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Prepared Remarks on First Fiscal Quarter 2015 Results

April 15, 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 April 15, 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-K 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.

As a quick additional note about our call today, please note that our prepared remarks will be longer than usual and we will post them on our website sandisk.com/IR upon commencement of the Q&A session.

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

SANJAY MEHROTRA, PRESIDENT & CHIEF EXECUTIVE OFFICER

Thank you Jay and good afternoon everyone. I will open my comments by saying that our financial performance over the past two quarters has been unacceptable to us as a management team. On today's call, we will discuss the underlying causes of our recent underperformance and the measures we are implementing that we believe will put SanDisk on a path to regain the excellence in execution that you have come to expect from us over the years. I will also summarize what has changed since we reported Q4-2014 results in January. Judy will then describe our first quarter results and guidance in more detail, and then I'll conclude with a summary of our path forward.

Our Q1 results and 2015 outlook have been adversely impacted by the unusual confluence of 4 main factors: (1) first, product issues, including qualification delays impacting embedded and enterprise sales; (2) second, our reduced 2015 opportunity in the enterprise market due to rapid market shifts; (3) third, weaker than anticipated pricing and (4) fourth, supply challenges.

Now let me share more detail on each of these factors.

First, starting with product issues, we have been working with a customer to qualify an embedded component for client SSD applications. Qualification work for this new embedded component was going well early in the first quarter. However, during Q1, we encountered an issue related to a material used in our product assembly at the very last stage of our customer's qualification process. We have a solution to this issue, but it requires our internal validation and customer re-qualification before production shipments can begin. The delay in sales of this embedded component was the single largest contributor to our Q1 revenue shortfall and will also impact our second quarter and 2015 results.

Continuing with product issues, we now expect that some of the 6Gb/s SAS and 12Gb/s SAS opportunities that we had included in our 2015 revenue outlook are reduced, primarily due to certain demand changes and delays in customer qualifications. As a result, we are reducing our estimates of 2015 sales of our SAS products. In spite of these challenges, we continue to believe that we will maintain a strong #2 market share position within the SAS market. In addition, we are advancing our 12 Gb/s SAS product roadmap with 15 nanometer NAND and a new higher performance controller and we expect to sample this product towards the end of this year.

The second factor impacting our performance is reduced opportunity for us in the enterprise market due to market shifts in PCIe and SATA. First, let me address the PCIe market. Our Q1 results as well as 2015 revenue estimates for our Fusion-io PCIe solutions are significantly below our original plan. The biggest contributor to our reduced 2015 enterprise PCIe outlook is that we are seeing a substantial portion of the PCIe TAM moving to lower cost solutions using enterprise SATA SSDs. This market shift has caused the near-term TAM to move from PCIe, where we are the market leader, to enterprise SATA solutions, where our share is low given our relatively recent entry. We believe the broadening deployment of NVMe infrastructure and availability of NVMe PCIe solutions, along with lower cost PCIe solutions built on captive NAND, will contribute to the PCIe market expanding again, likely beginning in 2016. We plan to launch our new Fusion-io based PCIe solutions with our captive 1Y technology-based NAND later this month, and expect revenue contribution from the new PCIe solutions later in the year after customer qualifications are completed.

In enterprise SATA SSDs, we have recently seen a demand shift to the 2TB capacity point in the hyperscale portion of the market, starting as early as the second quarter. We expect our 2TB enterprise SATA product to be ready for production later this year. The current lack of this offering will also impact our enterprise SATA sales this year. The longer term impact of the hyperscale market moving to these high capacity SATA SSDs is that it will expand the TAM. In enterprise SATA, we are working to improve our market position and broaden our portfolio with multiple new 15 nanometer product offerings launching later in the year.

Given the overall impact of these market shifts and certain SAS product issues that I described earlier, we no longer expect to reach our target of $1B of sales in enterprise this year. However, we still expect year-over-year enterprise revenue growth in 2015.

The third factor having an impact on our Q1 results and 2015 outlook is pricing. We experienced softer than expected pricing conditions in some parts of our business in Q1, including in global retail sales and in client SSDs. We also made the choice to pull back on sales of private label products late in the quarter because of the accelerated price decline in this channel. We now believe there is some industry oversupply in the first half of 2015.

