These prepared remarks include a correction on page 4, as compared to the delivered remarks.

SanDisk

SanDisk Corporation
951 SanDisk Drive
Milpitas, CA 95035
Phone: 408-801-1000
Fax: 408-801-8657

Prepared Remarks on Fourth Fiscal Quarter and Fiscal 2014 Results

January 21, 2015

JAY IYER, INVESTOR RELATIONS

Thank you and good afternoon everyone. With me on the call are Sanjay Mehrotra, President and CEO and Judy Bruner, Executive Vice President of Administration and CFO. In a moment, we will hear remarks from both of them, followed by Q&A.

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 also 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 January 21, 2015. In addition, during our call today, we will make forward-looking statements that refer to expectations, projections or other future events. Please refer to today's press release and our SEC filings including the most recent 10-Q for more information on the "Risk Factors" that could cause actual results to differ materially from those expressed in the forward-looking statements. SanDisk assumes no obligation to update these forward-looking statements, which speak as of today.

Before I turn the call over to Sanjay, I would like to inform you that our first quarter earnings conference call is being planned for April 15. We are also planning to host our 2015 Investor Day meeting on May 13 in Milpitas, California. Please mark your calendars.

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

SANJAY MEHROTRA, PRESIDENT & CHIEF EXECUTIVE OFFICER

Thank you Jay and good afternoon everyone. 2014 was a record year for revenue and non-GAAP earnings and our business generated strong cash flows. We are pleased to have returned more than 100% of our 2014 free cash flow to our investors through our capital return program. We successfully drove our portfolio mix shift toward high-value solutions during the year, with total SSD revenue contributing 29% of 2014 revenue, up from 19% of 2013 revenue.

Moving to the details of the business, we are disappointed with our fourth quarter execution. As we indicated in the October conference call, our inventory levels were extremely lean exiting the third quarter and were anticipated to become even leaner throughout the fourth quarter. We overestimated our ability to service our customers' demand variability with our low levels of inventory, creating supply shortfalls in certain products. Additionally, within the fourth quarter, unplanned maintenance activities in our Yokkaichi fab operations, as well as lower yield on certain memory die, led to unexpected reductions in production output. The combination of lean inventory and reduced memory output made our ability to meet our customer demand even more challenging during a seasonally strong period. These factors impacted our business, most notably in our retail and iNAND™ product lines. Within retail, the late timing of supply availability resulted in lost sales opportunities. Within iNAND, demand for our previous generation products fell more rapidly than forecasted by our customers, while we had limited ability to service demand for our newer products due to supply constraints. We are taking corrective measures to mitigate the recurrence of these events in the future to ensure that we can consistently meet our customers' expectations. It is clear that one of our top operational priorities for 2015 is to rebuild our inventory levels, which we expect to be restored to normal levels by mid-year.

In embedded, in the second half of 2014, we estimate that the smartphone market consumed more embedded flash based on X3 NAND technology than ever before and we are leading the industry in advancing the usage of X3 in embedded products with our 7th generation X3-technology. Over the course of this year, with our strong roadmap, we expect to win designs for our embedded X3 solutions at multiple OEM customers, with strong production ramp in the second half of 2015. Beyond the smartphone and tablet markets, we are pleased with the traction we are seeing for our embedded and removable solutions with customers in the connected home, automotive and content delivery markets.

Turning to enterprise SSDs, revenue grew on both a sequential and a year-over-year basis during the fourth quarter, with full year revenue nearly doubling on a year-over-year basis[1]. The fourth quarter enterprise SSD revenue was driven by continuing strength in SAS SSDs and a significant increase in revenue from sales of CloudSpeed™ enterprise SATA products to hyperscale customers. We have largely completed our overall Fusion-io integration and we are excited about the opportunities ahead with the broadest portfolio of enterprise SSD products in the industry. We made solid progress in moving the Fusion-io go-to-market strategy to an OEM-centric model and enhancing salesforce productivity. We continue to expect that our enterprise solutions revenue will achieve $1 billion in 2015.

