

FINAL TRANSCRIPT

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STEC - Q3 2010 STEC, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the STEC, Inc. Q3 2010 earnings conference call. (Operator Instructions). I would now like to introduce your host for today's conference, Mr. Mitch Gellman. Sir, you may be going.

Mitch Gellman - *STEC, Inc. - VP, IR*

Thank you very much, and thank you everyone. Good day and thanks for joining us to discuss our results for the third quarter of 2010. Joining me for today's discussion and Q&A session are Manouch Moshayedi, our Chairman and CEO, and Raymond Cook, our Chief Financial Officer.

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We hope that you had an opportunity to read the earnings release that we put out just after today's market close. And we look forward to discussing with you these results as well as our outlook for the fourth quarter of 2010.

First, I would like to give you a quick update, as I usually try to do, our upcoming conference schedule and events you may join us at. November calendar we will have a presentation on Thursday, November 4. We will be at the Needham & Company HD and memory and investor conference. That is in Boston. Again, November 4, and Raymond Cook, our CFO, will be attending.

The following week, Tuesday, November 9, Raymond and Scott Stetzer, our VP of Technical Marketing, will present at the Goldman Sachs Techtonics conference, and that is in New York City.

One other quick update. On December 1 we will be presenting at the Credit Suisse technology conference. And that will be in Scottsdale, Arizona. That will be Raymond and myself.

Various comments about the Company's future expectations, plans, prospects and characterizations of future events or circumstances made during today's earnings conference call, including the question-and-answer session, constitute forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995, and are based on management's current expectations.

These forward-looking statements including, but not limited to, statements concerning continued product research and development, the lifecycle of SSDs, growing acceptance, adoption and qualification of SSDs within the enterprise storage market, the benefits from data sharing software, and capabilities and performance of STEC's products, anticipated increase in sales of STEC's SAS-based ZeusIOPS SSDs in the fourth quarter of 2010, and expected fourth-quarter 2010 revenue and earnings per share entail various significant risks and uncertainties that could cause our actual results to differ materially from those expressed in such forward-looking statements.

These risks and uncertainties are detailed in periodic filings with the Securities and Exchange Commission. Special attention is directed to the portions of those documents entitled, Risk Factors and Management's Discussion and Analysis of Financial Conditions and Results of Operations.

Listeners are cautioned not to place undue reliance on these forward-looking statements, which represent our views only as of today. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if the estimates change. And therefore you should not rely on the forward-looking statements as representing our views as of any date subsequent to today.

Additionally, as we discuss our financial performance we will be referring to certain non-GAAP financial measures. And please see the reconciliations of our GAAP to non-GAAP measures included in today's earnings release.

Thanks again for joining us. And now I would like to turn the call over to Raymond Cook, our CFO. Raymond.

Raymond Cook - STEC, Inc. - CFO

Thank you, Mitch, and welcome everyone. Our net revenue for our third quarter of 2010 was \$86.1 million, which surpassed our guidance of \$78 million to \$80 million through the quarter.

Our net revenue by major product category was as follows. Our Flash-related products accounted for \$78.1 million or 91% of total revenue. And our DRAM-related products accounted for \$8 million or 9% of our total revenue. International sales comprised 54% of our total revenue in the third quarter of 2010.



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For the third quarter of 2010 our GAAP gross profit margin was 46.4% and our non-GAAP gross profit margin was 46.5%. Our Q3 2010 GAAP sales and marketing expense was \$5.1 million. GAAP general and administrative spending was \$7.1 million, and our GAAP research and development spending was \$12.1 million.

Total GAAP operating expense for the third quarter of 2010 was \$24.9 million and non-GAAP operating expense was \$21.8 million.

Our non-GAAP results for the third quarter of 2010 excluded stock option compensation expense of \$2.5 million and restructuring costs of \$625,000. The non-GAAP adjustments are detailed in our third-quarter of 2010 earnings release that was issued earlier today.

Our provision for income taxes was booked at an effective tax rate of approximately 11.1% for the quarter ended September 30, 2010. Our consolidated effective tax rate for 2010 is now estimated at 14%, which is 650 basis points lower than the forecasted effective tax rate we provided in August during our second-quarter earnings call.

