

# FINAL TRANSCRIPT

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## **STEC - Q1 2011 STEC Inc Earnings Conference Call**

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## CORPORATE PARTICIPANTS

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*STEC, Inc. - VP of IR*

**Raymond Cook**  
*STEC, Inc. - CFO*

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

## CONFERENCE CALL PARTICIPANTS

**Rajesh Ghai**  
*ThinkEquity LLC - Analyst*

**Sherri Scribner**  
*Deutsche Bank - Analyst*

**Rich Kugele**  
*Needham & Company - Analyst*

**Gary Mobley**  
*The Benchmark Company - Analyst*

**Brian Marshall**  
*Gleacher & Company - Analyst*

**Aaron Rakers**  
*Stifel Nicolaus - Analyst*

**Mike Crawford**  
*B. Riley & Co. - Analyst*

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*Technology Insights Research - Analyst*

**Alex Kurtz**  
*Sterne, Agee & Leach, Inc. - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen. Welcome to the STEC, Inc. Q1 2011 earnings call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions). As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mitch Gellman. You may begin.

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

Thank you. Good day, everyone. Thanks for joining us today to discuss our results for the first quarter of 2011. We hope that you had an opportunity to read this afternoon's news release describing our results for the first quarter of 2011 and we look forward to discussing with you these results, as well as our outlook for the second quarter of 2011.

For those of you who are planning on attending the Benchmark Company's 2011 one-on-one investor conference to be held in Milwaukee next week, we will participate in the conference and that will be on Thursday, May 12. Then on Tuesday, May 19,

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we present at the JPMorgan Technology, Media, and Telecom conference and that conference will be held in Boston. And then on Thursday, May 25, we will present at the 12th annual B. Riley & Co. investor conference and that will be held in Santa Monica, California.

Joining me for today's discussion and Q&A session are Manouch Moshayedi, our Chairman and CEO, and Raymond Cook, our Chief Financial Officer.

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 growing acceptance, adoption, and qualification of SSDs within the enterprise markets, anticipated postponement or reduction of sales due to the impact of the recent earthquake and tsunami in Japan on some of STEC's customers, expect the cost advantages, the benefits from CellCare, and other developing technologies, the capabilities and performance of STEC's products, the rapidly evolving storage industry and expected second-quarter 2011 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. Please see the reconciliations with 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 our CFO, Raymond Cook.

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**Raymond Cook** - STEC, Inc. - CFO

Thank you, Mitch, and welcome, everyone. Net revenue for our first quarter of 2011 was \$94.9 million. We've surpassed our guidance of \$90 million to \$92 million for the quarter. Net revenue by major product categories was as follows -- Flash-related products accounted for \$89.8 million or 95% of total revenue, DRAM-related products accounted for \$4.2 million or 4% of total revenue, and service revenue was \$940,000 or 1% of total revenue.

The Flash-related revenue was comprised of ZeusIOPS of \$69.4 million, MACH products of \$13.4 million and embedded SSDs of \$7 million. International sales comprised 67% of our total revenues in the first quarter of 2011.

For the first quarter of 2011, our GAAP gross profit margin was 42.4% and our non-GAAP gross profit margin was 42.5%. This decline in gross profit margin from Q4 2010 was primarily attributable to the [last time buy] of Flash for our gen 2 ZeusIOPS product. We anticipate that our gross profit margins will increase this quarter post the end-of-life of our gen 2 ZeusIOPS product.

Our Q1 2011 GAAP sales and marketing expense was \$5.7 million, GAAP general and administrative spending was \$7.4 million, and GAAP research and development spending was \$12.0 million. Total GAAP operating expense for the first quarter of 2011 was \$25.1 million and non-GAAP operating expenses was \$22.4 million.

Our non-GAAP results for the first quarter of 2011 excluded stock option compensation expense of \$2.8 million. The non-GAAP adjustments are detailed in our first quarter of 2011 earnings release that was issued earlier today.



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Our provision for income taxes was booked in an effective tax rate of approximately 6.6% for the quarter ended March 31, 2011. Our GAAP diluted earnings per share was \$0.27 for the first quarter of 2011. Our non-GAAP diluted earnings per share was \$0.32 for the first quarter of 2011, which was in line with our non-GAAP earnings-per-share guidance of \$0.32 to \$0.34.

