995 Equity Incentive Plan, adopted by the Stock Option and Compensation Committee of the

- Board of Directors of Applied Materials on December 12, 1996, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.26 Participation Agreement dated as of April 30, 1997 among Applied Materials, Inc. (as Lessee and Construction Agent), Credit Suisse Leasing 92A, L.P., (as Lessor and Borrower), Greenwich funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.27 Appendix 1 to Participation Agreement, Master Lease Agreement and Loan Agreement, dated as of April 30, 1997 (Definitions and Interpretation) for Applied Materials, Inc., previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.28 Loan Agreement dated as of April 30, 1997 among Credit Suisse Leasing 92A, L.P. (as Borrower), Greenwich Funding Corporation (as CP Lender), The Persons Named on Schedule I (as Eurodollar Lenders) and Credit Suisse First Boston (acting through its New York Branch, as Agent) for Revolving Commercial Paper, Eurodollar Credit and Base Rate Program, previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.29 Real Estate and Equipment Facility Master Lease dated as of April 30, 1997 between Credit Suisse Leasing 92A, L.P. (as Lessor), and Applied Materials, Inc. (as Lessee), previously filed with the Company's Form 10-Q for the quarter ended April 27, 1997, and incorporated herein by reference.
- 10.30 Underwriting Agreement between Applied Materials, Inc. and Morgan Stanley & Co. Incorporated dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 10.31 Prospectus Supplement for Applied Materials' \$400 million Senior Notes dated October 9, 1997, previously filed with the Company's Form S-3 dated October 9, 1997, and incorporated herein by reference.
- 12.1 Ratio of Earnings to Fixed Charges.
- 13 Applied Materials 1997 Annual Report for the fiscal year ended October 26, 1997 (to the extent expressly incorporated by reference).
- 21 Subsidiaries of Applied Materials, Inc.
- 23 Consent of Independent Accountants.
- 24 Power of Attorney.
- 27 Financial Data Schedule: filed electronically.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED MATERIALS, INC.

By /s/ JAMES C. MORGAN

 James C. Morgan
 Chairman of the Board and
 Chief Executive Officer

Dated: January 21, 1998

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ JAMES C. MORGAN ----- James C. Morgan	Chairman of the Board and Chief Executive Officer	January 21, 1998
/s/ JOSEPH R. BRONSON ----- Joseph R. Bronson	Senior Vice President, Chief Financial Officer and Chief Administrative Officer (Principal Financial Officer)	January 21, 1998
/s/ MICHAEL K. O'FARRELL -----	Vice President and Corporate Controller (Principal Accounting	January 21, 1998

Michael K. O'Farrell Officer)

Directors:
 James C. Morgan Director
 Dan Maydan* Director
 Michael H. Armacost* Director
 Deborah A. Coleman* Director
 Herbert M. Dwight, Jr.* Director
 Philip V. Gerdine* Director
 Tsuyoshi Kawanishi* Director
 Paul R. Low* Director
 Alfred J. Stein* Director

* By /s/ JAMES C. MORGAN January 21, 1998

 James C. Morgan, Attorney-in-Fact**

**By authority of powers of attorney filed herewith.

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REPORT OF INDEPENDENT ACCOUNTANTS ON
 FINANCIAL STATEMENT SCHEDULE

To the Board of Directors of Applied Materials, Inc.

Our audits of the consolidated financial statements referred to in our report dated November 19, 1997 appearing on page 52 of the 1997 Annual Report to Stockholders of Applied Materials, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the Financial Statement Schedule listed in Item 14(a) of this Form 10-K. In our opinion, this Financial Statement Schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PRICE WATERHOUSE LLP

 Price Waterhouse LLP

San Jose, California
 November 19, 1997

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SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

ALLOWANCE FOR DOUBTFUL ACCOUNTS
 (IN THOUSANDS)

	BALANCE AT BEGINNING OF YEAR	ADDITIONS- CHARGED TO INCOME	DEDUCTIONS- RECOVERIES	BALANCE AT END OF YEAR
	-----	-----	-----	-----
As of:				
October 26, 1997.....	\$ 4,169	\$ 2,433	\$ (1,024)	\$5,578
October 27, 1996.....	\$ 3,017	\$ 1,548	\$ (396)	\$4,169
October 29, 1995.....	\$ 1,089	\$ 2,138	\$ (210)	\$3,017

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RATIO OF EARNINGS TO FIXED CHARGES

(DOLLARS IN THOUSANDS)

	FISCAL YEAR				
	1997	1996	1995	1994	1993
Income before taxes and fixed charges (net of capitalized interest):					
Income from consolidated companies before provision for income taxes and cumulative effect of accounting change.....	\$798,921	\$922,436	\$698,543	\$334,497	\$153,558
Add fixed charges net of capitalized interest (1).....	44,161	42,819	34,504	27,032	23,227
Total income before taxes and fixed charges (net of capitalized interest).....	843,082	965,255	733,047	361,529	176,785
Fixed charges:					
Interest expense.....	20,705	20,733	21,401	15,962	14,206
Capitalized interest.....	750	5,108	--	--	--
Interest component of rent expense (2).....	23,013	22,086	13,103	11,070	9,021
Total fixed charges.....	\$ 44,468	\$ 47,927	\$ 34,504	\$ 27,032	\$ 23,227
Ratio of earnings to fixed charges.....	18.96x	20.14x	21.25x	13.37x	7.61x

(1) Capitalized interest includes interest capitalized during the period, less the amount of previously capitalized interest that was amortized during the period.

(2) For leases in which the interest factor can be specifically identified, the actual interest factor is used. For all other leases, the interest factor is estimated at one-third of total rent expense for the applicable period, which management believes represents a reasonable approximation of the interest factor.

SELECTED CONSOLIDATED FINANCIAL DATA

fiscal year ended*	1997	1996	1995	1994	1993
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	-----	-----	-----	-----	-----
Net sales	\$4,074,275	\$4,144,817	\$3,061,881	\$1,659,807	\$1,080,047
Gross margin	\$1,900,925	\$1,949,739	\$1,409,848	\$ 768,295	\$ 475,684
(% of net sales)	46.7	47.0	46.0	46.3	44.0
Research, development and engineering	\$ 567,612	\$ 481,394	\$ 329,676	\$ 189,126	\$ 140,161
(% of net sales)	13.9	11.6	10.8	11.4	13.0
Marketing, selling and administrative	\$ 566,595	\$ 539,694	\$ 386,240	\$ 239,932	\$ 174,529
(% of net sales)	13.9	13.0	12.6	14.4	16.2
Income from consolidated companies before taxes and cumulative effect of accounting change**	\$ 798,921	\$ 922,436	\$ 698,543	\$ 334,497	\$ 153,558
(% of net sales)	19.6	22.3	22.8	20.2	14.2
Effective tax rate (%)***	37.6	35.0	35.0	35.0	33.0
Net income	\$ 498,474	\$ 599,585	\$ 454,053	\$ 220,696	\$ 99,695
Earnings per share****	\$ 1.32	\$ 1.63	\$ 1.28	\$ 0.65	\$ 0.30
Average common shares and equivalents****	377,838	367,214	354,696	340,084	329,176
Order backlog	\$1,721,711	\$1,422,800	\$1,508,800	\$ 715,200	\$ 365,800
Working capital	\$2,368,269	\$1,757,842	\$1,449,882	\$ 734,104	\$ 395,388
Current ratio	2.7	2.9	2.7	2.5	2.0
Long-term debt	\$ 623,090	\$ 275,485	\$ 279,807	\$ 209,114	\$ 121,076
Stockholders' equity	\$2,942,171	\$2,370,425	\$1,783,503	\$ 966,264	\$ 598,762
Book value per share****	\$ 8.01	\$ 6.58	\$ 4.97	\$ 2.87	\$ 1.86
Total assets	\$5,070,766	\$3,637,987	\$2,965,379	\$1,702,665	\$1,120,152
Capital expenditures, net	\$ 339,364	\$ 452,535	\$ 265,557	\$ 180,440	\$ 95,351
Regular full-time employees	13,924	11,403	10,537	6,497	4,739

* THE FISCAL YEAR ENDS ON THE LAST SUNDAY IN OCTOBER OF EACH YEAR. THE FISCAL YEAR ENDS FOR THE PERIODS PRESENTED ARE: OCTOBER 26, 1997, OCTOBER 27, 1996, OCTOBER 29, 1995, OCTOBER 30, 1994 AND OCTOBER 31, 1993.

** FISCAL 1997 INCLUDES BAD DEBT EXPENSE OF \$16,318, ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSE OF \$59,500 AND INCOME FROM LITIGATION SETTLEMENTS OF \$69,000. FISCAL 1996 INCLUDES A RESTRUCTURING CHARGE OF \$25,100.

*** THE FISCAL 1997 TAX RATE IS HIGHER THAN THE EXPECTED RATE OF 35 PERCENT DUE TO THE NON-DEDUCTIBLE NATURE OF ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSE OF \$59,500.

**** RETROACTIVELY RESTATED TO REFLECT A TWO-FOR-ONE STOCK SPLIT IN THE FORM OF A 100 PERCENT STOCK DIVIDEND, EFFECTIVE OCTOBER 13, 1997.

[GRAPH]

STOCKHOLDERS' EQUITY

(in millions)

1993..... 599
1994..... 966
1995.....1,784
1996.....2,370
1997.....2,942

RETURN ON ASSETS

(percent)

1993.....10.1
1994.....15.6
1995.....19.4
1996.....18.2
1997.....11.4

DEBT TO CAPITAL RATIO
(percent)

1993.....22.1
1994.....21.7
1995.....16.9
1996.....13.7
1997.....19.0

24 APPLIED MATERIALS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

STOCK SPLIT

All share and per share amounts have been retroactively restated to reflect a two-for-one stock split in the form of a 100 percent stock dividend, effective October 13, 1997.

ACQUISITIONS

During fiscal 1997, the Company acquired Opal, Inc. (Opal) and Orbot Instruments, Ltd. (Orbot) in separate transactions for approximately \$292.5 million, consisting primarily of cash. Opal is a supplier of CD-SEM (critical dimension scanning electron microscope) systems for use in semiconductor manufacturing. Orbot supplies wafer and reticle inspection systems for use in the production of semiconductors. The acquisitions were completed by the early part of January 1997, and have been accounted for using the purchase method of accounting; accordingly, the Company's consolidated results of operations include the operating results of Opal and Orbot subsequent to the acquisition dates.