Our client SSDs completed a very strong year in 2014 with 36% year-over-year growth with strong penetration in both OEM and retail markets. Retail acceptance of

---

[1] Correction: Enterprise SSD revenue grew approximately 140% in 2014, on a year-over-year basis, which increase is larger than the increase described in the delivered remarks.

our X3-based SanDisk Ultra® II SSDs continues to be solid. With our OEM customers, we expanded our presence further with our 1Y nanometer X2 SSDs. Corporate adoption of our client SSDs continues to accelerate, driven by an increasing attach rate of SSDs in notebooks. I am pleased to note that qualification for our 1Y nanometer X3 SSDs is nearing completion with multiple OEM customers.

One headwind for our client SSDs, however, is that a major customer has decided to move away from our client SSD solution starting in Q1. Taking this into consideration, we estimate our 2015 total SSD sales, enterprise and client solutions combined, as a percent of revenue, to remain similar to the 29% revenue mix in 2014. We expect this mix to be driven by significantly higher sales in enterprise, partially offset by a decline in client SSD sales. Driven by market growth and continued share gains in corporate PC platforms, we anticipate that our client SSD revenue will grow again starting in 2016.

In retail, we do not see any material changes to the demand in the marketplace, although there could be pockets of demand weakness in certain regions like EMEA due to macroeconomic factors. We expect our retail channel, in which we have the #1 flash brand in the world, to continue to be a solid contributor to our overall business and profitability in 2015.

In manufacturing, the output from our wafer fabs was below our expectations for the fourth quarter and the full year for the reasons I described earlier, with the full year bit supply growth in 2014 increasing by 20% from 2013, at the low end of our original 20% to 30% growth range estimate. The primary driver of the low bit growth was a high mix of 19 nanometer wafers in order to service our OEM customers. The ramp of our 15 nanometer technology is proceeding well, with cost crossover with 1Y technology achieved late in the fourth quarter of 2014. We expect a strong production ramp of 15 nanometer throughout 2015, with the mix reaching 50% of our sales in the second half of the year. We are now utilizing 15 nanometer X3 technology in retail products and, in the first quarter of 2015, we will begin sampling the new technology in embedded applications. Our 3D NAND technology development continues to make good progress and we remain on track to begin pilot production in the second half of 2015 with volume production targeted in 2016. We remain confident that our 3D NAND memory products in production in 2016 will be competitive with those offered by others in the market at that time.

From a NAND industry standpoint, our estimate for 2015 supply bit growth is in the range of 35% to 40% and we continue to expect a healthy industry supply-demand environment. As we have previously mentioned, we will be implementing a 5% expansion to our wafer capacity in the first half of 2015 and this will increase our captive wafer capacity to approximately 3 million wafers in the second half of the year. We expect that our wafer capacity expansion, along with an increasing mix of 15 nanometer technology, and an increasing mix of X3, will bring our captive supply bit growth for 2015 to the high end of the industry bit growth range.

To conclude, we are focused on improving our supply and product availability and we will continue managing the business for profitable growth and strong cash flows. In 2015, while our revenue will be challenged in the first half of the year, we expect to return to solid growth in the second half of the year, driven by continuing share gains in enterprise storage and accelerating momentum in embedded solutions. We look forward to bringing greater value to a broader customer base with exciting new products and further extending our position as a pre-eminent supplier of innovative storage solutions. We remain excited about the future prospects of the company and plan to continue our strong capital return program.

With that, I will turn over the call to Judy for the financial review and outlook.

JUDY BRUNER, EXECUTIVE VICE PRESIDENT, ADMINISTRATION & CFO

Thank you, Sanjay. For the full year 2014, we grew our revenue by 7% and our non-GAAP EPS by 5%, including the dilutive impact of the Fusion-io acquisition. While these total results were quite strong, we are disappointed in our fourth quarter performance, and our first half of 2015 will be focused on recovering from the current headwinds in our supply and in our client SSD business. We expect that in the second half of 2015, we will return to year-over-year top-line growth and delivering non-

GAAP operating profits within our target financial model of 25%-30% of revenue. I'll take you through some details of our Q4 results and then discuss 2015 expectations in more detail.

Our Q4 revenue was approximately flat both sequentially and year-over-year, and was comprised of 69% commercial and 31% retail, compared to the year ago quarter which was 62% commercial and 38% retail.