From a balance sheet perspective, the following are select accounts of interest for the first quarter of 2011. Cash and cash equivalents increased \$20.4 million from Q4 of 2010 to \$190.8 million, accounts receivable decreased \$7.0 million from the end of December 2010 to \$40.8 million. Net inventory decreased \$7.3 million quarter over quarter to \$81.7 million. Capital expenditures were \$2.2 million for the quarter, offset by \$3.0 million in depreciation and amortization.

Current liabilities decreased \$13.7 million for the quarter to \$25.6 million and the Company had no long-term debt outstanding as of March 31, 2011. Net cash provided by operating activities for the three months ended March 31, 2011 was \$18.9 million.

During the second quarter of 2011, we are anticipating to begin construction of a new facility on the second half of our 10-acre lot in Penang, Malaysia. This new 210,000 square foot facility will be directly attached to our current 210,000 square foot facility and will allow us to significantly increase our manufacturing capabilities. We are estimating that the construction will take approximately six quarters at an estimated cost of approximately \$20 million.

Turning now to guidance for the second quarter of 2011, we expect our revenues to be in the range of \$80 million to \$90 million with non-GAAP diluted earnings per share to range from \$0.21 to \$0.30.

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.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions). Rajesh Ghai of ThinkEquity. Your line is open.

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### Rajesh Ghai - ThinkEquity LLC - Analyst

Thanks. Obviously the first question that comes to mind is the guidance, the revenue guidance. You mentioned that you've had, you believe you expect some customers to see an impact in terms of their supply chains as a result of Japan. I'm just wondering the disconnect is that none of the larger OEMs seem to have guided down on their revenue, but you seem to be doing that and can you explain why you expect the orders to come down for the next quarter?

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

The total amount in flux is about 3,000 units of ZeusIOPS which could be pretty insignificant for the users of these parts so you might not have seen any impact in terms of revenue, or at least a big impact in terms of revenue to our large customers. However, a couple of our customers have been impacted by a shortage of material in -- from Japan and they are -- if they don't receive these parts in time, they will delay the shipments of their systems to next quarter and, as a result, because we try to be a just-in-time supplier to them, we will ship the products of them next quarter.

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### Rajesh Ghai - ThinkEquity LLC - Analyst

So this is broad-based across several OEMs? Are you going to see at least a couple of OEMs being impacted by this -- by these supply-chain issues?

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

So, it all depends on the amount of inventory that they've had on their own stock at this moment. If they have a longer term amount of inventory, obviously they are less impacted or they might not even be impacted. A couple of the customers who have got much more of a just-in-time type of a inventory method, they have become impacted. And this is only from a couple of customers.

**Rajesh Ghai** - ThinkEquity LLC - Analyst

And you don't think it has anything to do with competitive issues with someone else taking market share away this quarter?

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

Those customers in fact use a single source.

**Rajesh Ghai** - ThinkEquity LLC - Analyst

A single source. Okay. And on the gross margin, Raymond, you mentioned that it was an impact of the gen 2 end-of-life. Was this something that you had anticipated in the past or is it something that you're not going to [fast come] as a surprise to you?

**Raymond Cook** - STEC, Inc. - CFO

We've talked. We've actually talked about this even in the last quarterly call that our margins with gen 2 would be affected until we run out of that product line. Which, at this point, we are and we are shipping gen 3, which has improved our margins again. So that was because of a couple of factors. One was the fact that -- the very first one was that for last-time buyer, the chips that we had to buy to provide to our customers, the remaining gen 2 products was higher-priced than previously we had contracted.

Number two was the fact that we sold about \$4 million less of ZeusIOPS in Q1 than we did in Q4 of last year. And that's about it.

**Rajesh Ghai** - ThinkEquity LLC - Analyst

Okay and it has nothing to do with the product mix because I noticed that ZeusIOPS has declined Q on Q and done the revenue.