In connection with the acquisitions, the Company incurred a \$59.5 million non-tax deductible charge for acquired in-process research and development. With the exception of this charge, the Company's results of operations for the year ended October 26, 1997 were not materially affected by the acquisitions. As of October 26, 1997, the Company had approximately \$199.6 million of net intangible assets (see Note 3 of Notes to Consolidated Financial Statements) and \$38.6 million of deferred tax liabilities that resulted from the acquisitions. With the exception of these items, the Company's financial condition as of October 26, 1997 has not been materially affected by the acquisitions.

The Company's pro forma net sales, income from operations, net income and earnings per share for the fiscal years ended October 26, 1997 and October 27, 1996, assuming the acquisitions occurred at the beginning of such fiscal years, would not have been materially different from the actual amounts reported for such periods.

RESULTS OF OPERATIONS

During 1996, the semiconductor industry experienced a slowdown as a result of excess production capacity and sharply decreasing device prices within the DRAM market segment. This slowdown caused semiconductor manufacturers to reduce and delay their investment in manufacturing equipment, thus negatively impacting the Company's results of operations in the second half of fiscal 1996 and first half of fiscal 1997. Industry conditions began to improve during the third fiscal quarter of 1997, and the Company was able to achieve record levels of quarterly new orders and net sales in the fourth fiscal quarter of 1997, driven by strengthening demand for leading-edge capability from logic and microprocessor device manufacturers, foundry capacity investments by customers primarily located in Taiwan, and selected strategic investments in 0.25 micron technology by DRAM manufacturers.

The Company's net sales in fiscal 1997 were relatively flat in comparison to fiscal 1996 net sales, as each fiscal year included two quarters of strong demand and two quarters that reflected the semiconductor industry slowdown. The continuing demand for the Company's advanced equipment reflects the semiconductor industry's need for the technical capability to fabricate advanced device structures and the continued investment in systems capable of performing processes required for smaller device geometries. Sales increased by 35.4 percent in fiscal 1996 compared to fiscal 1995, due primarily to stronger overall demand for the Company's advanced equipment.

APPLIED MATERIALS 25

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Information with respect to net sales by geographic region is as follows:

(DOLLARS IN THOUSANDS)	1997		1996		1995	
	\$	%	\$	%	\$	%
North America*	1,500,926	36.8	1,270,359	30.7	988,709	32.3
Europe	600,227	14.7	685,887	16.5	470,609	15.4
Japan	749,706	18.4	1,008,597	24.3	790,773	25.8
Korea	333,380	8.2	567,116	13.7	504,273	16.5
Taiwan	696,312	17.1	406,143	9.8	230,832	7.5
Asia-Pacific	193,724	4.8	206,715	5.0	76,685	2.5
	-----	-----	-----	-----	-----	-----
	4,074,275	100.0	4,144,817	100.0	3,061,881	100.0
	=====	=====	=====	=====	=====	=====

*PRIMARILY THE UNITED STATES

Gross margin as a percentage of net sales was 46.7 percent in fiscal 1997, compared to 47.0 percent in fiscal 1996 and 46.0 percent in fiscal 1995. The Company experienced rapid growth in fiscal 1995 and significantly ramped manufacturing capacity in response to strengthening customer demand. This steep ramp resulted in manufacturing inefficiencies in fiscal 1995, but allowed the Company to improve its gross margin in the first half of fiscal 1996 as business volume continued to increase and sufficient capacity was available to meet customer demand. During the second half of fiscal 1996, the Company's gross margin decreased as demand for semiconductor manufacturing equipment weakened. In the first half of fiscal 1997, the continuing slowdown in the semiconductor industry placed increasing downward pressure on the Company's gross margin; however, the effect was minimized as a result of improved manufacturing efficiencies, reduced cycle times and material cost reductions. In the second half of fiscal 1997, this emphasis on manufacturing improvements continued and the Company's gross margin improved significantly as business volume increased and the Company was in a position to quickly ramp its manufacturing capacity to meet the increased demand.

The Company's future operating results depend, to a considerable extent, on its ability to maintain a competitive advantage in the products and services it provides. Applied Materials believes it is critical to continue to make substantial investments in research and development to ensure the flow of innovative, productive, high-quality products and support services. Research, development and engineering expenses increased to 13.9 percent of net sales in fiscal 1997, from 11.6 percent in fiscal 1996 and 10.8 percent in fiscal 1995. This considerable investment reflects the Company's commitment to total product excellence and leading-edge technology. The increase in fiscal 1997 spending was primarily for the development of 300mm products and systems for 0.25 micron and

below production. In fiscal 1997, the Company introduced several advanced new products, including: the DxZ(TM)Optima(TM), which offers a new high-throughput platform for CVD (chemical

SALES BY GEOGRAPHIC REGION
(in millions)

[GRAPH]

	1995 -----	1996 -----	1997 -----
North America	\$ 988.7	\$1,270.4	\$1,501.0
Europe	470.6	685.9	600.2
Japan	790.8	1,008.6	749.7
Korea	504.3	567.1	333.4
Taiwan	230.8	406.1	696.3
Asia-Pacific	76.7	206.7	193.7
	-----	-----	-----
TOTAL	3,061.9 =====	4,144.8 =====	4,074.3 =====

RD&E EXPENSES
(in millions)

1995.....330
1996.....481
1997.....568

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MANAGEMENT'S DISCUSSION AND ANALYSIS

vapor deposition) applications; the high volume Silicon Etch MxP(R) Centura(R), which offers important advantages in system throughput, yield and cost of ownership; the Ultima HDP-CVD(TM) (high density plasma CVD) Centura(R) for advanced, high-speed 0.25 micron devices; the Endura(R) HP Liner/Barrier systems for depositing critical titanium and titanium nitride films in 0.25 micron devices; the High Temperature Silicon Nitride Centura(R), which uses single-wafer technology for depositing high temperature films; the Dielectric Etch IPS(TM) Centura(R), which is the industry's most advanced oxide etcher for 0.25 micron and below devices; and the Metal Etch DPS(TM) (decoupled plasma source) R1 Centura(R), which provides higher production-proven throughput and overall productivity than any other metal etch system available. The Company also introduced numerous process and technology advancements to existing products during 1997. The success of these new and enhanced products in the market has yet to be determined (see "Trends, Risks and Uncertainties").

Marketing, selling and administrative expenses as a percentage of net sales increased to 13.9 percent in fiscal 1997, from 13.0 percent in fiscal 1996 and

12.6 percent in fiscal 1995. During each of these fiscal years, the Company increased spending in marketing and selling programs to support the development of international markets and to increase the awareness of new products and services. Administrative expenses have increased during each of the last three fiscal years to support the Company's revenue and headcount levels, to improve information technology capability and to protect the Company's intellectual property rights.

During fiscal 1997, the Company determined that its outstanding accounts receivable balance from Thailand-based Submicron Technology PCL (SMT) might not be collectible. Therefore, the Company repossessed systems previously sold to SMT and recorded \$16.3 million of bad debt expense.

Fiscal 1996 results of operations include a restructuring charge of \$25.1 million in connection with an alignment of the Company's employment levels and facilities with the expected size of its future operations. During the early signs of the semiconductor industry slowdown, the Company reduced its workforce by approximately 800 employees and developed plans to consolidate certain facilities. The restructuring charge consisted of \$19.3 million for costs associated with the workforce reduction, and \$5.8 million for the consolidation of facilities (see Note 8 of Notes to Consolidated Financial Statements).

During fiscal 1997, the Company settled certain outstanding litigation with Novellus Systems, Inc. (Novellus) and General Signal Corporation (GSC). In connection with the Novellus settlement, the Company received \$80 million in damages for past patent infringement, and will receive ongoing royalties for certain system shipments subsequent to the date of the settlement. In connection with the GSC settlement, the Company paid \$11 million and acquired ownership from GSC of five patents regarding "cluster tool" architecture, which had originally belonged to Drytek Systems.

Interest expense was \$20.7 million in fiscal 1997 and 1996, and \$21.4 million in fiscal 1995. The Company's outstanding weighted average interest-bearing obligations and interest rates did not change significantly during any period presented; therefore, there were no significant changes in interest expense from period to period.

Interest income in fiscal 1997 was \$59.7 million, compared to \$39.6 million and \$26.0 million in fiscal 1996 and 1995, respectively. The increases from year to year can be attributed primarily to higher average cash and investment balances.

Applied Materials' effective income tax rate was 37.6 percent in fiscal 1997. This rate is higher than the expected rate of 35 percent due to the non-deductible nature of the \$59.5 million charge for acquired in-process research and development. The Company's effective income tax rate in fiscal 1996 and 1995 was 35 percent. In fiscal 1998, the Company's effective income tax rate is expected to be 35 percent.

Subsequent to the end of fiscal 1997, the Company settled all outstanding litigation with ASM International N.V. (ASM). As a result of this settlement, the Company received a convertible note for \$80 million, against which a payment of \$15 million was received in early November. ASM is also required to pay ongoing royalties for

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certain system shipments subsequent to the date of the settlement. The Company's results of operations for the first fiscal quarter of 1998 will include \$80 million of pre-tax non-operating income associated with this settlement, consisting of the \$15 million of cash and the unpaid balance of the note.

On November 12, 1997, the Company announced that it agreed to make a one-time payment of \$30 million to Trikon Technologies, Inc. for a non-exclusive, worldwide, perpetual license of MORI(TM) plasma source and Forcefill(TM) deposition technology. In the first fiscal quarter of 1998, the Company will recognize pre-tax acquired in-process research and development expense of approximately \$32 million, including transaction costs, in connection with this transaction.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 128 (SFAS 128), "Earnings Per Share," which the Company is required to adopt in the first fiscal quarter of 1998. Under the provisions of SFAS 128, primary earnings per share will be replaced by basic earnings per share and the dilutive effect of stock options will be excluded from the calculation. Upon adoption of SFAS 128, the Company's basic earnings per share for the years ended October 26, 1997, October 27, 1996 and October 29, 1995 are expected to be \$1.37, \$1.67 and \$1.32, respectively. For companies with potentially dilutive securities such as outstanding stock options, fully diluted earnings per share will be replaced with diluted earnings per share. Diluted earnings per share amounts are not expected to differ from the primary earnings per share amounts currently reported by the Company.

