



SanDisk Corporation

951 SanDisk Drive

Milpitas, CA 95035

Phone: 408-801-1000

Fax: 408-801-8657

Prepared Remarks on Second Fiscal Quarter 2013 Results

July 17, 2013

BRENDAN LAHIFF, INVESTOR RELATIONS

Thank you and good afternoon. With me on the call are Sanjay Mehrotra, President and CEO of SanDisk and Judy Bruner, Executive Vice President of Administration and CFO.

Before we begin, please note that any non-GAAP financial measures discussed during this call, as defined by the SEC in Regulation G, will be reconciled to the most directly comparable GAAP financial measure. That reconciliation is now available along with supplemental schedules on our website at sandisk.com/IR. Please note that non-GAAP to GAAP reconciliation tables for all applicable guidance will be posted on our website. This guidance is exclusive of any one-time transactions and does not reflect the effect of any acquisitions, divestitures or similar transactions that may be completed after July 17, 2013, except the guidance is inclusive of the expected impact of the acquisition of SMART Storage Systems, which is expected to close before the end of the third quarter of fiscal 2013. In addition, during our call

today, we will make forward-looking statements. Any statement that refers to expectations, projections or other characterizations of future events including financial projections and future market conditions, is a forward-looking statement. Actual results may differ materially from those expressed in these forward-looking statements. For more information, please refer to the “Risk Factors” discussed in the documents we file from time to time with the SEC, including our Annual Report on Form 10-K for fiscal 2012 and our subsequent quarterly reports on Form 10-Q. SanDisk assumes no obligation to update these forward-looking statements, which speak as of today.

With that, I will turn the call over to Sanjay.

SANJAY MEHROTRA, PRESIDENT & CHIEF EXECUTIVE OFFICER

Thank you Brendan and good afternoon everyone.

We are pleased to report record second quarter revenue and strong margins. We made excellent progress with our embedded mobile product portfolio with new design wins and our SSD business gained further momentum. We remained focused on strengthening our product portfolio and our execution in technology transitions remained outstanding. Our second quarter achievements have put the company on a path to deliver a record 2013.

Our second-quarter performance was driven by strong growth in our mobile embedded products with iNAND™ and iNAND MCP posting the largest revenue gains during the quarter. Our embedded solutions team has made significant progress over the past year and their efforts to diversify our customer base with an expanded array of compelling solutions is bearing fruit. Both smartphone and tablet adoption rates continue to be strong in the industry, with industry analysts forecasting more than 900 million smartphones to ship in 2013, with tablet volumes expected to approach 200 million. Further, China smartphone OEMs are becoming increasingly important in the global smartphone market, with analysts estimating the top China brands to ship more than 10 percent of smartphone volume this year. SanDisk has made significant inroads into this growing market with our iNAND and iNAND MCP offerings, building further upon our strong presence with global smartphone OEMs.

New smartphone launches, including numerous premium brands, continue to feature card slots to expand device storage beyond the embedded capacity. In particular, the attach rate of slots to non-iOS phones remain greater than 90% indicating strong OEM interest in providing storage expansion options to the end customer. This trend continues to play in our favor as reflected by another strong quarter for our retail business, which was, in part, driven by year-over-year and sequential revenue growth from retail sales of our branded microSD™ cards.

Recently we introduced the world's fastest 64 gigabyte SanDisk Extreme[®] microSD cards. With read and write speeds of 80 and 50 MB/sec respectively, the SanDisk Extreme microSD cards further extend our high performance mobile product offerings to address the increasingly feature rich camera and video applications in not only smartphones and tablets but in other device categories such as sports cameras. For the retail market, we also introduced new consumer SSDs such as the SanDisk Extreme II SSD and initial reviews have been very positive.

Turning to SSDs, for the client market, we have completed several customer qualifications of our SSDs made with our 19-nanometer technology and we began revenue shipments of these products during the quarter. We also began shipments of high-performance 19-nanometer client SSDs in small form factors using the PCIe interface. The client SSD market continues to grow, driven by increasing customer preference for high performance, instant-on capabilities in thin-and-sleek form factors. SanDisk is particularly well positioned to benefit from this trend, as we are providing our broad array of stand-alone and caching solutions to the vast majority of leading PC OEMs already.