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

That's what I said. That -- it's a small impact of it, of course, comes from the fact that I think we shipped about \$4 million or \$4.5 million less of ZeusIOPS in Q1 of 2011 than we did in Q4 of 2010. So that had a small amount of impact, but I think the biggest impact was the fact that we paid a little bit higher price for the Flash to fulfill the last orders of gen 2.

**Rajesh Ghai** - ThinkEquity LLC - Analyst

All right. Thank you.



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**Operator**

Sherri Scribner of Deutsche Bank. Your line is open.

**Sherri Scribner** - *Deutsche Bank - Analyst*

Thank you. I just wanted to delve a little bit more into the gross margin question. Approximately how much of the buy was related to buying Flash for the gen 2 product? How much of that was an impact to gross margins?

Also, just looking at the inventory, I'm a little confused because inventory actually went down. So I'm trying to understand how did inventory go down if you had to buy a bunch of Flash upfront during the quarter?

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

So some of the Flash that we shipped last quarter we already had in inventory and some of it we had to buy to fulfill all the orders. As you know, forecasting is not an exact science and we bought enough parts that we thought were going to be enough for us about five quarters ago, and we ended up having to buy some more parts to fulfill all the orders. So that's why.

And we see the inventory going down because we are now completely out of all the components that build gen 2 products.

**Sherri Scribner** - *Deutsche Bank - Analyst*

Okay, so in terms of the impact to gross margins during the quarter, how much of that was related to inventory?

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

Probably about \$4 million of ZeusIOPS, obviously, had some impact. But I would say probably 60% to 70% of the impact of that extra 1.5% that we took off in the gross margin had to do with the higher price of inventory.

**Sherri Scribner** - *Deutsche Bank - Analyst*

Okay. 60% to 70% was related to the higher price and about \$4 million was related to just buying inventory? Am I understanding that right -- (multiple speakers)?

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

No, \$4 million was related to lower amount of ZeusIOPS.

**Raymond Cook** - *STEC, Inc. - CFO*

\$5 million, \$5.5 million.

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

\$5.5 million.

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**Sherri Scribner** - Deutsche Bank - Analyst

Okay. And then in terms of the embedded product, that seems to be a new piece of revenue that you haven't had in the past. I know way back in the past you did have embedded, but what is that product and what are you shipping that for, and what are your expectations for that going forward?

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

That's the same as what we have been shipping. This now includes slim SATA and other types of SSDs that get embedded into mostly networking and industrial type of applications. We have been doing this business for a long time, but as mentioned -- as Raymond mentioned in his remarks, we are now separating the revenue because there seem to have been some confusion and/or some need for granularity on our numbers.

So we decided that, going forward, we were going to separate out the ZeusIOPS, MACH8 IOPS, embedded SSDs and whatever we have got in DRAM left which is about \$4 million this quarter.

**Sherri Scribner** - Deutsche Bank - Analyst

So was the embedded in sort of everything that wasn't Zeus before or was it a DRAM? I guess I'm confused.

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

No, no. There was no -- there is no DRAM in that embedded. Embedded is just all SSDs. It comes in all different forms and form factors and they go into industrial applications. So at that before we used to have ZeusIOPS and then we had other Flash and embedded was part of that other Flash.

**Sherri Scribner** - Deutsche Bank - Analyst

Okay. And then just looking at the Zeus revenue being down, I guess I'm a little surprised that you saw a 7% decline in the Zeus business sequentially. Is that related to competition or are there other things going on there?

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

Well, some of it has had to do with the fact that we transitioned from gen 2 to gen 3. So when we go through these types of transitions, some parts come out of the laboratories of our customers and get shipped as production.

So any sort of the revenue increase as we would have expected could be taken over by the fact that these inventories or parts were sitting all over the customers' labs in different systems in-house. And then they were collected at the last minute to be shipped for production. So that's, I think, a basic function of when we go through these types of transitions from one generation to the next generation.

**Sherri Scribner** - Deutsche Bank - Analyst

Okay. Thank you.

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

Thank you, Sherri.

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**Operator**

Rich Kugele of Needham & Company.