The decrease in our effective tax rate was driven by the increased percentage of total sales and earnings coming from lower tax jurisdictions outside of the United States.

Our GAAP diluted earnings per share was \$0.26 for the third quarter of 2010. Our non-GAAP diluted earnings per share was \$0.31 for the quarter -- for the third quarter of 2010, exceeding our non-GAAP earnings per share guidance of \$0.18 to \$0.20.

From a balance sheet perspective, the following are selected accounts of interest from the third quarter of 2010. Cash, cash equivalents and short-term investments increased \$12.7 million from Q2 2010 to \$160.6 million. Accounts Receivable decreased \$1.3 million from the end of June 2010 to \$39.3 million.

Net inventories increased \$21.1 million quarter-over-quarter to \$87.9 million. The increase was primarily attributable to the receipt of NAND Flash to be utilized in our third generation ZeusIOPS and MACH16 products, both of which are being manufactured with either SLC or MLC Flash memory.

Capital expenditures were \$2.0 million for the quarter, offset by \$3 million of depreciation and amortization. Current liabilities increased \$12 million for the quarter to \$43.9 million, primarily related to the increase in our net inventory position. And the Company had no long-term debt outstanding as of September 30, 2010.

Net cash provided by operating activities for the three months ended September 30, 2010 was \$13.8 million.

Turning now to our guidance for the fourth quarter of 2010. We expect our revenues to be in the range of \$88 million to \$90 million, with non-GAAP diluted earnings per share to range from \$0.31 to \$0.33.

I would like to thank you for joining us today. This concludes our prepared remarks. I will now open up the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Kate Kotlarsky, Goldman Sachs.



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Kate Kotlarsky - Goldman Sachs - Analyst

Thanks so much for taking my question. First, I was hoping you could comment on your Zeus revenues during the quarter, and if you can talk about what you guys had any greater than 10% customers for the Zeus product? Thank you.

Raymond Cook - STEC, Inc. - CFO

So our Zeus revenue for the quarter was \$59.1 million. As far as greater than 10% customers, for the three months ended we had one customer that was greater than 10%. And for the nine months ended we actually had three customers that were greater than 10% on a consolidated basis.

Kate Kotlarsky - Goldman Sachs - Analyst

Okay, thank you. And if I could just ask a question about the guidance. Could you talk about what gross margins are embedded in your Q4 guidance and how you guys are thinking about OpEx next quarter and into 2011?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

As I mentioned before in the last quarter's call, the only part of our OpEx that is going up is our R&D, and we continue to invest in our R&D. We think that our R&D expenditures will grow from a \$40 million run rate this year to about \$45 million to \$46 million next year.

Kate Kotlarsky - Goldman Sachs - Analyst

Okay, thank you so much. And just the last question for me. In terms of the tax rate for next year what should we assume?

Raymond Cook - STEC, Inc. - CFO

Well, we are estimating that 2010 will be approximately 14%. So the tax rate for going forward will be a function of the volume of our shipments that are derived internationally versus US.

Kate Kotlarsky - Goldman Sachs - Analyst

Okay, thank you.

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

Yes, some of our Japanese customers have picked up, and as we sell more to them than we do in the US our taxes will go down.

Kate Kotlarsky - Goldman Sachs - Analyst

Thank you.

Operator

Rich Kugele, Needham & Company.

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Rich Kugele - *Needham & Company - Analyst*

Just a few questions here. I guess, first, you did talk about what your expectations were for SAS as a percentage of your mix. But I am also interested if you have any thoughts on your ultimate mix either this year or next between MLC -- enterprise class MLC and SLC?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

So already one of our largest customers has converted to MLC. We are qualified across-the-board with them. And going into Q1 of 2011, I think almost 100% of sales to that customer will be the MLC-based Gen 3 product.

Our Gen 4 MLC will be ready for qualification at customers at the end of Q1. I think by Q4 of 2011 the Gen 4 MLC will be qualified across-the-board everywhere. And I don't think that after that there is really going to be a need for SLC-based ZeusIOPS.