In enterprise SSDs, we are pleased to report another quarter of solid double-digit sequential growth, representing our 3rd consecutive quarter of record revenues. Further building on this momentum, we are excited with our recently-announced agreement to acquire SMART Storage Systems, an innovative supplier of SATA and

SAS SSDs for the enterprise space. This acquisition will help us further deepen our enterprise product offerings by building upon our successful line of SAS SSDs. Upon the close of the acquisition, which is expected in the third quarter, SMART's current portfolio of SATA products will immediately expand our competitive capabilities and open up a \$1.6 billion incremental opportunity for SanDisk in enterprise SATA. Additionally, the acquisition will also add two new Tier 1 storage OEMs to our customer roster, and we will be qualified with our enterprise SSDs at six of the top seven storage OEMs upon close of the acquisition. Further, this acquisition will enable us to augment our engineering team with talented engineers from SMART Storage Systems. SMART's Guardian Technology™, which is a suite of key firmware and hardware design technologies that together enhance the endurance and reliability of enterprise SSDs, has already won strong customer endorsements and we expect to broaden its benefits by implementing it in our other future product offerings. As industry demand for enterprise SSDs continues to grow, we believe that vertically integrated manufacturers with captive NAND flash supply have a distinct long-term advantage in terms of both development capability and supply continuity over others that must procure NAND.

From a manufacturing standpoint, in the second quarter, our 19-nanometer technology represented approximately 85% of fab output. We expect to begin initial production of 1Y technology late in the third quarter of 2013 with meaningful output commencing in the fourth quarter.

Switching to supply topics, our forecast for SanDisk captive bit supply growth remains unchanged in the 20 percent range for 2013, and between 25 and 35 percent for 2014. For the industry, our expectation for healthy supply and demand balance in 2013 and 2014 remains unchanged. Our bit growth estimates for the industry have consistently included the assumption of new wafer capacity additions as well as conversions of some DRAM capacity to NAND and early generation of 3D NAND, and we have not heard anything new that would change our estimates. As we mentioned at our Investor Day, we do not expect the early generations of 3D NAND to be cost-effective versus 2D planar NAND, nor to have any meaningful contribution to the industry bit supply until the 2015 – 2016 timeframe.

In late June, we announced our decision to commence construction of Phase 2 of Fab 5 with expected completion of the building shell in mid-2014. I will remind you that the primary use of the new clean room space will be to enable the 1Y and 1Z technology transitions in Fabs 3, 4 and Phase 1 of Fab 5 and for a pilot line for BiCS NAND. We do not expect Phase 2 of Fab 5 to contribute to any meaningful increment to our total wafer output in 2014.

In closing, we are very pleased to have reported record second quarter revenues and strong margins setting the stage for a stronger second half of 2013. With robust long-term demand drivers coupled with our broadening portfolio of solutions and growing

traction with a diverse customer base, we are excited about our future prospects. We remain focused on executing to our technology strategy, prudently managing our capacity, driving profitable growth and creating shareholder value. With that, I will turn the call over to Judy for her financial review and outlook.

JUDY BRUNER, EXECUTIVE VICE PRESIDENT, ADMINISTRATION & CFO

Thank you, Sanjay. We delivered robust second quarter results reflecting the benefits of our diversified product portfolio and customer base, our low cost leading edge memory supply, and our disciplined capacity management. And we are pleased to have accelerated returns to our stockholders with \$280 million spent on share repurchase during the second quarter and \$370 million year-to-date.

Our record second quarter revenue grew 10% sequentially and 43% year-over-year. Our ASP/GB was up 5% from Q1, increasing sequentially for the third consecutive quarter, driven by a higher revenue mix of embedded products coupled with a stable supply/demand environment. And this is the first time in our history that our ASP/GB increased on a year-over-year basis, rising 6% from Q2 of last year, reflecting an increased mix of SSDs and embedded products along with a strong pricing environment. The year-over-year shift in our product mix toward SSDs and embedded products is also manifesting itself in an increased average capacity of per-unit sales. Average capacity per unit increased a strong 92% year-over-year. Our

bits sold increased 4% sequentially and 35% year over year, with the growth in our bit supply coming primarily from continued transition to 19nm memory.

Our second quarter revenue came 65% from our commercial customers and 35% from retail, with strong year-over-year growth in both channels. Our retail sales grew 22% year-over-year, with continued improving mix of high performance products and particularly strong growth in the average capacity of our retail mobile cards. Geographically, we achieved strong year-over-year retail growth in all major regions. Our commercial revenue grew 57% year-over-year, with embedded products and SSDs being the biggest contributors. Looking at the mix of our total revenue by form factor, the combination of embedded and SSD products achieved the highest-ever proportion of our revenue at 46%, with embedded revenue at 30% and SSDs at 16%. Our removable product revenue was flat year-over-year with retail card and USB revenue growing enough to offset the decline from OEM bundled card sales and our de-prioritization of non-branded card sales.