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**Rich Kugele** - Needham & Company - Analyst

Thank you. Good afternoon, gentlemen. Just a couple of questions. I guess first, Raymond, you talk about the gross margin recovering in the second quarter as you shift, I guess, more to gen 3 Zeus and you don't have that last buy of Flash. Can you just talk about how much you would expect gross margins to recover?

And then secondly, just in terms of trajectory of gross margins, especially in the second half of the year, after you moved to the ASIC, you talked about cost savings. Can you just talk about how much we should anticipate and perhaps what your long-term gross margin targets are?

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

I think that we will recover margins back to the 44% to 45% range in Q2 due to the fact that now we are again shipping a contracted type of price Flash. And the ASIC shipments will only come into play once the part is qualified which is not expected to get qualification before Q1 of 2012. So it would not have any positive impact on us.

As we move forward, as you saw, our MACH business also has grown and we are expecting it to grow even further. That product line is being shipped at a lower margin than our ZeusIOPS and the go forward gross margins will highly depend on the growth of that product line versus our Zeus. And if Zeus grows faster than MACH product, then we should expect similar type of 45% -- 44% to 45% margin. However, if MACH product grows faster, then we should expect lower than 45% margin.

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**Rich Kugele** - Needham & Company - Analyst

Okay, that's helpful. And then obviously, following up on EMC's press release yesterday, they seem to be more endorsing the PCIe angle, not necessarily in place of but certainly in addition to more than they've talked about in the past. You have one coming out later this year.

How would you expect that product to represent as a percentage of your mix over time and how would that factor into the margin commentary you just provided?

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

I think PCIe will be a good impact, for the type of product for us going forward. Again, that product will be introduced as samples to our customers in the next couple of quarters and we would think that the PCIe margin structure would be very similar to our ZeusIOPS. So in the 45% to 50% range margin as we go forward.

But, again, as we have spoken many times in the past, as the volumes go up and revenue increases, there would be some margin pressure overall. But we are trying to make sure that we at least keep a 40% plus margin as a result. We have basically set our gross margin goal at 40% on a long-term basis.

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And that's why we are expecting a huge demand coming in in 2012 and that is why we are already planning to build our second facility in Malaysia at a future period in time for when the growth comes.

**Rich Kugele** - *Needham & Company - Analyst*

Okay. Thanks very much.

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

Thanks a lot, Rich.

**Operator**

Gary Mobley of Benchmark.

**Gary Mobley** - *The Benchmark Company - Analyst*

Just a follow-up on your last comment regarding your newly planned facility. What was the utilization rate for the existing facility? And, Raymond, how would you anticipate the expenses associated with the new facility to be handled up? What percent would be capitalized, what percent would be expensed?

**Raymond Cook** - *STEC, Inc. - CFO*

The new facility that we are going to build will mirror the old one that we have. It will be about 210,000 square feet. We're estimating that it will cost somewhere in the \$18 million to \$20 million range to build out that facility and it will take about a year and a half to have it complete.

In our current facility that we have, our capacity is about 120,000 units a quarter, but that again is running at full capacity 24/7. We are currently running it at one shift to meet demands and moving to a second shift when required. It will significantly increase our overall capacity.

**Gary Mobley** - *The Benchmark Company - Analyst*

And the expenses, I would assume the bulk of the \$18 million to \$20 million would be capitalized but you will have some ramp up cost probably in, what, the 2012 timeframe?

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

No, mostly capitalized.

**Raymond Cook** - *STEC, Inc. - CFO*

Yes, no, the comps will be capitalized. It will be for the actual facility for life.



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**Gary Mobley** - *The Benchmark Company - Analyst*

All right and I had some questions regarding your recent acquisition of KQ. Should we just assume that the additional operating expenses there will be somewhat minimal with the addition of 30 employees? And then, as well, maybe if you can talk about some of the benefits of KQ.

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

Yes. There should be a minimal impact to our costs and these are -- the reason why we acquired this company was that we had an ongoing software development division here at STEC with about 10 engineers for the past year also. And then we thought adding 33 more engineers would be very helpful to provide a much faster time to production.