Rich Kugele - *Needham & Company - Analyst*

Okay, and what should we expect -- do you anticipate your overall volumes to compensate for the revenue hit from the ASP difference?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

There is no revenue hit. I think we are not expecting a revenue hit. The customers seem to buy twice the density for the same price, so ASPs should stay pretty constant, except that we will be shipping out twice the density.

Rich Kugele - *Needham & Company - Analyst*

Okay, that's helpful. Thank you. Then can you give us a sense on what, either in the quarter or your expectations going forward, of what percentage of your shipments are tied to automated tiering applications, or going into automated tiering, versus just storage applications?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Virtually all of our customers -- the large customers have got an automated tiering software today. And once they put that on their system, they will have to sell the system with SSDs onboard. So we think that SSDs usage in our customer base has gone up because of that.

I don't know exactly what percentage of our sales are going into systems that are using automated tiering, but it could be a very large percentage.

Rich Kugele - *Needham & Company - Analyst*

Already, today?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Yes.

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Rich Kugele - *Needham & Company - Analyst*

Okay. Then, lastly, obviously the revenues are going up nicely. Can you just talk about what feedback mechanisms you have deployed over the past year to prevent, or at least diminish, the risks of inventory overstocking?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Well, there is really nothing that we can do for -- to be able to see what customers are doing with their inventory, except that now we are basically trying to ship more on time and as fast as the customers need. So there is really no need for anyone to buy in advance of when they're going to put the SSDs into their systems.

And because we are giving discounts to customers on a quarterly basis, there is really no need for them to buy this quarter if they're going to use it next quarter.

Rich Kugele - *Needham & Company - Analyst*

Okay, all right, great. Thank you.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

I wanted to dig into the SAS comments a little bit. You mentioned that you had made significant strides towards qualifying SAS with two customers. Are you qualified with those customers? Are you qualified on your SAS drives with any customers right now?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

So I think you know, earnings we mentioned that about 40% of our sales were expected to be SAS.

Raymond Cook - *STEC, Inc. - CFO*

That's correct. We expect about 40% of our revenue to be SAS in the fourth quarter.

Sherri Scribner - *Deutsche Bank - Analyst*

Is that drives for qualification or is that drives that are already qualified?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Those are drives that are already qualified. I think you saw one of our largest customers announce a few systems using our MLC SAS drives. Our customers in Japan are all using SAS drives. So SAS 3 gig and SAS 6 gig is becoming pretty important right now at the customer base. We only have one large customer who is using still Fibre Channel drives.

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Sherri Scribner - Deutsche Bank - Analyst

Okay. And it sounds like a lot of those qualifications, a lot of those uses are for storage applications. Is that the case or are you also seeing qualifications and uses in servers?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

No, they are all in storage applications.

Sherri Scribner - Deutsche Bank - Analyst

Okay. And is there -- with that move to 40% of your business being SAS in the fourth quarter, is there a gross margin difference or a price difference, an ASP difference?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

No, price of our SAS and Fibre Channel exactly the same.

Sherri Scribner - Deutsche Bank - Analyst

Great. Then the DRAM business was down a bit this quarter. What are your expectations for that business going forward?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

As I have mentioned many times before, on the DRAM side we look at DRAM as a pressure valve for our manufacturing. So as we see our SSD business grow our DRAM should come down. And if there is a hiccup on SSD, our DRAM business should go up. So we're just trying to balance our manufacturing lines with having that extra DRAM.

In this last quarter there was really no need to do too much DRAM, so we stayed at \$9 million. And I think DRAM will stay at that same level, \$8 million to \$10 million level on a quarterly basis.

Sherri Scribner - Deutsche Bank - Analyst

Okay. Great. Then in terms of the revenue you mentioned that you were -- in terms of the inventory you mentioned you bought some NAND in advance. Are you still making purchase agreements for NAND in advance? With NAND pricing coming down I am wondering if that might benefit you if you didn't make those purchase agreements going forward.

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

The NAND pricing for the SLC cards that we are buying currently are not going down; they are staying pretty steady still. On the MLC part, again, the part that we buy are pretty special parts and there is really no price degradation today.