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 130 (SFAS 130), "Reporting Comprehensive Income," and No. 131 (SFAS 131), "Disclosures About Segments of an Enterprise and Related Information." These statements are effective for fiscal years beginning after December 15, 1997. The Company will be required to comply with the provisions of these statements in fiscal 1999. The Company has not assessed the effect that these new standards will have on its consolidated financial statements and/or disclosures.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

The Company's financial condition remained strong, with a ratio of current assets to current liabilities of 2.7:1 at October 26, 1997, compared to 2.9:1 at October 27, 1996. As of October 26, 1997, the Company had \$1,543.0 million in cash, cash equivalents and short-term investments, compared to \$1,037.6 million at October 27, 1996.

The Company generated \$701.7 million of cash from operations in fiscal 1997, compared to \$692.0 million and \$142.7 million in fiscal 1996 and 1995, respectively. Fiscal 1997 net income (plus non-cash charges for bad debt expense, acquired in-process research and development, depreciation and amortization) of \$793.7 million and increases of \$352.5 million and \$137.6 million in accounts payable and accrued expenses and income taxes payable, respectively, were partially offset by increases in deferred taxes, accounts receivable and inventories of \$52.5 million, \$332.0 million and \$171.2 million, respectively. Accounts receivable and inventories increased primarily as a result of increased business volume in the second half of fiscal 1997.

The Company used \$1,046.9 million for investing activities in fiscal 1997, compared to \$602.8 and \$487.0 million in fiscal 1996 and 1995, respectively. Cash used for investing activities in fiscal 1997 was primarily for the acquisitions of Opal and Orbot, capital expenditures to support the Company's growth, and net purchases of short-term investments. Cash used for investing activities in fiscal 1996 and 1995 was for capital expenditures and net purchases of short-term investments.

The Company generated \$390.7 million from financing activities in fiscal 1997, compared to \$30.4 and \$472.9 million in fiscal 1996 and 1995, respectively. The primary source of cash from financing activities in fiscal 1997 was the issuance of \$400 million of senior notes payable for general corporate purposes, including

capital expenditures and working capital needs. The main use of cash in fiscal 1997 was for stock repurchases and the early retirement of certain long-term debt. During fiscal 1997, the Company repurchased 2,654,000 shares of its common stock in the open market at an average price of \$29.46 per share, for a total cash outlay of \$78.2 million. In fiscal 1996, the Company repurchased 2,370,000 shares at an average price of \$15.63 per share, for a total cash outlay of \$37.1 million. In March 1996, the Board of Directors authorized the Company to repurchase up to 5,000,000 shares of its common stock in the open market through February 1999 in order to reduce the dilution from the Company's stock-based employee benefit and incentive plans. In December 1997, the Board of Directors rescinded the limitation of the number of shares and extended the authorization to March 2001. The primary sources of cash from financing activities in fiscal 1995 were the issuance of \$370.4 million of common stock and \$73 million of medium-term notes.

At October 26, 1997, the Company's principal sources of liquidity consisted of \$1,543.0 million of cash, cash equivalents and short-term investments, and \$308.4 million of available credit facilities. The Company has a \$240 million revolving line of credit agreement which expires in February 2000; no amount was outstanding under this agreement at the end of any fiscal year presented. In addition to cash and available credit facilities, the Company may from time to time raise additional capital in the debt and equity markets. During fiscal 1997, two rating agencies upgraded the Company's debt rating to BBB+ and A3, respectively. The Company's liquidity is affected by many factors, some based on the normal ongoing operations of the business and others related to the uncertainties of the industry and global economies. Although the Company's cash requirements will fluctuate based on the timing and extent of these factors, management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy commitments for capital expenditures and other cash requirements for the next fiscal year.

Significant facility improvement and expansion projects are underway in the United States to ensure that sufficient capacity is available to meet customer needs. In Santa Clara, California, the Company is converting an existing building to a dedicated 300mm development and applications center, and is constructing another applications laboratory facility at an expected combined cost of approximately \$430 million over the next two fiscal years. Also, in 1997, the Company announced its plans to double the size of its manufacturing facilities in Austin, Texas by the middle of fiscal 1998. Capital expenditures are expected to be approximately \$750 million in fiscal 1998. This amount includes funds for the continuation and completion of aforementioned and other facilities expansion and investments in demonstration and test equipment, information systems and other capital equipment.

TRENDS, RISKS AND UNCERTAINTIES

The semiconductor industry has historically been cyclical and subject to sudden and sharp changes in supply and demand. The timing, length and severity of these cycles are difficult to predict, and each cycle presents

CAPITAL EXPENDITURES, NET (in millions)

[GRAPH]

1995	1996	1997
-----	-----	-----

Land, Building, and Improvements	118	226	158
Other	148	227	181
	---	---	---
Total	266	453	339
	===	===	===

WORKING CAPITAL
(in millions)

1995.....	1,450
1996.....	1,758
1997.....	2,368

MANAGEMENT'S DISCUSSION AND ANALYSIS

unique challenges. During periods of reduced and declining demand, the Company must be able to quickly align its cost structure with the expected size of its future operating levels, and motivate and retain key employees. During periods of rapid growth, the Company must be able to acquire and/or develop sufficient manufacturing capacity to meet customer demand and hire and assimilate an adequate number of qualified people.

The Company's backlog was approximately \$1.7 billion as of October 26, 1997, compared to approximately \$1.4 billion as of October 27, 1996. The Company schedules production of its systems based upon order backlog and customer commitments. Backlog includes only orders for which written authorizations have been accepted and shipment dates within 12 months have been assigned. Due to possible customer changes in delivery schedules and cancellation of orders, the Company's backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period could adversely affect the Company's results of operations.

The Company sells systems and provides services to customers located throughout the world. Managing global operations and sites located throughout the world presents challenges associated with cultural diversities and organizational alignment. Moreover, each region in the global semiconductor equipment market exhibits unique characteristics that can cause capital equipment investment patterns to vary significantly from period to period. Although international markets provide the Company with significant growth opportunities, periodic economic downturns, trade balance issues, political instability and fluctuations in interest and foreign currency exchange rates are all risks that could affect global product and service demand. Many Pacific Rim countries are currently experiencing banking and currency difficulties that could lead to economic recession in those countries. Specifically, the decline in value of the Korean currency, together with difficulties obtaining credit, could result in a decline in the purchasing power of the Company's Korean customers. This in turn could result in the cancellation or delay of orders for the Company's products from Korean customers, thus adversely affecting the Company's results of operations. In addition, if Japan's economy weakens further, investments by Japanese customers may be negatively affected and it is possible that economic recovery in other Pacific Rim countries could be delayed. The Company actively manages its exposure to changes in foreign currency exchange rates, but there can be no assurance that future changes in foreign currency exchange rates will not have a material effect on its results of operations or financial condition.

The Company's new order levels in recent quarters have included a significant amount of strategic investments by DRAM manufacturers. The DRAM market is still characterized by excess capacity and low device prices. If DRAM customers decrease strategic investments in manufacturing equipment, the Company's results of operations could be adversely affected.

The Company operates in a highly competitive industry characterized by increasingly rapid technological changes. The Company's competitive advantage and future success are therefore dependent on its ability to develop new products (including those for 300mm technology and 0.25 micron and below production), to qualify these new products with its customers, to successfully introduce these products to the marketplace on a timely basis, to commence production to meet customer demands and to develop new markets in the semiconductor industry for its products and services. The successful introduction of new technology and products is increasingly complex. If the Company is unable, for whatever reason, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, its results of operations could be adversely impacted.

The Company is currently involved in litigation regarding patent infringement, intellectual property rights, antitrust and other matters (see Note 13 of Notes to Consolidated Financial Statements) and could become involved in additional litigation in the future. There can be no assurance about the outcome of current or future litigation or patent infringement inquiries.

The Company completed acquisitions of Opal and Orbot in fiscal 1997. These acquisitions marked the Company's entrance into the metrology and inspection semiconductor manufacturing equipment markets. To date, the Company's results of operations have not been materially affected as a result of the acquisitions, except for

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MANAGEMENT'S DISCUSSION AND ANALYSIS

a one-time charge for acquired in-process research and development. However, the Company expects the acquired companies to contribute significantly to its results of operations in the future. If the Company is not able to successfully integrate the operations of these newly acquired companies or expand their customer bases, the Company's expectations for its future results of operations may not be met. Also, to the extent that there is an impairment, for whatever reason, in the value of intangible assets recorded in connection with the acquisitions, the Company's results of operations could be adversely affected.

The Company has commenced, for all of its information systems, a year 2000 date conversion project to address all necessary code changes, testing and implementation. The "Year 2000 Computer Problem" creates risk for the Company from unforeseen problems in its own computer systems and from third parties with whom the Company deals on financial transactions worldwide. Such failures of the Company's and/or third parties' computer systems could have a material impact on the Company's ability to conduct its business, and especially to process and account for the transfer of funds electronically. Management has not yet assessed the year 2000 compliance expense and related potential effect on the Company's earnings.

When used in this Annual Report, including this Management's Discussion and Analysis, the words "anticipate," "estimate," "expect" and similar expressions are intended to identify forward-looking statements. These statements are subject to certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. Such risks and uncertainties include, but are not limited to, those discussed above. The Company undertakes no obligation to update the information, including the forward-looking statements, in this Annual Report.

MARKET RISK DISCLOSURE

INTEREST RATE RISK As of October 26, 1997, the Company's investment portfolio includes fixed-income securities of \$1.3 billion. These securities are subject to interest rate risk, and will decline in value if interest rates increase. Due to the short duration of the Company's investment portfolio, an immediate 10 percent increase in interest rates would not have a material effect on the Company's financial condition.

The Company's long-term debt bears interest at fixed rates; therefore, the Company's results of operations would only be affected by interest rate changes to the extent that variable rate short-term notes payable are outstanding. Due to the short-term nature and insignificant amount of the Company's notes payable, an immediate 10 percent change in interest rates would not have a material effect on the Company's results of operations over the next fiscal year.