Our retail revenue was down 2% sequentially and down 18% year-over-year. Typically the fourth quarter has been the strongest quarter of the year for our retail revenue. While we expected some year-over-year decline in Q4 retail revenue due to the contraction of the imaging market, we believe the market did grow sequentially, while our revenue was constrained by our limited supply and low channel inventory levels. In addition, there were some pockets of pricing weakness in EMEA and APAC. On a regional basis, we generated sequential retail revenue growth in North America, where we were better able to meet the timing requirements of customer demand, and this was offset by a decline in revenue in Europe and APAC where our supply constraints were more pronounced.

Our commercial revenue was flat sequentially and up 12% year-over-year. Within our commercial revenue, on a sequential basis, our Enterprise SSD revenue grew strongly, while our Client SSD revenue was down modestly primarily due to seasonality and anticipated supply constraints. Our combined SSD revenue increased to 31% of our total revenue in the fourth quarter, up from 27% in Q3. Our embedded revenue grew sequentially by 10%, with a decline in revenue from iNAND solutions and strong growth in custom embedded revenue. As Sanjay described, our iNAND revenue was below our original expectations due to a faster than anticipated decline in demand for our older generation products, combined with supply constraints for our newer iNAND products. Finally within our commercial revenue, sales of wafers and components were down sequentially as we prioritized supply for value-added solutions, and our license and royalty revenue grew slightly on a sequential basis.

Turning to a few metrics, for the fourth quarter, on a sequential basis, our gigabytes sold increased 4% and ASP per gigabyte declined by 4%. On a year-over-year basis, our fourth quarter gigabytes sold increased 32% and ASP per gigabyte declined 24%. For the full year 2014, our revenue bit growth was 36% in comparison to the 20% supply bit growth that Sanjay described. This difference in bit growth left our inventory levels too lean, and we are working to rebuild our inventory levels in the first half of 2015.

Turning to gross margin, for 2014 our blended ASP per gigabyte declined by 22% and our all-in cost per gigabyte also declined by 22%. Our full year non-GAAP gross margin was 48%, in the middle of our target financial model of 45% to 51%, and up 70 basis points from 2013. In the fourth quarter, our non-GAAP gross margin decreased sequentially from 49% to 45%, below our previous forecast of 47% to 49%. There were three primary factors that contributed to the sequential decline in gross margin and the miss from our forecast:

- First, was a lower mix of retail revenue which carries a higher than average gross margin. The lower retail mix was driven primarily by supply constraints.
- Second, as Sanjay previously discussed, we experienced faster than expected demand reductions for certain end-of-life products, which made available trailing edge technology node X2 NAND. In an attempt to meet customer demand timing requirements, we used this older node X2 NAND in products that would normally use more current node X3 NAND memory. This inefficient memory usage, as well as the lower fab output, put upward pressure on our memory costs.
- Third, we took inventory reserves related to a faster than expected decline in demand for certain end-of-life OEM products, as well as for our ULLtraDIMM product which has become the subject of a court injunction stemming from litigation to which we are not a party.

The yen rate in our fourth quarter cost of sales was 102.5 compared to 101 in Q3, which resulted in a small positive impact to gross margin. Including all these factors, our fourth quarter cost per gigabyte increased sequentially by 3% compared to the 4% decrease in ASP per gigabyte.

Our Q4 non-GAAP operating expenses decreased sequentially by $12M, driven by a reduction in restructuring expenses related primarily to Fusion-io integration activities. Our non-GAAP operating margin was 24% in Q4 and 28% for the full year, inclusive of Fusion-io related restructuring charges. Other Income & Expense was a net expense in Q4 due to charges related to the spin-out of the ioControl business, now known as NexGen. Our non-GAAP tax rate declined in the fourth quarter due to the re-instatement of the R&D tax credit. For the full year, our non-GAAP tax rate was 30.9% and the GAAP tax rate was 32.3%. Our diluted share count came down on both a GAAP and non-GAAP basis, driven by strong share repurchases. In Q4, we spent approximately $500 million on the repurchase of over 5.5 million shares.

Q4 cash flow from operations was $488 million, bringing full year cash flow from operations to $1.7 billion. Our fourth quarter free-cash-flow was $476 million, including a net return of $55 million of cash from the flash ventures. For 2014, our free-cash-flow was $1.5 billion and our capital return program totaled 103% of free-cash-flow. During the year, we paid $235 million in dividends and repurchased 14.3 million shares, resulting in a net reduction in shares outstanding of 9.5 million shares.