We bought parts that we have committed to for 51 nanometer NAND for our Gen 2 to make sure that we have enough parts through the end of life of that product. And as we move from Gen 2 to Gen 3 we are buying 43 nanometer SLC NAND and MLC NAND.

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Sherri Scribner - Deutsche Bank - Analyst

Okay, and the build this quarter was related to the Gen 3 NAND, is that right, 43 nanometer?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

No, some of the inventory build was related to still 51 nanometer NAND.

Sherri Scribner - Deutsche Bank - Analyst

Okay, so you're still getting 51 nanometer. Okay, great, thank you.

Operator

Rajesh Ghai, ThinkEquity.

Rajesh Ghai - ThinkEquity - Analyst

Thanks and congratulations on the strong quarter. I guess wondering if you can provide us any update on competitive activity in terms of sampling or qualification that you may have seen during the quarter?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

We actually haven't seen anything new during this quarter. What we updated the market with last quarter, I think, is the last comments that we have got on that subject.

We saw some samples of customers. All we have heard that the samples might not be working at this point, so they might have been delayed a little bit until maybe Q1 of next year. But as soon as those samples start working, you could expect that 9 months to 12 months after that they will start doing production. There is really nothing else to add to that.

Rajesh Ghai - ThinkEquity - Analyst

Okay. And you mentioned that your mix is shifting to SAS 40% of your mix in Q4 is likely to be SAS. And you also mentioned that one customer was -- one large customer was still Fibre Channel. So I just wanted to understand this 40% SAS, is this all non-EMC customers or is that the way to think about that or is that spread across several OEMs?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

Well, as I mentioned, most other customers have moved to SAS already, so our MLC ZeusIOPS that we ship out is all SAS today. There was no need for Fibre Channel MLC, even though we have it available.

On customers that are outside of the United States they all use SAS. So that is -- there is no Fibre Channel activity there. There is only one large customer really that is still with Fibre Channel, and I think once we have our Gen 4 SAS parts available, we will be qualifying that particular part also at our large customer.

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Rajesh Ghai - *ThinkEquity - Analyst*

And, is it right to assume of that, given that you're going to sell 40% of your SSDs in the SAS interface, you have seen a pretty strong pickup in ZeusIOPS from your non-EMC customers this quarter, and do you expect that to continue in Q4?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Yes.

Rajesh Ghai - *ThinkEquity - Analyst*

Okay, and one last question. And can you give us some color and metrics on that, if you can, in terms of the pickup from non-EMC OEMs?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

I can't really tell you anything besides what we have already discussed. Every one of our customers has come out with a data tiering software. Because of that software their usage of SSDs has increased. And most of those systems were SAS-based so they're using more and more of SAS ZeusIOPS.

Rajesh Ghai - *ThinkEquity - Analyst*

And one last question on the guidance, on top line, at the midpoint of the guidance range you are looking at about 3% sequential growth in Q4, which is typically a pretty strong quarter for most storage OEMs, including your largest customer. So I'm just wondering, 3% Q1, Q2 growth versus your OEMs typically reporting 5% to 15% Q-on-Q growth, what is it that makes you so conservative?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

We are always conservative. There is not something that has just made as conservative. We have always been conservative, and are going to stay conservative. So we know what we can do this quarter, and those are the numbers that we put out. And if we get -- we still have two more months to go for the quarter, if we get some upside, then we can come out and beat our numbers, otherwise those are the numbers that we have right now.

Rajesh Ghai - *ThinkEquity - Analyst*

All right. Thank you so much.

Operator

Gary Mobley, Benchmark.

Gary Mobley - *Benchmark - Analyst*

Hi guys. Congratulations on a solid quarter, and especially on the gross margin. The last time you had, I guess, this high of a mix from the ZeusIOPS product, call it 69%, was the fourth quarter of last year. And since then your gross margin has come down

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about 350 basis points. So is it fair to logically imply that your gross margins for ZeusIOPS have come down by a fairly sizable margin in that timeframe?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Well, as I mentioned before, we are giving customers a discount quarter after quarter. So that discount, if it is not followed by price change in semiconductor itself, it will just have to come out either out of our cost in manufacturing or out of our gross margins. The discounts are very small. But after a while, after a year and a half, we will -- they will impact the margin by a couple of percentage points.