FOREIGN CURRENCY EXCHANGE RATE RISK The Company enters into derivative financial instruments such as forward exchange contracts to hedge certain firm commitments denominated in foreign currencies and currency option contracts to hedge certain anticipated, but not yet committed, transactions expected to be denominated in foreign currencies. The Company does not use derivative financial instruments for trading or speculative purposes. Forward exchange contracts are denominated in the same currency as the underlying transaction (primarily Japanese yen and British pounds), and the terms of the forward foreign exchange contracts generally match the terms of the underlying transactions. As of October 26, 1997, the majority of the Company's outstanding forward exchange contracts are marked to market (see Note 2 of Notes to Consolidated Financial Statements), as are the underlying transactions being hedged; therefore, the impact of exchange rate changes on the forward contracts will be substantially offset by the impact of such changes on the underlying transactions. The effect of an immediate 10 percent change in exchange rates on the forward exchange contracts and the underlying hedged positions denominated in Japanese yen and British pounds would not be material to the Company's financial condition or results of operations. The Company's downside risk with respect to currency option contracts (Japanese yen and British pounds) is limited to the premium paid for the right to exercise the option. Premiums paid for options outstanding as of October 26, 1997 were not material.

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CONSOLIDATED STATEMENTS OF OPERATIONS

FISCAL YEAR ENDED	1997	1996	1995
	-----	-----	-----
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
Net sales	\$4,074,275	\$4,144,817	\$3,061,881
Cost of products sold	2,173,350	2,195,078	1,652,033
	-----	-----	-----
Gross margin	1,900,925	1,949,739	1,409,848
Operating expenses:			
Research, development and engineering	567,612	481,394	329,676
Marketing and selling	314,381	313,631	223,296
General and administrative	252,214	226,063	162,944
Bad debt expense	16,318	--	--
Acquired in-process research and development	59,500	--	--
Restructuring	--	25,100	--

Income from operations	690,900	903,551	693,932
Income from litigation settlements, net	69,000	--	--
Interest expense	20,705	20,733	21,401
Interest income	59,726	39,618	26,012
Income from consolidated companies before taxes	798,921	922,436	698,543
Provision for income taxes	300,447	322,851	244,490
Income from consolidated companies	498,474	599,585	454,053
Equity in net income/(loss) of joint venture	--	--	--
Net income	\$ 498,474	\$ 599,585	\$ 454,053
Earnings per share	\$ 1.32	\$ 1.63	\$ 1.28
Average common shares and equivalents	377,838	367,214	354,696

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

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CONSOLIDATED BALANCE SHEETS

fiscal year end	1997	1996
	-----	-----
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 448,043	\$ 403,888
Short-term investments	1,094,912	633,744
Accounts receivable, less allowance for doubtful accounts of \$5,578 and \$4,169	1,110,885	822,384
Inventories	686,451	478,552
Deferred income taxes	324,568	281,586
Other current assets	105,498	72,915
Total current assets	3,770,357	2,693,069
Property, plant and equipment, net of accumulated depreciation	1,066,053	919,038
Other assets	234,356	25,880
Total assets	\$ 5,070,766	\$ 3,637,987
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ 55,943	\$ 77,522
Current portion of long-term debt	10,563	22,640
Accounts payable and accrued expenses	1,157,808	791,897
Income taxes payable	177,774	43,168

Total current liabilities	1,402,088	935,227
Long-term debt	623,090	275,485
Deferred income taxes	47,177	11,607
Other liabilities	56,240	45,243
Total liabilities	2,128,595	1,267,562
Commitments and contingencies	--	--
Stockholders' equity:		
Preferred stock; \$.01 par value per share; 1,000 shares authorized; no shares issued	--	--
Common stock; \$.01 par value per share; 500,000 shares authorized; 367,250 and 360,470 shares outstanding	3,672	3,605
Additional paid-in capital	850,902	761,573
Retained earnings	2,098,038	1,599,564
Cumulative translation adjustments	(10,441)	5,683
Total stockholders' equity	2,942,171	2,370,425
Total liabilities and stockholders' equity	\$ 5,070,766	\$ 3,637,987

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Fiscal Year Ended	1997	1996	1995
(IN THOUSANDS)			
Cash flows from operating activities:			
Net income	\$ 498,474	\$ 599,585	\$ 454,053
Adjustments required to reconcile net income to cash provided by operations:			
Bad debt expense	16,318	--	--
Acquired in-process research and development expense	59,500	--	--
Depreciation and amortization	219,435	148,865	83,231
Equity in earnings of joint venture	--	--	--
Deferred income taxes	(52,543)	(85,852)	(99,345)
Changes in assets and liabilities, net of amounts acquired:			
Accounts receivable	(332,047)	(43,789)	(442,935)
Inventories	(171,201)	(60,036)	(186,412)
Other current assets	(29,041)	23,369	(43,097)
Other assets	(8,525)	(3,183)	(3,462)
Accounts payable and accrued expenses	352,540	167,346	304,807
Income taxes payable	137,560	(73,938)	64,246
Other liabilities	11,242	19,662	11,613
Cash provided by operations	701,712	692,029	142,699
Cash flows from investing activities:			
Capital expenditures, net of retirements	(339,364)	(452,535)	(265,557)
Cash paid for acquisitions, net of cash acquired	(246,333)	--	--
Proceeds from sales of short-term investments	664,194	707,620	351,230
Purchases of short-term investments	(1,125,362)	(857,877)	(572,712)
Cash used for investing	(1,046,865)	(602,792)	(487,039)
Cash flows from financing activities:			
Short-term borrowings, net	(21,731)	22,360	18,847

Long-term debt borrowings	407,568	29,832	134,992
Long-term debt repayments	(67,372)	(25,164)	(51,303)
Issuances of common stock, net	150,446	40,381	370,353
Repurchases of common stock	(78,197)	(37,052)	--
	-----	-----	-----
Cash provided by financing	390,714	30,357	472,889
	-----	-----	-----
Effect of exchange rate changes on cash	(1,406)	(1,551)	(3,024)
	-----	-----	-----
Increase in cash and cash equivalents	44,155	118,043	125,525
Cash and cash equivalents--beginning of year	403,888	285,845	160,320
	-----	-----	-----
Cash and cash equivalents--end of year	\$ 448,043	\$ 403,888	\$ 285,845
	=====	=====	=====

CASH PAYMENTS FOR INTEREST WERE \$18,802, \$23,708 AND \$22,349 IN 1997, 1996 AND 1995, RESPECTIVELY. CASH PAYMENTS FOR INCOME TAXES WERE \$130,247, \$429,651 AND \$221,430 IN 1997, 1996 AND 1995, RESPECTIVELY.

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany balances and transactions. The Company's 50 percent joint venture investment in Applied Komatsu Technology, Inc. (AKT) is accounted for using the equity method, and is included in other long-term assets. The Company's fiscal years presented are the 52 week periods that ended on the last Sunday of October in each year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

All highly-liquid investments purchased with a maturity of three months or less are considered to be cash equivalents. All of the Company's short-term investments are classified as available-for-sale as of the balance sheet dates. Investments classified as available-for-sale are recorded at fair value and any material temporary difference between an investment's cost and its fair value is presented as a separate component of stockholders' equity.

INVENTORIES

Inventories are stated at the lower of cost or market, with cost determined on a first-in, first-out (FIFO) basis.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives for financial reporting purposes are as follows: buildings and improvements, 5 to 33 years; demonstration and manufacturing equipment, 3 to 5 years; and furniture, fixtures and other equipment, 3 to 20 years. Leasehold improvements are amortized over the shorter of the useful life of the improvement or the lease term.

LONG-LIVED ASSETS

Effective October 28, 1996, the Company adopted Statement of Financial

Accounting Standards No. 121 (SFAS 121), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS 121 requires that long-lived assets and certain identifiable intangible assets to be held and used, or disposed of, be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During fiscal 1997, the Company determined that none of its long-lived assets had been impaired, and therefore the Company did not adjust the carrying amounts of such assets.

INTANGIBLE ASSETS

Purchased technology and goodwill are presented at cost, net of accumulated amortization, and are being amortized using the straight-line method over their estimated useful lives of eight years.

REVENUE RECOGNITION

Revenue related to systems is generally recognized upon shipment, which usually precedes customer acceptance. A provision for the estimated future cost of system installation and warranty is recorded when revenue is recognized. Service revenue is generally recognized ratably over the period of the related contract.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into derivative financial instruments such as forward exchange contracts to hedge certain firm commitments denominated in foreign currencies and currency option contracts to hedge certain anticipated, but not yet committed, transactions expected to be denominated in foreign currencies. The terms of the currency instruments used are generally consistent with the timing of the committed or anticipated transactions being hedged. The purpose of the Company's foreign currency management activity is to protect the Company from the risk that eventual cash flows from foreign currency denominated transactions may be adversely affected by changes in exchange rates. Gains and losses on forward exchange

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

and option contracts are deferred and recognized in income when the related transactions being hedged are recognized. If the underlying transaction being hedged fails to occur, or occurs prior to the maturity of the financial instrument, the Company immediately recognizes the gain or loss on the associated financial instrument. Forward exchange contracts that have been marked to market are included in accounts payable and accrued expenses on the Company's consolidated balance sheet. Premiums paid for currency option contracts have not been material. The Company does not use derivative financial instruments for trading or speculative purposes.

FOREIGN CURRENCY TRANSLATION

The Company's subsidiaries located in Japan and Europe operate primarily using local functional currencies. Accordingly, all assets and liabilities of these subsidiaries are translated using exchange rates in effect at the end of the period, and revenues and costs are translated using average exchange rates for the period. The resulting cumulative translation adjustments are presented as a separate component of stockholders' equity.

Subsidiaries in Israel, Korea, Taiwan, Southeast Asia and China use the U.S. dollar as the functional currency. Accordingly, assets and liabilities are translated using period-end exchange rates, except for inventories and property, plant and equipment, which are translated using historical rates. Revenues and costs are translated using average exchange rates for the period, except for costs related to those balance sheet items that are translated using historical rates. The resulting translation gains and losses are included in income as they are incurred.

EMPLOYEE STOCK PLANS

In accordance with the provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," the Company may elect to continue to apply the provisions of Accounting Principles Board's Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and related interpretations in accounting for its employee stock option and stock purchase plans or adopt the fair value method of accounting prescribed by SFAS 123. The Company has elected to continue to account for its stock plans using APB 25, and therefore is not required to recognize compensation expense in connection with these plans. Companies that continue to use APB 25 are required to present in the notes to the consolidated financial statements the pro forma effects on reported net income and earnings per share as if compensation expense had been recognized based on the fair value of options granted (see Note 10).

CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, short-term investments, trade accounts receivable and derivative financial instruments used in hedging activities.