Our non-GAAP gross margin increased over 600 basis points sequentially to 46.7% in Q2, exceeding our previous forecast primarily because of better than expected pricing and product mix. Our cost per gigabyte declined 5% sequentially and 21% year-over-year, with the primary drivers being increased 19 nanometer mix and a weaker yen, partially offset by the impact of increased revenue mix from products containing a higher proportion of non-flash memory costs. The sequential

improvement in our 19nm memory mix was the result of beginning to sell client SSDs using 19nm technology. The cost improvement due to the yen reflected a Q2 yen-rate in cost of sales of 85, compared to 81 in Q1 and 79 in the year-ago quarter.

Our Q2 non-GAAP operating expenses were \$260 million, equal to our previous forecast. Our Q2 non-GAAP operating margin was a robust 29.0% and our non-GAAP tax rate was 31.5%, slightly below the rate we had forecasted. Our diluted share count increased slightly sequentially as our accelerated share repurchases were only partially counted in weighted shares for Q2, and this decrease was offset by the impact of our 2017 convertible debt which added 1.6 million shares to diluted share count. For Q2 reporting, the 2017 convertible was in-the-money with a conversion price of \$52.37 compared to the Q2 average stock price of \$57.05. Accounting rules do not allow us to count the offsetting shares expected from our call option which will act to increase the effective conversion price of the convertible to \$73.33. We have posted a schedule on our website which outlines the share dilution expected from the convertible at various stock prices, and also shows the expected offset from the call option at maturity of the convertible.

Turning to the balance sheet and cash flow, we generated our highest-ever Q2 cash flow from operations at \$391 million. We spent \$928 million to pay off the remainder of our 2013 convertible debt, and we spent \$280 million on share repurchases to retire 5.07 million shares at an average price of \$55.27. Other key

cash flow items included \$71 million of expenditures for non-fab capex and a receipt of \$20 million from the fab joint ventures. Our total gross cash and investments ended the quarter at \$5.35 billion. Our accounts receivable increased sequentially due to higher sales and due to the timing of both our retail and commercial sales being more weighted toward the second half of the quarter due to retail seasonality and OEM customer needs. The fab joint ventures invested in approximately \$130 million of fab equipment for SanDisk technology transitions in the second quarter, bringing year-to-date fab investments to approximately \$180 million. Our off-balance sheet fab equipment lease guarantees stood at \$612 million at the end of the quarter.

I'll now turn to forward-looking commentary. The forecasts I will provide include the estimated non-GAAP impact of the SMART Storage Systems acquisition, which we expect will close before the end of our third quarter.

We are seeing strong demand for all key product lines, and we expect supply/demand balance to remain healthy. Our bit supply growth will be limited and will come primarily from continued transition to 19 nanometer memory, which is now being used broadly across our client SSD products. Our third quarter revenue forecast is \$1.525 billion to \$1.575 billion, and we now expect our full year revenue to be between \$5.95 billion and \$6.05 billion, a substantial increase from our previous estimates.

We forecast our third quarter non-GAAP gross margin to be in the range of 47% - 48%, reflecting a positive impact from a weaker yen exchange rate and a higher 19 nanometer mix, partially offset by some downward movement in our blended pricing primarily due to product mix, including a seasonal increase in USB sales for back-to-school shopping and the mix of custom embedded products. We now expect our full year gross margin to be north of 45%, higher than our previous forecast of 42% - 44%.

We expect our expenses to increase in the second half of 2013 due to the SMART Storage Systems acquisition, the timing of certain R&D project expenses, and increased headcount for development of our expanded product roadmap and to support our growing commercial customer base. We forecast Q3 non-GAAP expenses to be between \$285 million and \$290 million, and we now expect the full year non-GAAP operating expenses to be approximately \$1.1 billion. We expect our tax rate to remain about the same, and we expect our diluted share count to be approximately constant with a continued strong rate of share repurchase offset by increased accounting dilution from our convertible debt.

We expect 2013 total capital investments, which include investments from our Flash Ventures, to be near the lower end of the range previously provided, or approximately \$1.1 billion, with a total net cash outlay of approximately \$350 million.

In summary, we are pleased to raise our 2013 forecasts for revenue and gross margins, and we now expect to deliver a record year in top and bottom line results.

We will now open the call for your questions.

BRENDAN LAHIFF, INVESTOR RELATIONS

We want to thank everyone for joining our call today. A webcast replay of today's call should be available on our investor relations website shortly. Thank you and have a good evening.

SanDisk and SanDisk Extreme are trademarks of SanDisk Corporation, registered in the United States and other countries. iNAND is a trademark of SanDisk Corporation. Guardian Technology is a trademark of Smart Storage Systems. microSD is a trademark of SD-3C, LLC. Other brand names mentioned herein are for identification purposes only and may be the trademarks of their respective holder(s).

© 2013 SanDisk Corporation. All rights reserved.