Continuing on we think that once we move into 33 nanometer Flash and Gen 4 our margin should begin to go up a little bit from here, because the price of that product is expected to come down more than what we are paying today and the price segmentation that we have seen over the past year and half right now in the Flash market.

Gary Mobley - *Benchmark - Analyst*

Over the long term, however, is it still your expectation that ZeusIOPS gross margins go down to the 42% level?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

No, we are still targeting ZeusIOPS margins above 45%.

Gary Mobley - *Benchmark - Analyst*

Okay, just (multiple speakers).

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Excuse me?

Gary Mobley - *Benchmark - Analyst*

I just had one additional question, really a clarification. You mentioned \$40 million in R&D spending for fiscal year 2010. I'm assuming you're talking about non-GAAP numbers there?

Raymond Cook - *STEC, Inc. - CFO*

That's correct.

Gary Mobley - *Benchmark - Analyst*

And then \$45 million non-GAAP for next year?

Raymond Cook - *STEC, Inc. - CFO*

Correct.

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Gary Mobley - Benchmark - Analyst

All right, thank you, guys.

Operator

Mike Crawford, B. Riley & Co.

Mike Crawford - B. Riley & Co. - Analyst

First, regarding the MLC Flash you use, I think, Manouch, you mentioned that it is a specialty part. Is this when you -- I think, it is referred to as enhanced MLC? And is that going to be the case with Gen 4 and beyond or will just plain old MLC ever be good enough?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

No, it is not plain old MLC. Because -- it is not the enhanced MLC, but it is definitely screened MLC, so we get rid of some of the bad blocks. So on an ongoing basis there is some extra screening that the MLC manufacturers would have to go through to produce this product.

On the enhancement part of it, our CellCare technology takes care of that. And we are able to increase the endurance of the MLC by ourselves to the controller.

Mike Crawford - B. Riley & Co. - Analyst

Okay, thank you. Then with MACH drives serving a lower tier that is maybe a bigger TAM, is this something that you think becomes larger than Zeus revenues for STEC at some point or do you think Zeus is going to be your dominant revenue driver for the next couple of years at least?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

Well, MACH -- our MACH business is growing very fast. In fact, it has grown tremendously from Q2 to Q3. And we expect the MACH to grow even further. The number of units that we ship out in MACH is much larger than what we ship in ZeusIOPS.

But, of course, the price of each MACH that we send out, the average price is about \$500 apiece versus \$3,000 to \$4,000 for the ZeusIOPS. So it makes a difference on that front. But going forward you can imagine the number of systems that could use MACH are much larger than Zeus.

Mike Crawford - B. Riley & Co. - Analyst

And then final question relates to this ZeusRAM product that I think you developed for Sun, which is within Oracle now. Can you just talk a little bit more about what the idea is with that product and what it can mean for you?

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Manouch Moshayedi - STEC, Inc. - Chairman and CEO

One of the strong suits of our Company is the fact that we've had these long-term relationships with enterprise storage players. And we definitely take their input at heart, and we build products for their systems. So periodically you'll see SSDs that we build out specifically for different systems of different companies. So that shouldn't be a surprise that we do that.

It is a specific application for one customer; however, it is applicable in multiple other applications and other customers are now becoming interested in it as well.

Mike Crawford - B. Riley & Co. - Analyst

Okay, thank you.

Operator

Gary Hsueh, Oppenheimer & Co.

Gary Hsueh - Oppenheimer & Co. - Analyst

A few quick questions here near-term oriented around Q3 for Raymond. Raymond, did I hear you right, total Flash revenue, \$71.9 million, DRAM revenue \$8 million?

Raymond Cook - STEC, Inc. - CFO

Yes, Flash was \$78.1 million and DRAM was \$8 million.