The Company invests in a variety of financial instruments such as certificates of deposit, municipal bonds and treasury bills, and, by policy, limits the amount of credit exposure with any one financial institution or commercial issuer.

The Company's customers consist of semiconductor manufacturers located throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral to secure accounts receivable. The Company maintains an allowance for doubtful accounts based upon the expected collectibility of all accounts receivable.

The Company is exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments, but does not expect any counterparties to fail to meet their obligations.

STOCK SPLIT

On September 11, 1997, the Company declared a two-for-one stock split in the form of a 100 percent stock dividend to holders of record of the Company's common stock on September 25, 1997. The dividend shares were distributed to stockholders on October 13, 1997. All prior period common stock and applicable share and per share amounts have been retroactively restated to reflect this stock dividend.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

EARNINGS PER SHARE Earnings per share is computed using the weighted average number of common shares and equivalents outstanding during the period.

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 128 (SFAS 128), "Earnings Per Share," which the Company is required to adopt in the first quarter of fiscal 1998. Under the provisions of SFAS 128, primary earnings per share will be replaced by basic earnings per share and the dilutive effect of stock options will be excluded from the calculation. Upon adoption of SFAS 128, the Company's basic earnings per share for the years ended October 26, 1997, October 27, 1996 and October 29, 1995 are expected to be \$1.37, \$1.67 and \$1.32, respectively. For companies with potentially dilutive securities such as outstanding stock options, fully diluted earnings per share will be replaced with diluted earnings per share. Diluted earnings per share amounts are not expected to differ from the primary earnings per share amounts currently reported by the Company.

RECLASSIFICATIONS Certain amounts in fiscal years prior to 1997 have been reclassified to conform to the 1997 financial statement presentation.

RECENT ACCOUNTING PRONOUNCEMENTS In June 1997, the FASB issued Statement of Financial Accounting Standard No. 130 (SFAS 130), "Reporting Comprehensive Income," and No. 131 (SFAS 131), "Disclosures About Segments of an Enterprise and Related Information." These statements are effective for fiscal years commencing after December 15, 1997. The Company will be required to comply with the provisions of these statements in fiscal 1999. The Company has not assessed the effect that these new standards will have on its consolidated financial statements and/or disclosures.

2. FINANCIAL INSTRUMENTS

INVESTMENTS At October 26, 1997 and October 27, 1996, the fair value of the Company's short-term investments approximated cost. Accordingly, temporary differences between the short-term investment portfolio's fair value and its cost have not been presented as a separate component of stockholders' equity. Information about short-term investments is as follows:

	1997	1996
	-----	-----
(IN THOUSANDS)		
Obligations of states and political subdivisions	\$ 218,689	\$ 189,566
U.S. commercial paper, corporate bonds and medium-term notes	410,088	159,929
Bank certificates of deposit	233,794	134,078
U.S. treasury securities	176,764	121,840
Other debt securities	55,577	28,331
	-----	-----
	\$1,094,912	\$ 633,744
	=====	=====

Investments in debt and equity securities of \$218.0 million and \$233.5 million are included in cash and cash equivalents at October 26, 1997 and October 27, 1996, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information about the contractual maturities of short-term investments at October 26, 1997 is as follows:

	DUE IN ONE YEAR OR LESS	DUE AFTER ONE YEAR THROUGH THREE YEARS	DUE AFTER THREE YEARS
	-----	-----	-----
(IN THOUSANDS)			
Obligations of states and political subdivisions	\$102,011	\$ 68,975	\$ 47,703
U.S. commercial paper, corporate bonds and medium-term notes	312,960	62,617	34,511
Bank certificates of deposit	233,794	--	--
U.S. treasury securities	120,010	8,640	48,114
Other debt securities	8,313	28,925	18,339
	-----	-----	-----
	\$777,088	\$169,157	\$148,667

=====

Gross unrealized holding gains and losses and gross realized gains and losses on sales of short-term investments were not material as of, or for the years ended, October 26, 1997 and October 27, 1996. The Company manages its cash equivalents and short-term investments as a single portfolio of highly marketable securities which is intended to be available to meet the Company's current cash requirements.

DERIVATIVE FINANCIAL INSTRUMENTS

The notional amounts of derivative financial instruments as of October 26, 1997 and October 27, 1996 were as follows:

	1997 ----	1996 ----
(IN THOUSANDS)		
Forward exchange contracts to sell U.S. dollars for foreign currency (primarily yen)	\$224,956	\$330,093
Forward exchange contracts to sell foreign currency (primarily yen) for U.S. dollars	\$477,881	\$504,612
Currency option contracts to sell Japanese yen for U.S. dollars	\$429,257	\$250,000
Currency option contracts to sell U.S. dollars for British pounds	\$ 38,648 =====	\$ -- =====

All forward exchange and currency option contracts outstanding have maturities of less than one year from October 26, 1997. Management believes that these contracts should not subject the Company to undue risk from foreign exchange movements because gains and losses on these contracts generally offset gains and losses on the assets, liabilities and transactions being hedged.

FAIR VALUE OF FINANCIAL INSTRUMENTS

For certain of the Company's financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, notes payable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their short maturities. Consequently, such instruments are not included in the following table that provides information regarding the carrying amounts and estimated fair values of other financial instruments, both on and off the balance sheets:

	1997 -----		1996 -----	
	CARRYING AMOUNT -----	ESTIMATED FAIR VALUE -----	CARRYING AMOUNT -----	ESTIMATED FAIR VALUE -----
(IN THOUSANDS)				
Long-term debt, including current portion	\$633,653	\$647,983	\$298,125	\$305,593
Forward exchange contracts:				
Sell foreign currency	\$491,796	\$491,240	\$533,893	\$534,993
Buy foreign currency	\$217,016	\$216,779	\$318,261	\$318,182
Currency option contracts				
Sell foreign currency	\$ 4,636	\$ 10,337	\$ 2,475	\$ 3,344
Buy foreign currency	\$ 525	\$ 351	\$ --	\$ --
	=====	=====	=====	=====

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The estimated fair value of long-term debt is based primarily on quoted market prices for the same or similar issues. The fair value of forward exchange and currency option contracts is based on quoted market prices of comparable instruments.

3. BALANCE SHEET DETAIL

	1997	1996
	-----	-----
(IN THOUSANDS)		
INVENTORIES:		
Customer service spares	\$ 207,938	\$ 182,320
Raw materials	106,406	70,959
Work-in-process	256,737	140,964
Finished goods	115,370	84,309
	-----	-----
	\$ 686,451	\$ 478,552
	=====	=====
PROPERTY, PLANT AND EQUIPMENT:		
Land	\$ 112,050	\$ 95,739
Buildings and improvements	561,803	438,276
Demonstration and manufacturing equipment	398,588	292,136
Furniture, fixtures and other equipment	329,178	277,199
Construction in progress	164,136	162,296
	-----	-----
	1,565,755	1,265,646
	-----	-----
Accumulated depreciation	(499,702)	(346,608)
	-----	-----
	\$ 1,066,053	\$ 919,038
	=====	=====
OTHER ASSETS:		
Purchased technology, net	\$ 186,127	\$ --
Goodwill, net	13,438	--
Other	34,791	25,880
	-----	-----
	\$ 234,356	\$ 25,880
	=====	=====
ACCOUNTS PAYABLE AND ACCRUED EXPENSES:		
Accounts payable	\$ 347,584	\$ 192,607
Compensation and employee benefits	219,384	170,881
Installation and warranty	216,962	187,873
Other	373,878	240,536
	-----	-----
	\$ 1,157,808	\$ 791,897
	=====	=====

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. APPLIED KOMATSU TECHNOLOGY JOINT VENTURE

In September 1993, the Company entered into an agreement with Komatsu, Ltd. to form Applied Komatsu Technology, Inc. (AKT), a joint venture corporation that develops, manufactures and markets systems used to produce flat panel displays. The Company's initial investment in AKT aggregated \$6.9 million, which included contributed cash, the net book value of certain tangible and intangible assets and costs of formation. Komatsu, Ltd. contributed \$35 million of cash to AKT. The difference between the Company's investment and its interest in the book value of AKT's net assets will be amortized when AKT achieves sustained profitability. The Company's investment in AKT has been reduced to zero as a result of its share of AKT's net losses since formation. Royalties received by the Company on AKT sales did not materially affect the Company's results of operations in fiscal 1997, 1996 or 1995.

5. NOTES PAYABLE

The Company has credit facilities for borrowings in various currencies up to \$364.3 million on an unsecured basis; \$240 million represents a revolving credit agreement in the United States with a group of nine banks. This agreement includes facility fees, allows for borrowings at various rates including the lead bank's prime reference rate and expires in February 2000. The facility contains certain financial and other covenants with which the Company was in compliance as of October 26, 1997. The remaining \$124.3 of credit facilities are primarily with Japanese and European banks at rates indexed to their prime reference rate. At October 26, 1997, \$55.9 million was outstanding under Japanese credit facilities at an average annual interest rate of 0.7 percent.

6. LONG-TERM DEBT

Information with respect to the Company's long-term debt at October 26, 1997 and October 27, 1996 is as follows:

	1997	1996
	-----	-----
(IN THOUSANDS)		
Japanese debt, 1.55-5.55%, maturing 1998-2011	\$ 60,653	\$ 72,625
9.62% unsecured senior notes	--	52,500
6.65-7.00% medium-term notes due 2000-2005, interest payable March 15 and September 15	73,000	73,000
8% noncallable unsecured senior notes due 2004, interest payable March 1 and September 1	100,000	100,000
6.75% noncallable unsecured senior notes due 2007, interest payable April 15 and October 15	200,000	--
7.125% noncallable unsecured senior notes due 2017, interest payable April 15 and October 15	200,000	--
	-----	-----
	633,653	298,125
Current portion	(10,563)	(22,640)
	-----	-----
	\$ 623,090	\$ 275,485
	=====	=====

\$50.0 million of Japanese debt is secured by property and equipment having a net book value of approximately \$66.3 million at October 26, 1997.

During the first quarter of fiscal 1997, the Company repaid its unsecured senior notes prior to their scheduled maturities. The noteholders received approximately \$56.1 million, representing principal, accrued interest and prepayment charges, on December 19, 1996. The prepayment charge was not material.

In October 1997, the Company issued \$200 million of ten-year and \$200 million of twenty-year unsecured senior notes.