Moving to the fourth factor, supply challenges, in the first quarter, due to our supply constraints, we were unable to meet the timing of delivery required to fulfill all of the demand for a large hyperscale customer in enterprise SATA. This mismatch in supply availability resulted in a reduced share award for us with this customer. Separately, our overall petabyte supply for the year has been somewhat reduced as we are now planning for a higher mix of 1Y technology relative to 15 nanometer in the 2H-2015 to support the mix of our business requirements.

In response to these challenging business conditions and in order to position ourselves to successfully achieve our long-term growth objectives and to better align ourselves with the markets and customers we are serving, I will highlight a few of the changes we are making within the company.

From an organization perspective, we are combining all of our enterprise solutions teams, including our InfiniFlash™ system solutions and software, under a unified enterprise group led by Sumit Sadana, our chief strategy officer. This will enable greater synergies between the teams, accelerate decision-making and improve execution in enterprise. John Scaramuzzo, senior vice president, enterprise storage solutions and Ravi Swaminathan, vice president, systems and software solutions, will report to Sumit. Further, we are combining our mobile solutions and client SSD groups into one group focused on client platforms led by Drew Henry, who has been leading our mobile solutions group.

In addition, we have created a Chief Technology Officer position that will be assumed by Kevin Conley. Kevin, who has been leading our client SSD solutions group, has many years of strong engineering experience and has a keen understanding of customer eco-system and market trends. Having Kevin in this new position, with his background and customer relationships, will improve our ability to both predict technology trends and tailor our roadmap and investments to meet customer needs.

We believe all of these organizational changes will simplify and improve our product roadmap execution as well as enhance our focus on the customer.

Within our global engineering organizations, we are strengthening our product development, validation and qualification processes. For example, we are deepening our engagements with our customers to validate our solutions on their next generation platforms earlier in the development cycle and before entering final qualification. In enterprise, we have had to support multiple hardware and firmware platforms as we integrated several companies that were acquired over a fairly short timeframe. We are now reducing the number of platforms and product architectures as we converge the roadmaps. This will increase leverage of engineering resources and improve our product execution. We have discussed these changes with our customers and they are not only enthusiastic about these improvements we are making, but it is clear that they are vested in our success.

Further, in light of the near term revenue outlook, we are lowering our expenses with a reduction in force during Q2 of approximately 5% of our non-factory headcount and are implementing other measures to reduce our expenses from our original 2015 plans.

Before I ask Judy to provide her financial discussion, I will note that our team's top priority in 2015 is to focus, execute and re-invigorate SanDisk and this will require the combined energy and time of the entire SanDisk team. I want to be clear that the reason we decided to postpone our Investor Day is because I want my team to be wholly focused on execution. Having said that, we expect to be fully engaged with you through various conferences, meetings and other forums throughout the year.

I will now turn the call to Judy for the financial discussion and I will then come back for further remarks.

JUDY BRUNER, EXECUTIVE VICE PRESIDENT, ADMINISTRATION & CFO

Thank you, Sanjay. As Sanjay described, the entire management team is committed to substantially improving our financial performance. I will review our Q1 results and then discuss our outlook.

Our first quarter revenue of $1.33 billion was down 23% sequentially and down 12% year-over-year. Our Q1 revenue came 35% from retail and 65% from commercial channels. Our retail revenue was down 15% sequentially and down 13% year-over-year. While there were lingering effects of our Q4 supply challenges on our retail sales, we were able to supply and sell a higher than forecasted number of units, albeit at lower prices than we had expected. In total, our retail revenue met our expectations for the quarter. By product category, the year-over-year retail revenue decline is being driven primarily by the imaging card market. Our Q1 forecast miss came from our commercial sales, where our revenue was down 27% sequentially and down 11% year-over-year. Within our commercial revenue, there were three key drivers of the sequential decline.

(1) The largest sequential decline within commercial revenue came from embedded products. While we expected a decline in this area due largely to seasonality and some supply limitations, we had expected some partial offset from a new embedded component for client SSD applications. As Sanjay described, we encountered qualification delays for this embedded component,

which resulted in a larger than expected sequential decline in embedded revenue.