Gary Hsueh - Oppenheimer & Co. - Analyst

Oh, I'm sorry, \$78.1 million. Okay. And, Manouch, in terms of the ZeusOPS, that definitely drove the topline beat. I was wondering if you could just help finalize what your characterization of that beat is? Is it primarily with your largest OEM customer, EMC, or did you enter the incremental \$9 million I think in ZeusOPS versus your expectation for \$50 million, or was that more of a broadening in terms of your customer base?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

That was more of a broadening across three other large customers.

Gary Hsueh - Oppenheimer & Co. - Analyst

Okay, great. Then when you speak about the shift to MLC in the first quarter of 2011, Gen 3, and then later on Gen 4, can you help frame what our expectation should be for gross margin performance in 2011 based on a number of factors. One of them being quarterly ASP declines. Another being basically lower ASP, or your cost per bit for enterprise MLC. And then the other thing being maybe a little bit more complex controller on the MLC side. How does that shake out in terms of determining your gross margin performance in 2011?

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Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

I think we look at gross margin as something that is going to stay around these levels for a good period of time. Because our cost of manufacturing is going down with our Gen 4, we are able to absorb some of the degradation that we are seeing in pricing on a quarterly basis. So we expect the margins to stay pretty much where they are today.

Gary Hsueh - *Oppenheimer & Co. - Analyst*

What kind of cost mechanisms on Gen 4, because the way I have heard you describe MLC it sounds like customers definitely have a much bigger appetite for higher densities. But they are paying the same prices, and I would think that the controller technology is getting more complicated, so at the margin it seems like gross margins should continue to come down, perhaps a little bit more steeply in 2011 with MLC. Is there something I'm missing here?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

No, I don't think so. I think margins will remain the same. It might kick up a little bit, as I mentioned before, because MLC parts will drop in price. It is not going to stay constant as SLC has been. And also when we move from Gen 3 to Gen 4, move from FPGA to ASIC, there is a tremendous amount of cost that comes out of the SSD. Which obviously, we will transfer most of that to our customers, but we will balance out our margins in that as well. So we expect the margins to stay where they are. We don't see much margin degradation over time.

Gary Hsueh - *Oppenheimer & Co. - Analyst*

Okay, thanks. Good job on a good quarter.

Operator

Aaron Rakers, Stifel Nicolaus.

Aaron Rakers - *Stifel Nicolaus - Analyst*

Thanks for taking the question. First, just a point of clarification. You guys are not providing a breakdown of the Zeus first MACH product, is that correct?

Raymond Cook - *STEC, Inc. - CFO*

So, we did provide a breakdown of our Flash and DRAM, and within Flash we gave Zeus color.

Aaron Rakers - *Stifel Nicolaus - Analyst*

I'm sorry. I missed that. What was that again?

Raymond Cook - *STEC, Inc. - CFO*

We gave Flash and DRAM breakdown for our revenue. And within our Flash it provides the number.

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Aaron Rakers - *Stifel Nicolaus - Analyst*

Okay, so when I read through your Q that you guys have just published, it looks like EMC was about 52% of revenue, or about \$45 million in total revenue.

I guess for your guidance going into the December quarter are you assuming a similar type of contribution or would you anticipate kind of the typical kind of Q4 uptick from that major customer?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

We are not going to discuss one customer's sales here. So we are not -- we can't give you any color on that.

Aaron Rakers - *Stifel Nicolaus - Analyst*

Okay, fair enough. Then, also, outside of those customers, I think last quarter you guys had a contribution of something like 14% from other -- another customer. And now you are saying only one customer was north of 10%. That would intrinsically imply that one of the other customers wasn't as material as a contributor in this last quarter.

How would you characterize the ramp of your new, bigger customers, i.e., some of -- not to name specific names, but some of the larger systems vendors?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Yes, again, I mentioned this last quarter. All of these customers moved up from \$2 million to \$5 million. They are in the \$8 million to \$10 million range. And they will probably get into the teens in the next quarter. So they are ramping up pretty nicely by themselves. They might not be a huge number as a percentage of our sales today, but they are growing quite significantly as a customer percentagewise.