The Company has certain debt agreements containing covenants that limit additional borrowings by U.S. subsidiaries, liens placed on assets and sale and leaseback transactions. As of October 26, 1997, the Company was in compliance with all covenants.

As of October 26, 1997, aggregate debt maturities were as follows: \$10.6 million in fiscal 1998; \$7.2 million in fiscal 1999; \$36.0 million in fiscal 2000; \$10.3 million in fiscal 2001; \$4.8 million in fiscal 2002 and \$564.8 million thereafter.

7. ACQUISITIONS

During fiscal 1997, the Company acquired Opal, Inc. (Opal) and Orbot Instruments, Ltd. (Orbot) in separate transactions for approximately \$292.5 million, consisting primarily of cash. Opal is a supplier of CD-SEM (critical dimensions scanning electron microscope) systems for use in semiconductor manufacturing. Orbot supplies wafer and reticle inspection systems for use in the production of semiconductors. The acquisitions were completed by the early part of January 1997, and have been accounted for using the purchase method of accounting; accordingly, the Company's consolidated results of operations include the operating results of Opal and Orbot subsequent to the acquisition dates.

In connection with the acquisitions, the Company incurred a \$59.5 million non-tax deductible charge for acquired in-process research and development. With the exception of this charge, the Company's results of operations for the year ended October 26, 1997 were not materially affected by the acquisitions. As of October 26, 1997, the Company had approximately \$199.6 million of net intangible assets (see Note 3) and \$38.6 million of deferred tax liabilities that resulted from the acquisitions. With the exception of these items, the Company's financial condition as of October 26, 1997 was not materially affected by the acquisitions.

The Company's pro forma net sales, income from operations, net income and earnings per share for the years ended October 26, 1997 and October 27, 1996, assuming the acquisitions occurred at the beginning of such years, would not have been materially different from the actual amounts reported for such periods.

8. RESTRUCTURING

During the fourth quarter of fiscal 1996, the Company recorded a restructuring charge of \$25.1 million in connection with a reduction of its workforce and related consolidation of facilities. These actions reduced the Company's cost structure and were taken in response to an industry downturn that resulted in a significant reduction in new orders received by the Company.

Restructuring activity in fiscal 1997 and 1996 was as follows:

(IN THOUSANDS)	REDUCTION IN	
	WORKFORCE	FACILITIES
Fiscal 1996 provision	\$ 19,329	\$ 5,771
Amount utilized	(13,238)	(348)
	-----	-----
Balance, October 27, 1996	6,091	5,423
Amount utilized in fiscal 1997	(6,091)	(5,272)
	-----	-----
Balance, October 26, 1997	\$ --	\$ 151
	=====	=====

The provision for the reduction in workforce includes severance and other benefits for approximately 800 employees, the majority of whom were based in Santa Clara, California and Austin, Texas. In addition, approximately 870 temporary and contractor positions were eliminated as part of the restructuring.

The provision for facilities includes lease obligations relating to idle or subleased buildings and write-offs of related facility improvements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. STOCKHOLDERS' EQUITY

The following table summarizes activity in the Company's Stockholders' Equity accounts:

(IN THOUSANDS)	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	CUMULATIVE TRANSLATION ADJUSTMENTS
	SHARES	AMOUNT			
Balance at October 30, 1994	336,416	\$3,365	\$388,131	\$ 545,926	\$ 28,842
Net issuance under stock plans*	6,040	60	49,102	--	--
Stock offering	16,100	161	321,030	--	--
Translation adjustments	--	--	--	--	(7,167)
Net income	--	--	--	454,053	--
	-----	-----	-----	-----	-----
Balance at October 29, 1995	358,556	3,586	758,263	999,979	21,675
Net issuance under stock plans*	4,284	43	40,338	--	--
Stock repurchases	(2,370)	(24)	(37,028)	--	--
Translation adjustments	--	--	--	--	(15,992)
Net income	--	--	--	599,585	--
	-----	-----	-----	-----	-----
Balance at October 27, 1996	360,470	3,605	761,573	1,599,564	5,683
Net issuance under stock plans*	9,434	94	167,499	--	--
Stock repurchases	(2,654)	(27)	(78,170)	--	--
Translation adjustments	--	--	--	--	(16,124)
Net income	--	--	--	498,474	--
	-----	-----	-----	-----	-----
Balance at October 26, 1997	367,250	\$3,672	\$850,902	\$2,098,038	\$(10,441)
	=====	=====	=====	=====	=====

*INCLUDES 3,786 AND 1,238 SHARES OF TREASURY STOCK ISSUED UNDER STOCK PLANS IN 1997 AND 1996, RESPECTIVELY. INCLUDES TAX BENEFITS OF \$82,543, \$11,894 AND \$36,940 FOR 1997, 1996 AND 1995, RESPECTIVELY.

In fiscal 1995, the Company sold 16,100,000 shares of common stock in a public offering at a price of \$20.69 per share prior to underwriters' commissions. Proceeds, net of underwriters' commissions and other offering costs, were \$321.2 million.

STOCK REPURCHASE PROGRAM In March 1996, the Board of Directors authorized a plan that allows the Company to repurchase shares of its common stock in the open market until March 1999, which reduces the dilution from the Company's employee benefit and incentive plans such as the stock option and employee stock purchase plans. In fiscal 1997, 2,654,000 shares were repurchased under this plan at an average price of \$29.46 per share. In fiscal 1996, 1,970,000 shares were repurchased under this plan at an average price of \$14.97 per share.

The Company repurchased 400,000 shares of its common stock in the open market in accordance with an authorization from the Board of Directors to fund certain stock-based employee benefit plans. All shares under this authorization were purchased in fiscal 1996 at an average price of \$18.88 per share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EMPLOYEE BENEFIT PLANS

STOCK OPTIONS

The Company grants options to key employees and non-employee directors to purchase shares of its common stock at the fair market value on the date of grant. Options generally vest over one to four years, and currently expire no later than ten years from the date of grant. There were 12,445,000, 12,554,000 and 18,908,000 shares available for grant at the end of fiscal 1997, 1996 and 1995, respectively. Stock option activity was as follows:

	1997	WEIGHTED AVERAGE EXERCISE PRICE	1996	WEIGHTED AVERAGE EXERCISE PRICE	1995	WEIGHTED AVERAGE EXERCISE PRICE
	-----	-----	-----	-----	-----	-----
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)						
Outstanding, beginning of year	30,564	\$10.05	27,938	\$10.51	23,076	\$ 4.85
Granted	13,324	21.21	16,894	14.79	11,616	17.28
Exercised	(7,744)	6.00	(3,074)	3.52	(6,098)	2.22
Canceled	(2,087)	12.82	(11,194)	20.32	(656)	8.31
	-----	-----	-----	-----	-----	-----
Outstanding, end of year	34,057	\$15.16	30,564	\$10.05	27,938	\$10.51
Exerciseable, end of year	8,298	\$ 8.51	9,584	\$ 5.53	7,692	\$ 3.05
	=====	=====	=====	=====	=====	=====

The following table summarizes information with respect to options outstanding and exerciseable at October 26, 1997:

RANGE OF EXERCISE PRICES (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	OPTIONS OUTSTANDING			OPTIONS EXERCISEABLE	
	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
\$0.01-\$9.96	6,812	\$ 6.73	3.0	5,615	\$ 6.49
\$9.97-\$19.93	19,924	13.29	5.2	2,605	12.32
\$19.94-\$29.89	5,300	23.03	6.3	78	23.82
\$29.90-\$39.85	928	35.37	6.7	--	--
\$39.86-\$49.81	1,093	45.78	6.9	--	--
	34,057	\$15.16	5.1	8,298	\$ 8.51

During 1996, the Company canceled options to purchase 9,802,728 shares. The canceled options were originally granted between June 15, 1995 and May 21, 1996 at exercise prices ranging from \$13.10 to \$26.25 per share. New options to purchase 9,802,728 shares at exercise prices ranging from \$11.94 to \$14.25 per share were then granted. All vesting under the canceled options was lost and new vesting periods were started. Executive officers of the Company were not permitted to cancel options.

EMPLOYEE STOCK PURCHASE PLAN

On December 1, 1995, the Company established an employee stock purchase plan (ESPP). Under this plan, substantially all employees may purchase the Company's common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value as of the beginning or end of each six-month offering period. Stock purchases under this plan are limited to 10 percent of an employee's compensation, up to a maximum of \$15,000, in any calendar year. During fiscal 1997 and 1996, 1,697,284 and 771,346 shares, respectively, were issued under this plan. As of October 26, 1997, 5,531,370 shares were reserved for future issuance under the plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

STOCK-BASED COMPENSATION

The Company has adopted the disclosure-only provisions of SFAS 123. Accordingly, no compensation cost has been recognized for any of the Company's stock option plans. If compensation cost for the Company's stock option and employee stock purchase plans had been determined based on the fair value at the grant date for awards in fiscal 1997 and 1996 consistent with the provisions of SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	1997	1996
Net income as reported	\$498,474	\$599,585
Pro forma net income	\$466,395	\$589,750
Earnings per share as reported	\$ 1.32	\$ 1.63
Pro forma earnings per share	\$ 1.23	\$ 1.61

The effects on the above pro forma disclosures of applying SFAS 123 are not likely to be representative of the effects on pro forma disclosures of future years. Since SFAS 123 is applicable only to options granted subsequent to December 15, 1995, the pro forma effects will not be fully reflected until fiscal 2000.

In calculating pro forma compensation, the fair value of each option grant and stock purchase right is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for option and ESPP grants in fiscal 1997 and 1996:

	Stock Options		ESPP	
	1997	1996	1997	1996
Dividend yield	None	None	None	None
Expected volatility	55%	55%	55%	55%
Risk free interest rate	6.27%	6.11%	6.39%	6.01%
Expected lives	3.6	3.6	.5	.5

Using the Black-Scholes option-pricing model, the weighted average estimated fair value of employee stock options granted in fiscal 1997 and 1996 was \$10.96 and \$6.78, respectively. The weighted average estimated fair value of purchase rights granted under the employee stock purchase plan was \$7.31 and \$6.02 for fiscal 1997 and 1996, respectively.

EMPLOYEE BONUS PLANS

The Company has various employee bonus plans. A profit sharing plan provides for the distribution of a percentage of pre-tax profits to substantially all of the Company's employees, up to a maximum percentage of compensation. Another plan awards annual bonuses to the Company's executive staff based on the achievement of profitability and other specific performance criteria. The Company also has agreements with certain key technical employees that provide for additional compensation related to the success of new product development and achievement of specified profitability criteria. Charges to expense under these plans were \$125.9 million, \$112.8 million and \$55.8 million in fiscal 1997, 1996 and 1995, respectively.