The product that we are building is basically a software that could go along -- is a data management software that could go along with our SSDs for server environments to make sure that when servers or server OEMs ask for SSD, we can show them how SSDs can actually improve their performance and the cost basis. Up to this point there is no such a thing in the server markets. So someone has to come up and provide that software and since we are a SSD company and it impacts us most, we started working on this.

**Gary Mobley** - *The Benchmark Company - Analyst*

That's it for me. Thanks.

**Operator**

Brian Marshall of Gleacher & Company.

**Brian Marshall** - *Gleacher & Company - Analyst*

Thanks for taking my question. I would like to go back to guidance. So if we are talking about 3,000 drives here, roughly \$3,000 ASP, we are kind of talking about \$10 million. So if we exclude this one-time impact of the Japan tragedy, is it safe to assume that guidance for June again without this would be \$90 million to \$100 million?

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

For the June quarter? You mean the third quarter?

**Brian Marshall** - *Gleacher & Company - Analyst*

Yes, correct. The quarter that we are guiding for.

**Raymond Cook** - *STEC, Inc. - CFO*

That's the second quarter. What we're showing in our guidance for the second quarter is if the 3,000 Zeus drives do not materialize.

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**Brian Marshall** - *Gleacher & Company - Analyst*

Yes, so basically what I'm looking at is this where it says \$3,000 -- call it \$3,200 ASP per drives. 3,000 units, that's about \$10 million. So if Japan didn't happen, and we add that back to the guidance (multiple speakers) \$80 million to \$90 million. Yes would the guidance in reality be \$90 million to \$100 million without this Japan impact?

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

Well, it could have been very similar to our Q1 numbers if there was no Japan impact.

**Brian Marshall** - *Gleacher & Company - Analyst*

Okay, so that implies \$90 million to \$100 million without Japan. All right. So I guess if that's the case is it logical to assume -- I know you are not guiding for Q3, the September quarter, but if there is a return to normalcy and we don't have any more Japan situations out there, is it logical to assume that we would have a pretty big bounceback then?

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

What?

**Raymond Cook** - *STEC, Inc. - CFO*

Bounceback.

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

Bounceback, yes. It should be. It should be actually obviously once the impact of the product shortages.

**Brian Marshall** - *Gleacher & Company - Analyst*

And can you give a little bit of granularity on your top 3 OEM customers relative to unit shipments from December of 2010 to March of 2011, please?

**Raymond Cook** - *STEC, Inc. - CFO*

We don't break out that kind of color. We talk about our customers, our A, B and C customers.

**Brian Marshall** - *Gleacher & Company - Analyst*

Yes. That's fine. Did A, B and C all decline sequentially?

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

No.

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**Raymond Cook** - *STEC, Inc. - CFO*

No.

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

Actually, the numbers [inaudible].

**Brian Marshall** - *Gleacher & Company - Analyst*

Okay, I'll go to my next question then. Now coming across one individual example of one of your OEMs, basically selling low-end SATA-based SSDs with sort of a Fibre Channel interface chip to get the Fibre Channel SSD status, but very low performance. How do customers ensure that OEMs are actually delivering SSD performance that they are paying for and they are not getting low performance that's masked by Fibre Channel interface technology?

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

We are going out there and trying to educate the end customers on what they are getting when they are buying any of these systems. And the customer has been doing what you just mentioned, other customers are going out there and talking to (technical difficulties).

**Brian Marshall** - *Gleacher & Company - Analyst*

Hello?

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

-- is ongoing right now to the end user customers to make sure that they have my name.

(technical difficulties)

**Brian Marshall** - *Gleacher & Company - Analyst*

Hello?

**Operator**

Aaron Rakers of Stifel Nicolaus. Your line is open.

**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Can you hear me okay?

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

Yes, Aaron.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Sorry. There must have been some background on that prior one. Yes, a couple of product questions if I can. So EMC, I want to go back to their announcements from yesterday. EMC noting that they would have an MLC-based offering exiting this year.

I think your prior comment was that you would expect to see your gen 4 product, the ASIC-based solution, driving the MLC adoption, but that looks to basically materialize in 2012. So the question is as EMC pushes here, do you expect that to be someone else's competitive offering as far as EMC's initial MLC product?