Aaron Rakers - *Stifel Nicolaus - Analyst*

And then final question for me is, where are you guys at as far as the transition to the ASIC-based product?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

As I mentioned again, Q1 of next year we will send out the qualification samples to our customers, and we expect to get qualified by the end of the year or maximum by Q1 of 2012.

Aaron Rakers - *Stifel Nicolaus - Analyst*

Okay, thank you, guys.

Operator

Richard Shannon, Northern Capital.

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Richard Shannon - Northland Capital - Analyst

I guess first question for me, Manouch, I think you mentioned -- you said a customer is going to move to virtually 100% MLC-based SSDs sometime early next year. How do you view this customer? Are they a Tier 1 or a little bit lower tier customer? And do you think there is any breadth to that trend, i.e. do you think any other vendors will move substantially in that direction any time soon?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

So, Richard, this customer is a very, very large customer. He is our second largest customer. He announced a few systems just a couple of weeks ago using our SAS MLC ZeusIOPS. So there is really no mystery to who this customer is. And we think that once they deploy their data tiering software into these systems at the end of this year, I think their usage of MLC ZeusIOPS will grow significantly.

The rest of the customers, frankly, are waiting for a Gen 4 MLC to come up. They were a little bit late in the qualification of MLCs this year. So if they start qualifying now it will coincide with the introduction of our Gen 4 MLC. And it is basically useless type of a time to spend on that, because within the next six months we will be shipping out our MLC Gen 4.

So that is -- so basically one or two customers are the ones that are using our ZeusIOPS Gen 3 in MLC parts today.

Richard Shannon - Northland Capital - Analyst

Great. A second question for me. Fibre Channel on Zeus, as you talked about the increase in the SAS interface in this quarter, where do you think your Fibre Channel sits as a percentage of your Zeus revenues as you exit like next year, for instance? Is that something that gets close to zero or will it trail off a little bit longer than that?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

Yes, I think it will trail off. Our initial indications from our customer who is using it is that up to about 2015, 2016, they would still support the Fibre Channel type of SSDs. However, coming out of 2011 I think that most of the customers would have already transitioned to SAS, and maybe 60% of our business would be where we are at on SAS.

Richard Shannon - Northland Capital - Analyst

Manouch, can you update us on where you are with the PCI Express product? I think you're qualifying now. What is the latest update, and when do you expect that to ramp?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

So PCI Express will come out at the end of Q1 to mid-Q2. And that is when we expect it to be sent out as qual samples to customers. The qual uses the same controller as our Gen 4 product.

Richard Shannon - Northland Capital - Analyst

Okay, great. Then the last question from me. Manouch, I think there is -- you were awarded a patent not too long ago. I am kind of curious about the breadth of that patent and what you intend to use it for. Will that be something that you extract licensing or what is the importance of that for STEC?

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Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Well, first of all, this is not the only patent we have. We have a list of patents. In fact, our Investor presentation, if you go to our website to our Investor Relations website and go to Presentations, on one of the pages you will see a list of patents that are related to our SSD products.

So it is not just one. I think it is 21 patents that now we have been granted. Just for SSDs there is about 52 more patents that are filed and should be issued in the next year or two.

So again, one patent, obviously, it came out and made some noise, but there is 21 of them out there. That just to show you how long we have been in this SSD business and how much -- how deep our technology goes and how difficult it is to get there if you are trying to bypass all of our patents.

Richard Shannon - *Northland Capital - Analyst*

Okay, but that particular patent that came out just recently, it was not over -- more broad than all the other ones that you have been awarded thus far then?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Well, we've got pretty good patents in that list of 21.

Richard Shannon - *Northland Capital - Analyst*

Okay, great. I appreciate the thoughts, Manouch. Thanks.

Operator

Nehal Chokshi, Technology Insight.

Nehal Chokshi - *Technology Insight - Analyst*

Thanks for taking my question and good quarter, good guidance. What do you think -- do you have any visibility into what your SAS SSD marketshare is going to be in the fourth quarter? Have your customers given you an indication as to -- are you 100% or are you first source 60%, 70%, any thoughts there?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

Marketshare versus hard drives or marketshare versus other SSDs?