EMPLOYEE SAVINGS AND RETIREMENT PLAN

The Employee Savings and Retirement Plan is qualified under Section 401(k) of the Internal Revenue Code. The Company contributes a percentage of the amount of salary deferral contributions made by each participating employee. Company contributions are invested in the Company's common stock and become 20 percent vested after an employee's third year of service, and fully vest after seven years of service. The Company's matching contributions under this plan were \$13.2 million, \$14.9 million and \$14.8 million for fiscal 1997, 1996 and 1995, respectively.

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Certain of the Company's foreign subsidiaries have defined benefit pension plans covering substantially all of their eligible employees. The benefits under these plans are based on years of service and final average compensation levels. Funding is limited by the local statutory requirements of the countries in which the subsidiaries are located. Expenses under these plans were \$7.4 million, \$6.7 million and \$4.2 million, consisting principally of service cost, for fiscal 1997, 1996 and 1995, respectively. The aggregate accumulated benefit obligation, projected benefit obligation and fair value of plan assets at October 26, 1997 were \$25.3 million, \$42.6 million and \$13.5 million, respectively.

11. INCOME TAXES

The components of income from consolidated companies before taxes were as follows:

	1997	1996	1995
	-----	-----	-----
(IN THOUSANDS)			
U.S.	\$678,049	\$697,659	\$584,804
Foreign	120,872	224,777	113,739
	-----	-----	-----
Income from consolidated companies before taxes	\$798,921	\$922,436	\$698,543
	=====	=====	=====

The components of the provision for income taxes were as follows:

	1997	1996	1995
	-----	-----	-----
(IN THOUSANDS)			
Current:			
U.S.	\$261,120	\$266,693	\$243,576
Foreign	60,594	99,739	62,627
State	31,276	39,122	37,378
	-----	-----	-----
	352,990	405,554	343,581
	-----	-----	-----
Deferred:			
U.S.	(51,939)	(70,382)	(90,264)
Foreign	1,207	(6,289)	(4,179)
State	(1,811)	(6,032)	(4,648)
	-----	-----	-----
	(52,543)	(82,703)	(99,091)
	-----	-----	-----
Provision for income taxes	\$300,447	\$322,851	\$244,490
	=====	=====	=====

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal income tax rate of 35 percent as follows:

	1997	1996	1995
	-----	-----	-----
(IN THOUSANDS)			
Tax provision at U.S. statutory rate	\$279,622	\$322,851	\$244,490
Acquired in-process research and development	20,825	--	--
Effect of foreign operations taxed at various rates	17,632	18,261	16,457
State income taxes, net of federal benefit	19,152	21,509	21,274
Research tax credits	(6,540)	(3,624)	(4,273)
FSC benefit	(17,645)	(24,266)	(14,770)
Tax exempt interest	(4,274)	(2,674)	(2,514)
Foreign tax credits	(10,999)	(17,264)	(18,352)
Other	2,674	8,058	2,178
	-----	-----	-----
Provision for income taxes	\$300,447	\$322,851	\$244,490
	=====	=====	=====

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the net deferred income tax assets were as follows:

	1997	1996
	-----	-----
(IN THOUSANDS)		
Deferred income tax assets:		
Inventory reserves and basis difference	\$ 74,642	\$ 58,576
Warranty and installation reserves	71,103	75,264
Accrued liabilities	145,394	113,323
Other	33,429	34,423
Deferred income tax liabilities:		
Depreciation	(11,554)	(11,063)
Purchased technology	(38,598)	--
Other	2,975	(544)
	-----	-----
Net deferred income tax assets	\$277,391	\$269,979
	=====	=====

U.S. income taxes have not been provided for approximately \$54.8 million of cumulative undistributed earnings of certain non-U.S. subsidiaries. The Company intends to reinvest these earnings indefinitely in operations outside of the United States.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. INDUSTRY SEGMENT AND FOREIGN OPERATIONS

The Company operates exclusively in the semiconductor wafer fabrication equipment industry. The Company's selling and support services operations are its principal revenue-producing activities. For geographical reporting, revenues are attributed to the geographic location of the sales and service organizations, and costs directly and indirectly incurred in generating revenues are similarly attributed. Corporate assets consist primarily of cash, cash

equivalents and short-term investments. Corporate operating expenses consist primarily of general and administrative expenses not allocable to specific geographic regions.

During fiscal 1997, 1996 and 1995, no individual customer accounted for greater than 10 percent of the Company's net sales.

	NET SALES -----	INCOME FROM OPERATIONS -----	TOTAL ASSETS -----
(IN THOUSANDS)			
1997:			
North America*	\$1,500,926	\$ 454,616	\$2,263,706
Europe	600,227	62,814	386,623
Japan	749,706	101,421	621,111
Korea	333,380	77,831	152,114
Taiwan	696,312	214,382	232,295
Asia-Pacific	193,724	27,760	97,279
Corporate	--	(247,924)	1,317,638
	-----	-----	-----
Consolidated	\$4,074,275	\$ 690,900	\$5,070,766
	=====	=====	=====
1996:			
North America*	\$1,270,359	\$ 344,343	\$1,566,000
Europe	685,887	113,865	291,223
Japan	1,008,597	288,853	614,805
Korea	567,116	124,866	118,159
Taiwan	406,143	125,312	119,665
Asia-Pacific	206,715	63,780	60,906
Corporate	--	(157,468)	867,229
	-----	-----	-----
Consolidated	\$4,144,817	\$ 903,551	\$3,637,987
	=====	=====	=====
1995:			
North America*	\$ 988,709	\$ 228,247	\$1,226,231
Europe	470,609	103,617	249,216
Japan	790,773	150,893	574,914
Korea	504,273	205,766	46,557
Taiwan	230,832	90,077	137,583
Asia-Pacific	76,685	29,925	45,707
Corporate	--	(114,593)	685,171
	-----	-----	-----
Consolidated	\$3,061,881	\$ 693,932	\$2,965,379
	=====	=====	=====

*Primarily the United States.

Intercompany transfers of products from North America (primarily the United States) to other regions were \$1,661.0 million, \$1,789.0 million and \$1,267.1 million in fiscal 1997, 1996 and 1995, respectively, and from Europe were \$102.2 million, \$122.0 million and \$81.4 million in fiscal 1997, 1996 and 1995, respectively. Transfers and commission arrangements between geographic areas are at prices sufficient to recover a reasonable profit. At October 26, 1997, net

accounts receivable from customers located in North America (primarily the United States) were \$272.9 million and net accounts receivable from customers located in Europe, Japan, Korea, Taiwan and Asia-Pacific were \$139.4 million, \$432.9 million, \$64.3 million, \$165.8 million and \$35.6 million, respectively.

13. COMMITMENTS AND CONTINGENCIES

The Company leases certain of its facilities and equipment under noncancelable operating leases and has options to renew most leases, with rentals to be negotiated. The Company also leases certain office and general operating facilities in Santa Clara, California, under an agreement that provides for monthly payments based on the London interbank offering rate (LIBOR) or the relevant commercial paper (CP) rate. In accordance with this agreement, the Company must maintain compliance with covenants identical to those contained in its credit facilities. At the end of this lease, the Company has to acquire the properties at their original cost or arrange for these properties to be acquired. The Company is contingently liable under 82 percent first-loss clauses for up to approximately \$53 million at October 26, 1997. Management believes that these contingent liabilities should not have a material adverse effect on the Company's financial condition or results of operations.

Total rent expense in fiscal 1997, 1996 and 1995 was \$69.0 million, \$66.2 million and \$41.7 million, respectively. Future minimum lease payments at October 26, 1997 are: \$50.0 million in fiscal 1998; \$36.6 million in fiscal 1999; \$24.8 million in fiscal 2000; \$19.9 million in fiscal 2001; \$15.8 million in fiscal 2002 and \$69.9 million thereafter.

Trade notes and accounts receivable from certain Japanese customers are sold with recourse and at a discount to financial institutions. As of October 26, 1997, \$191.2 million of such receivables were outstanding.

LEGAL MATTERS

During fiscal 1997, the Company settled certain outstanding litigation with Novellus Systems, Inc. (Novellus). In connection with this settlement, the Company received \$80 million in damages for past patent infringement and will receive ongoing royalties for certain system shipments subsequent to the date of the settlement.

Subsequent to the above-mentioned settlement, several new lawsuits with Novellus have been initiated by and against Applied Materials. The Company, as plaintiff, filed a patent infringement lawsuit against Varian Associates, Inc. (Varian), alleging infringement of several of the Company's patents for physical vapor deposition (PVD) technology. As a result of Novellus' acquisition of Varian's thin film PVD business unit, this lawsuit has been amended to include Novellus as a defendant. Varian denied all allegations and counterclaimed for declaratory judgment of invalidity and unenforceability and alleging conduct by the Company violative of the antitrust laws. Novellus has filed suit against the Company alleging infringement of three patents for PVD technology which were formerly owned by Varian. Finally, Varian has filed suit against the Company alleging a broad range of conduct in violation of federal antitrust laws and state unfair competition and unfair business practice laws. Discovery recently commenced in the patent infringement actions. No trial dates have been set.

During the fourth fiscal quarter of 1997, the Company paid \$11 million to settle all outstanding litigation with General Signal Corporation, and acquired ownership of five patents regarding "cluster tool" architecture which had originally belonged to Drytek Systems.

In the first fiscal quarter of 1998, the Company settled all outstanding litigation with ASM International N.V. (see Note 14).

As a result of the acquisition of Orbot, the Company has been named as a defendant in a lawsuit captioned KLA v. Orbot. The plaintiff alleges that Orbot infringes its patent for mask and reticle inspection equipment. The case is currently in discovery; no trial date has been set.

In April 1997, the Company initiated separate lawsuits against AST Elektronik GmbH (AST) and AG Associates, Inc. (AG), alleging infringement of certain patents concerning rapid thermal processing technology. In October 1997, AST and AG each filed counterclaims alleging infringement by the Company of patents concerning related technology. Discovery is commencing. Trials have been set for March 1999.