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

There is no one else out there that has MLC that works in those systems. So the EMC product that they are talking about is in line with what we are offering in our gen 4. So if the qualification is done at the end of this year, then they can ship it at the end of this year. If it happens at Q1 of 2012, it happens at Q1 of 2012. That's the only enterprise-grade SSD out there with MLC today.

**Aaron Rakers** - *Stifel Nicolaus - Analyst*

So if EMC makes an announcement in the third quarter, basically your thought is is that EMC's announcement is more of a Q4 or 1Q event, basically.

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

Again, I can't talk for EMC or for any other customers, but depending on what systems they are putting it in and what type of criteria they have for MLC today, there's hundreds of different MLC SSDs out there.

But whether or not they work 10 times a day or you can write 10 times a day to them for five years in a row, that's the criteria that we are talking about when we say we can get MLC to work in enterprise. In many occasions, we have seen that customers have been able to use lower grade SSDs in their systems and still sell it to their customers.

So any announcements from anybody that comes out could be something that has been worked and they can use their lower grade product at that point. But when we talk about MLC products working, we are talking about MLC product that you can write to 10 times a day for five years in a row.

**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Fair enough. And then on the PCIe offering, your comment was that you would expect over the next couple of quarters to start shipping that in the sample qualification units. I think last quarter you had mentioned that that would start shipping this next quarter and my understanding was maybe implying June quarter shipments to sample qualifications.

Has that changed? Has the timeline of that changed at all with regard to the PCIe offering?

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

Yes, it has changed. We are shipping our PCIe product in the third quarter of this year.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Third quarter. Fair enough. And then the final question for me, I'm looking at the revenue contributions and the one thing that stands out is the MACH8 or MACH8 product. Obviously a \$13.4 million jump quite a bit.

Can you talk about what is going on in that product family and how we should think about that business trajectory going forward, I guess, tying in the MACH16 product as well?

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

Yes, we think that actually MACH16 would be a very successful product once it is qualified across the board with our customers. And as you've seen, there's a lot of usage of a SATA 3 gig SSD out there by OEMs who are able to use that type of a lower IOP type of product (inaudible). So we think that a MACH16 type product would be quite successful.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

And that timeframe is qualification-wise is when again?

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

We have sent out samples of it, so any -- within the next couple of quarters we should have qualifications done at customers.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Thank you.

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**Operator**

Mike Crawford of B. Riley & Co. Your line is open.

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**Mike Crawford** - *B. Riley & Co. - Analyst*

Thank you. Could you provide the total use -- ZeusIOPS drive units shipped in the quarter?

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

Total Zeus, I think it was between 20,000 and 25,000 units.

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**Mike Crawford** - *B. Riley & Co. - Analyst*

And what about total SSDs?

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

And total SSDs I don't have but total MACH8 was also I think between 20,000 and 25,000 units.

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**Raymond Cook** - STEC, Inc. - CFO

It was 27,000 for the MACH8, for the MACH family.

**Mike Crawford** - B. Riley & Co. - Analyst

Okay. Thank you, and then with the PCIe product, is that going to be with MLC and CellCare or are you going to offer that with SLC as well?

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

We will offer it in both configuration.

**Mike Crawford** - B. Riley & Co. - Analyst

Okay. And regarding Malaysia, so predominantly, you are operating at one shift now, but I guess if, since you've mentioned that MACH is expected to ramp, does that mean you are expecting to be moving towards more of two shifts in the latter half of this year?

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

We will ramp up as needed, but basically as we move forward we have to assess what the demand is from customers. But we think that MACH8 product as you saw 25,000 units or 27,000 units this quarter, our capacity today in Malaysia is somewhere around I think 120,000, 140,000 units per quarter in SSDs. We are right now basically building somewhere around 50,000 units per quarter.

So we still have quite a long way to go before we have full capacity in Malaysia. However, we are forecasting a very large amount of growth coming in, in 2012 and we are trying to prepare ourselves in advance of that time.

**Mike Crawford** - B. Riley & Co. - Analyst

And then with the PCIe product using the Flash-based server cache, with the software solutions, how quickly can you incorporate projects that KQI has been working on? And I think you've also had a small team of engineers here in California working on into -- into your products including the PCI Express.