Nehal Chokshi - *Technology Insight - Analyst*

Versus other SSDs within the customers that you'll be shipping those SAS SSDs to.

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Manouch Moshayedi - STEC, Inc. - Chairman and CEO

They are 100% marketshare.

Nehal Chokshi - Technology Insight - Analyst

It will be 100%, okay. All right. Then do you have any visibility -- do you have any better visibility into your customers, especially your biggest customers' inventory relative to a year ago?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

We can't see their inventory. But we basically we try to give all kinds of incentives to our customers not to buy in advance, and give us orders -- just in time type orders so we can build it for them just in time.

We would not like to see our customers have any inventory on the shelf. And we would like to see them basically have us ship our SSDs directly to a manufacturing facility, for them to be able to just build it right there and then ship it out to their customers.

There is really no need for our customers to order any parts in advance. We've got plenty of inventory of components and a good amount of capacity. And having our customers keep inventory is just not very productive and efficient for them.

And especially with the incentives that we are giving them not to buy during the current quarter if they don't need it, I think most of the customers have finally gotten the message, and everybody is just buying when they need the parts. And that is how we go forward on the inventory. But there is really no visibility that we can say for sure 100% no one has got too little or too much inventory.

Nehal Chokshi - Technology Insight - Analyst

It sounds like you have implemented new mechanisms to incentivize your customers to make sure they don't carry too much inventory relative to a year ago.

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

That's true.

Nehal Chokshi - Technology Insight - Analyst

Okay, all right. Very good. Then last question for me is that one of your customers has announced midrange arrays with SATA-based SSDs -- midrange storage arrays. So first, do you guys have Zeus on a SATA interface? And secondly, if so, what is the type of demand that you're seeing there?

Manouch Moshayedi - STEC, Inc. - Chairman and CEO

That is a Flash cache application. It is not in a data storage application right now. And we don't see it as a competitive type of a product to our ZeusIOPS today.

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Nehal Chokshi - *Technology Insight - Analyst*

Okay, all right. Thank you.

Operator

Chuck Griega, Blue Lion Capital.

Chuck Griega - *Blue Lion Capital - Analyst*

I am just curious if you could talk a little bit about your inventory build sequentially, and how we should be thinking about it for the fourth quarter and then into 2011?

Manouch Moshayedi - *STEC, Inc. - Chairman and CEO*

As you know, we have -- we are moving from our Gen 2 products to our Gen 3 products. Our Gen 2 uses a 51 nanometer component and our Gen 3 uses a 43 nanometer component.

Because some of the customers still have got Gen 2 demand, we have purchased 51 nanometer parts to last us until that part becomes completely end-of-life. That is why you see a bubble in our inventory today. We expect that inventory to normalize by the end of Q1 when we think that our Gen 2 sales will go down to very negligible amounts.

Chuck Griega - *Blue Lion Capital - Analyst*

Okay. Then just a quick -- if you could maybe shed a little more insight into the tax rate. Tax rate for the year in the 14% range, is that what you said?

Raymond Cook - *STEC, Inc. - CFO*

Yes, we are estimating our consolidated 2010 effective tax rate to be about 14%. Which is lower than what we had anticipated earlier, but it is primarily due to the mix of our revenues and sales that are occurring inside the United States versus internationally.

Chuck Griega - *Blue Lion Capital - Analyst*

Do you think that tax rate can be maintained next year?

Raymond Cook - *STEC, Inc. - CFO*

It will depend upon the mix between the international and the domestic sales. I think what we have stated previously is that we would anticipate it would be sub 20%.

Chuck Griega - *Blue Lion Capital - Analyst*

Okay, thank you.

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Operator

I am not showing any further questions at this time. Please continue with any closing remarks.

Mitch Gellman - STEC, Inc. - VP, IR

Okay, thank you. This is Mitch. I would just like to thank you for joining us today. Please keep in mind if you're going to be attending any of the conferences, the three that I mentioned, in the next three to four weeks, look forward to seeing you there.

And please pay attention to our calendar events, as we have other invitations coming up in December and we would like you to have the opportunity to join us there as well. Thanks again.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Thank you and have a great day.

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