In the normal course of business, the Company from time to time receives and makes inquiries with respect to possible patent infringement. Management believes that it is unlikely that the outcome of the above mentioned lawsuits or patent infringement inquiries will have a material adverse effect on the Company's financial condition or results of operations.

14. SUBSEQUENT EVENTS

Subsequent to the end of fiscal 1997, the Company settled all outstanding litigation with ASM International N.V. (ASM). As a result of this settlement, the Company received a convertible note for \$80 million, against which a payment of \$15 million was received in early November. ASM is also required to pay ongoing royalties for certain system shipments subsequent to the date of the settlement. The Company's results of operations for its first fiscal quarter of 1998 will include \$80 million of pre-tax non-operating income associated with this settlement, consisting of the \$15 million in cash and the unpaid balance of the note.

On November 12, 1997, the Company announced that it agreed to make a one-time payment of \$30 million to Trikon Technologies, Inc. for a non-exclusive, worldwide, perpetual license of MORI(TM) plasma source and Forcefill (TM) deposition technology. In the first fiscal quarter of 1998, the Company will recognize pre-tax acquired in-process research and development expense of approximately \$32 million, including transaction costs, in connection with this transaction.

15. UNAUDITED QUARTERLY CONSOLIDATED FINANCIAL DATA

	QUARTER				FISCAL YEAR
	FIRST	SECOND	THIRD	FOURTH	
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)					
1997:					
Net sales	\$835,776	\$900,862	\$1,057,241	\$1,280,396	\$4,074,275
Gross margin	\$371,656	\$414,017	\$ 498,896	\$ 616,356	\$1,900,925
Net income*	\$ 29,577	\$102,131	\$ 186,631	\$ 180,135	\$ 498,474
Earnings per share	\$ 0.08	\$ 0.27	\$ 0.49	\$ 0.47	\$ 1.32

* THE FIRST QUARTER INCLUDES NON-TAX DEDUCTIBLE ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSE OF \$59,500; THE THIRD QUARTER INCLUDES PRE-TAX BAD DEBT EXPENSE OF \$16,318 AND INCOME FROM A LITIGATION SETTLEMENT OF \$80,000; THE FOURTH QUARTER INCLUDES PRE-TAX EXPENSE FROM A LITIGATION SETTLEMENT OF \$11,000.

	QUARTER				FISCAL YEAR
	FIRST	SECOND	THIRD	FOURTH	
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)					
1996:					
Net sales	\$1,040,580	\$1,127,855	\$1,115,424	\$860,958	\$4,144,817
Gross margin	\$ 496,800	\$ 541,291	\$ 531,976	\$379,672	\$1,949,739
Net income**	\$ 171,626	\$ 185,821	\$ 169,066	\$ 73,072	\$ 599,585
Earnings per share	\$ 0.47	\$ 0.51	\$ 0.46	\$ 0.20	\$ 1.63

**THE FOURTH QUARTER INCLUDES A PRE-TAX RESTRUCTURING CHARGE OF \$25,100.

50 APPLIED MATERIALS

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REPORT OF INDEPENDENT ACCOUNTANTS

TO THE STOCKHOLDERS AND BOARD OF DIRECTORS OF APPLIED MATERIALS, INC.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and of cash flows present fairly, in all material respects, the financial position of Applied Materials, Inc. and its subsidiaries at October 26, 1997 and October 27, 1996 and the results of their operations and their cash flows for each of the three years in the period ended October 26, 1997, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PRICE WATERHOUSE LLP
San Jose, California
November 19, 1997

STOCKHOLDERS' INFORMATION

LEGAL COUNSEL
Orrick, Herrington & Sutcliffe
San Francisco, California

INDEPENDENT ACCOUNTANTS
Price Waterhouse LLP
San Jose, California

NUMBER OF REGISTERED STOCKHOLDERS
3,893

STOCK LISTING
Applied Materials, Inc. is traded on the Nasdaq
National Market, Nasdaq Symbol: AMAT

TRANSFER AGENT
Shareholders should direct all inquiries to:
Harris Trust Company of California

Stockholder Services
P.O. Box A3504
Chicago, Illinois 60690
(312) 461-6001

FORM 10-K

A copy of Applied Materials' Annual Report on Form 10-K, filed with the Securities and Exchange Commission, contains additional information relating to the Company, and is available without charge. We welcome questions from potential and existing stockholders.

PLEASE CONTACT:

Investor Relations
Applied Materials, Inc.
3050 Bowers Avenue
Santa Clara, California
95054-3298
(800) 882-0373

STOCK PRICE HISTORY*

FISCAL YEAR	1997		1996	
	HIGH	LOW	HIGH	LOW
First quarter	24 5/32	12 15/16	27 11/16	15 11/16
Second quarter	27 7/32	22 1/16	22 1/16	16
Third quarter	46 5/16	25 7/16	20 1/4	11 1/4
Fourth quarter	54	33 7/16	14 7/8	11 1/2

THE PRECEDING TABLE SETS FORTH THE HIGH AND LOW CLOSING SALE PRICES AS REPORTED ON THE NASDAQ NATIONAL MARKET DURING THE LAST TWO YEARS.

*RETROACTIVELY RESTATED TO REFLECT A TWO-FOR-ONE STOCK SPLIT IN THE FORM OF A 100 PERCENT STOCK DIVIDEND, EFFECTIVE OCTOBER 13, 1997.

SUBSIDIARIES OF APPLIED MATERIALS, INC.

LEGAL ENTITY NAME

Applied Materials Japan, Inc.	Japan
Applied Materials Europe BV(1)	Netherlands
Applied Materials International BV	Netherlands
Applied Acquisition Subsidiary	California
Applied Materials International Inc.	California
Applied Materials (Holdings)(2)	California
Applied Materials Asia-Pacific, Ltd.(3)	Delaware
Applied Materials Israel, Ltd.	Israel
Opal, Inc.(4)	Delaware
Orbot Instruments, Ltd.(5)	Israel

(1) Applied Materials Europe BV owns the following:

Applied Materials GmbH	Germany
Applied Materials France SARL	France
Applied Materials Ltd.	England
Applied Materials Ireland Ltd.	Ireland
Applied Materials Sweden AB	Sweden
Applied Materials Israel Services (1994) Ltd.	Israel
Applied Materials Italy Srl.	Italy
Applied Materials Belgium S.A.	Belgium

(2) Applied Materials (Holdings) owns the following subsidiary:

Applied Implant Technology, Ltd.	California
----------------------------------	------------

(3) Applied Materials Asia-Pacific, Ltd. owns the following subsidiaries:

Applied Materials Korea, Ltd.	Korea
Applied Materials Taiwan, Ltd.	Taiwan
Applied Materials South East Asia, Ltd.(a)	Singapore
Applied Materials China, Ltd.(b)	Hong Kong
AMAT	

(Thailand) Limited

Thailand

(4) Opal, Inc. owns the following subsidiary:

Opal Technologies Ltd.(c)	Israel
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(5) Orbot Instruments, Ltd. owns the following subsidiaries:

Orbot Instruments, Inc.	Delaware
Orbot Instruments Pacific, Ltd.	Hong Kong

(a) Applied Materials South East Asia, Ltd. owns the following

subsidiary:		
Applied Materials (AMSEA) Sdn Bhd		Malaysia
(b) Applied Materials China, Ltd. owns the following subsidiary:		
Applied Materials China Tianjin Co. Ltd.		P.R. China
(c) Opal Technologies Ltd. owns the following subsidiary:		
Integrated Circuit Testing GmbH		Germany
50-50 joint venture between Applied Materials, Inc. and Komatsu Ltd.:		
Applied Komatsu Technology, Inc.		Japan

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-8 (Nos. 2-69114; 2-77988; 2-77987; 2-85545; 2-94205; 33-24530; 33-52072; 33-52076; 33-63847; 33-64285; 333-31289; 333-31291; 333-21367) of Applied Materials, Inc. of our report dated November 19, 1997 appearing on page 52 of the Annual Report to Stockholders which is incorporated in this Annual Report on Form 10-K. We also consent to the inclusion of our report on the Financial Statement Schedule, which appears on page 18 of this Annual Report on Form 10-K.

Price Waterhouse LLP
San Jose, California
January 21, 1998

POWER OF ATTORNEY

The undersigned directors and officers of Applied Materials, Inc., a Delaware corporation (the "Company") hereby constitute and appoint James C. Morgan and Gerald F. Taylor, and each of them with full power to act without the other, the undersigned's true and lawful attorney-in-fact, with full power of substitution and resubstitution, for the undersigned and in the undersigned's name, place and stead in the undersigned's capacity as an officer and/or director of the Company, to execute in the name and on behalf of the undersigned an annual report of the Company on Form 10-K for the fiscal year ended October 26, 1997 (the "Report"), under the Securities and Exchange Act of 1934, as amended, and to file such Report, with exhibits thereto and other documents in connection therewith and any and all amendments thereto, with the Securities and Exchange Commission, granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing necessary or desirable to be done and to take any other action of any type whatsoever in connection with the foregoing which, in the opinion of such attorney-in-fact, may be of benefit to, in the best interest of, or legally required of, the undersigned, it being understood that the documents executed by such attorney-in-fact on behalf of the undersigned pursuant to this Power of Attorney shall be in such form and shall contain such terms and conditions as such attorney-in-fact may approve in such attorney-in-fact's discretion.

IN WITNESS WHEREOF, I have hereunto set my hand this 11th day of December, 1997.

/s/ MICHAEL H. ARMACOST

Michael H. Armacost
Director

/s/ DEBORAH A. COLEMAN

Deborah A. Coleman
Director

/s/ HERBERT M. DWIGHT, JR.

Herbert M. Dwight, Jr.
Director

/s/ PHILIP V. Gerdine

Philip V. Gerdine
Director

/s/ TSUYOSHI KAWANISHI

Tsuyoshi Kawanishi
Director

/s/ PAUL R. LOW

Paul R. Low
Director

/s/ ALFRED J. STEIN

Alfred J. Stein
Director

/s/ JAMES C. MORGAN

James C. Morgan
Chairman, Chief Executive Officer and
Director
(Principal Executive Officer)

/s/ DAN MAYDAN

Dan Maydan
President and Director

/s/ GERALD F. TAYLOR

Senior Vice President and Chief Financial
Officer (Principal Financial Officer)

/s/ MICHAEL K. O'FARRELL

Michael K. O'Farrell
Vice President and Corporate Controller
(Principal Accounting Officer)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED OCTOBER 26, 1997.

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