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

I think the first product that will ship with the solution at our software group that is coming out will be in 2012. So we still have about a year to go before we actually have a mature enough product to sample to customers.

**Mike Crawford** - B. Riley & Co. - Analyst

Thanks. The final question relates to what is likely to be featured in -- and is that what you would call a gen 5 drive then or --?

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

That could -- that could ship in all of our gen 4 as well. Once the software is available we could integrate it into our gen 4 as well.

**Mike Crawford** - B. Riley & Co. - Analyst

Okay. Thank you.

**Operator**

Nehal Chokshi of Technology Research. Your line is open.

**Nehal Chokshi** - Technology Insights Research - Analyst

I want to go back to Brian Marshall's question real quickly. Typically your guidance has had a spread of \$2 million not \$10 million. So I'd actually think that that \$10 million spread actually represents the uncertainty and not that it would be \$90 million to \$100 million if there wasn't this uncertainty.

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

Yes, so the \$10 million, I think we explained it on our press release as well that the \$10 million or the larger than expected gap between the low-end and high-end of our numbers has specifically to do with shortage of components in some of our customers. Now if there was no earthquake and there was no shortage, obviously we would be guiding about \$90 million at this time.

**Nehal Chokshi** - Technology Insights Research - Analyst

Okay but it wouldn't be as large of a range though. It wouldn't be \$90 million or \$100 million because that's not typical practice.

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

No. We would be probably within a \$2 million range like we always did.

**Nehal Chokshi** - Technology Insights Research - Analyst

Right. Very good. And then so the \$90 million to \$92 million, if not the supply disruption, it would still be down slightly Q over Q total which would -- you know how would ZeusOPS have played out then? Would that have still been down Q over Q or would you have expected that to be flat and there are other components within sets mix that would've been more down?

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

We come out to be a little conservative on numbers every time that we do an announcement. You know. this last quarter we announced \$92 million to \$94 million and or \$90 million to \$92 million and we were above it. So the guidance probably would have been 90 -- say, similar or flat to Q1, \$90 million to \$92 million gross.

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**Nehal Chokshi** - *Technology Insights Research - Analyst*

Okay. All right and then gen 3 as a percent of Zeus revenue in Q1. What was that?

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

Gen 3 in Q1. I don't think we have broken it out that way.

**Nehal Chokshi** - *Technology Insights Research - Analyst*

Well, let me ask the question differently. IBM was shipping out mostly in December quarter. Is there any other OEM that is shipping MLC now with your drives?

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

IBM is the only company today that buys gen 3 MLC. We actually don't have the capacity to build gen 3 MLC for any other large customers.

**Nehal Chokshi** - *Technology Insights Research - Analyst*

I also want to get your thoughts on EMC's announcement that they plan to create an all Flash array at some point in the future. Do you guys see this thing as a good thing for STEC? More specifically, do you definitely believe that STEC can get into this opportunity? Or do you think that they are trying to create their own controllers here?

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

I don't think EMC is trying to create their own controllers. But I see this as an extremely positive type of event and it goes along with our discussions from last quarter that we think that 2012 and beyond will see a huge upswing in revenue of SSDs as a whole. Because what EMC announced yesterday, it tells you that not only all current Fibre Channel SAS and SATA drives that are being sold, hard drives that are being sold today in the enterprise market, not only they are susceptible to a change to all SSDs, but new applications are coming out such as what EMC announced yesterday that will even take that further.

So I see the amount of SSDs as a whole that are going to be used in enterprise for replacement of hard drives which will be higher than the existing hard drive market. And I think as most of our customers go forward and see really the benefit of SSDs and how fast they perform and how power-efficient they are, I think that will prompt everyone to start designing systems that use more and more SSDs and design systems that are just purely based on SSDs.

So it was an extremely positive press release from EMC or announcement from EMC. And I think that others will definitely follow suit and it will definitely all lead to much higher amount of SSDs as we move forward.