Our share of flash venture fab investments during Q4 was $209 million, and non-fab capital investments were $67 million, bringing 2014 gross capital investments to approximately $1.15 billion. Our 2014 capital investments were funded primarily by flash venture working capital and secondarily by flash venture operating leases. Our cash outlay for capital investments in 2014 was $207 million or 18% of the gross investment. Our inventory ended the year at $698 million, the lowest level in both dollars and weeks-of-supply since late 2011 when our product mix was very different and our revenue was much lower. The longer cycle time for SSDs, coupled with the increased breadth of our product portfolio, has led to a need for higher inventory weeks of supply, whereas we currently have the lowest weeks of supply since Q3 of 2011.

Turning to our expectations for 2015, we will be rebuilding our inventory buffers in order to meet the needs of our customers and accommodate normal variability in product demand. In order to restore our inventory health, we believe 2015 revenue bit growth can be no more than 30%, inclusive of non-captive inventory, in comparison to our expected captive supply bit growth at the high end of the anticipated industry growth of 35%-40%. As Sanjay described, we expect our Client SSD revenue to decline due a large customer moving away from our solution. The key product areas where we expect revenue growth in 2015 are Enterprise and embedded solutions. In total, we expect our revenue to experience a year-on-year decline in both the first and second quarters, and return to year-on-year growth in the second half of 2015. Our first quarter revenue forecast is $1 billion, 400 million to $1 billion, 450 million, and our 2015 revenue forecast is $6.5 billion to $6.8 billion.

In terms of gross margin, the first quarter will continue to be impacted by using an inefficient memory mix as well as some extra non-captive memory. We will also start to incur some start-up costs in cost of sales related to our Malaysia assembly and test factory, which will begin production in the middle of the year. These factors plus the sequentially lower revenue level will put pressure on gross margins. Offsetting these factors will be a more favorable Yen rate of approximately 108 in our Q1 cost of sales based primarily on Q4 purchase rates and previous hedges. In total, we expect Q1 non-GAAP gross margin to be similar to that of the fourth quarter or approximately 45%. We expect gross margins to improve across the second through fourth quarters, based on improving inventory levels, product transitions to 1Y and 1Z, a higher usage of X3 memory, increasing enterprise revenue mix and a more favorable Yen rate, assuming the Yen to Dollar exchange rate stays at current levels. We expect that the gross margin improvement will be more concentrated in the second half of the year. We forecast our full year 2015 non-GAAP gross margin to be 47% to 48%, in the middle of our target financial model of 45% to 51%, with Q3 and Q4 non-GAAP gross margin in the upper half of our model.

We expect non-GAAP operating expenses for the first quarter to be between $365 million and $375 million, and for the full year we expect our non-GAAP expenses to be approximately $1.5 billion. This is somewhat higher than our target financial model of 20% to 21% of revenue as we continue to make key investments. In terms of non-GAAP operating margin, we expect to be solidly in our 25% - 30% target financial model in the second half of the year. Our forecast for non-GAAP Other Income and Expense is approximately $15 million of income for the year, and we expect our non-GAAP tax rate to remain about the same at 31%.

Our 2015 capital investment is estimated at approximately $1.4 billion including a 5% capacity add and the addition of a 3D NAND pilot line. We expect cash usage to be between $300 million and $400 million for these capital investments, with the remainder funded by flash venture working capital and leases. We will manage our business with a focus on achieving our target financial model for free-cash-flow of 15% of revenue, and we will continue a strong share repurchase program which should lead to diluted shares coming down again in 2015.

In summary, we expect to strengthen the business across 2015. With inventory rebuilding in the first half of 2015, and strong roadmaps and customer relationships in place, we look forward to a strong second half of the year. We expect full year 2015 revenue to be similar to slightly higher than in 2014, driven by growth in enterprise and embedded solutions revenue. We expect to deliver healthy profit margins and be solidly within our target financial model of 25% - 30% non-GAAP operating margin by the second half of the year. We intend to spend at least 100% of our 2015 free-cash-flow on our capital return program this year. We will now take your questions.

<u>JAY IYER, INVESTOR RELATIONS</u>

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 again and have a good evening.