**Nehal Chokshi** - *Technology Insights Research - Analyst*

Okay, my final question is that can you talk a little bit more about this data management software for the server environment. You said that is unique that STEC is the only one creating it, but Fusion-io appears to be beta'ing a direct cache software. So is this supposed to incorporate that capability plus something more? Or is it just something completely different?



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

I would say basically that capability plus something more. So obviously once the product comes out then we can put out the specifications of it. But we're trying to do what our customers demand that SSDs show in their systems once they are fully implemented. So everything that we're doing today and we've always done in the past is based on customer input and seeing what is the real need out there.

**Nehal Chokshi** - Technology Insights Research - Analyst

Thank you very much.

**Operator**

Alex Kurtz of Sterne, Agee. Your line is open.

**Alex Kurtz** - Sterne, Agee & Leach, Inc. - Analyst

Thanks for taking the question. Back on the topic of EMC, you know, as you look at V-Max last quarter, by my estimation that product grew sequentially into the March quarter. They had some very strong uptake in some new software they released. And if I sort through an adjustment based on this NAND impact of about \$9 million to \$10 million that's been spoken about earlier, maybe it would've been in the high 70s, but not the same kind of growth rate that EMC saw sequentially.

Is it possible that EMC is building inventory of your drives? Can you sort of give us a reset on sort of what that relationship looks like from an inventory perspective?

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

I doubt that they're building any inventory of our drives whatsoever. We are basically shipping them parts on a just-in-time basis and there's no need why any party, any of our customers today buy parts in advance in inventory. So I don't think that there is any inventory at any of our customers at this point.

**Alex Kurtz** - Sterne, Agee & Leach, Inc. - Analyst

And, Raymond, sorry if I missed it earlier, but did you break out EMC as a percent of revenue this quarter?

**Raymond Cook** - STEC, Inc. - CFO

No, we did not. We showed you our ABC customers.

**Alex Kurtz** - Sterne, Agee & Leach, Inc. - Analyst

Okay. Thank you.

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

You're welcome.

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**Operator**

Aaron Rakers of Stifel Nicolaus. Your line is open.

**Aaron Rakers - Stifel Nicolaus - Analyst**

Thanks for letting me do a follow-up. So you guys just published your 10-Q and it looks like you gave the ABC customer breakdown. You know by that breakdown it looks like EMC was down anywhere from 29% to 30% sequentially. I guess I'm trying to understand the trajectory of that business and the question I guess I'm asking is that X the Japan issue -- first of all, am I correct X and then, secondly, X the Japan issue, how do we think about the profile of that customer revenue contribution over the next couple of quarters?

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

We are forecasting a stable type of business with all of our customers stable and growing, with all of our customers. So unless something is going on inside of any of our customers that we don't know about actually in-house we are forecasting all the same. Now EMC particularly has been one customer who has been able to take SATA drives and put it in front of either SAS or Fibre Channel bridge and ship it as SSDs into their system.

So we've spoken about this in the past. Some of the revenue growth that EMC is experiencing, which we don't get is because that business is going to SATA SSD providers. Some other customers that have grown, I think, are customers actually out of EMC will -- number one customer, EMC was no longer a number one customer for us in Q1. They are growing pretty fast and we are single sourcing in those customers as well for the high-end systems.

**Raymond Cook - STEC, Inc. - CFO**

One thing I would point out, when you do look at that sales concentration in the Q, it's looking at Q1 of 2010 versus Q1 of 2011. So if you remember back Q1 of 2010 is when we had inventory carryover from 2009 to 2010 so EMC was under a 10% customer in that timeframe.

**Aaron Rakers - Stifel Nicolaus - Analyst**

Fair but with what was said relative to what was provided last quarter, EMC still looks to be your second-largest customer.

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

Yes. True. Yes.

**Aaron Rakers - Stifel Nicolaus - Analyst**

Okay. Perfect. Thanks.

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

Thank you.

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**Operator**

Thank you. I'm showing no further questions in the queue at this time.

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

All right. Thanks, LaToya. Everyone, thanks for joining us today and, again, if you are in Milwaukee this week, Boston the following week or Santa Monica, California next week, we'll look forward to seeing you at the conferences. Thank you.

**Operator**

Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day.

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