(2) The second key driver of sequential decline in commercial revenue was the phasing out of our client SSD program with a large customer. This decline was as expected for Q1.

(3) Enterprise SSD was the third key area contributing to the sequential commercial revenue decline, and this was also a miss from our Q1 forecast. The key drivers of the sequential enterprise decline included a lost opportunity in enterprise SATA due to a supply timing mismatch with a hyperscale customer, and lower PCIe sales due largely to the rapidly shifting enterprise market, both as Sanjay described.

On a year-over-year basis, the Q1 decline in commercial revenue was driven by the client SSD program loss with one customer and by lower private label sales, partially offset by growth in enterprise, embedded and also client SSD revenue from other OEM customers. Our sales to private label accounts were down year-over-year due to both supply constraints and our conscious pull back from this channel due to aggressive pricing late in Q1.

Our overall ASP per gigabyte declined 10% sequentially and 29% year-over-year. The price decline was more pronounced in retail and private label markets. While prices were soft in most retail geographies, one contributing factor in Europe was the impact of the weak Euro on our US dollar sales. Our gigabytes sold declined 15% sequentially and increased 24% year-over-year.

Turning to gross margin, our Q1 non-GAAP gross margin of 43% was lower than our January estimate due primarily to lower enterprise sales mix, higher inventory-related charges and higher price decline. The inventory-related charges were largest for non-captive memory used in our enterprise PCIe products and for SSD controllers, both due to demand reductions. Non-captive memory comprised 2% of our Q1 bit sales, and the yen to dollar exchange rate in our captive memory cost of sales was 108 as expected. Our all-in cost per gigabyte declined 6% sequentially and 17% year-over-year.

Within our Q1 non-GAAP operating expenses of $376 million, we took a $41 million charge in the Restructuring & Other line that includes legal settlements as well as Fusion-io related restructuring charges. Excluding the legal settlements, our non-GAAP expenses were below our January forecast primarily due to lower incentive compensation and lower than planned headcount.

Our Q1 GAAP expenses include a $61 million impairment charge for an in-process R&D project from the Fusion-io acquisition. The impairment charge was driven by our decision to cancel this project in order to reduce the number of platforms under development, and to redirect resources towards our next-generation PCIe platform.

Our Q1 non-GAAP operating margin, inclusive of the restructuring and litigation settlements, was 15%.

Our GAAP taxes for Q1 include a discrete benefit of $21 million from a tax audit settlement. The non-GAAP tax rate of 32% includes the audit settlement and other one-time items spread in the full year rate. Our diluted share count came down on both a GAAP and non-GAAP basis, driven by strong share repurchases. In Q1, we spent $750 million to repurchase over 9.3 million shares.

Our share of flash venture fab investments during Q1 was $282 million, and non-fab capital investments were $98 million, primarily related to our Malaysia and China assembly and test facilities, and our India development center. The combined fab and non-fab capital investments for Q1 of $380 million utilized cash of $109 million, with the difference funded by joint venture working capital and leases. With cash flow from operations of $309 million, our free cash flow for Q1 was $200 million. Our Joint Venture equipment lease guarantees were $606 million at the end of Q1.

Now I'll turn to our outlook. In Q2, we expect a sequential decline in revenue, influenced by three primary drivers. First, our Q2 client SSD revenue will be down sequentially due to the end of life in Q1 of the SSD program with a major customer, which we previously expected would end in Q2. Second, we expect enterprise revenue to decline sequentially in Q2 in SATA and SAS for the reasons Sanjay described. Finally, the lower price points we saw in the latter part of Q1 will also impact several parts of our business in Q2. We expect our total Q2 revenue to be in the range of $1.150 billion to $1.225 billion.

In the second half of the year, we expect sequential revenue growth in both Q3 and Q4, but we no longer expect year-over-year revenue growth in the second half. We believe that the primary drivers of sequential quarterly revenue growth in the second half will be our embedded products, continued gains with key client SSD customers and stronger seasonality. Within enterprise, we expect our business to stabilize in the second half of 2015 and regain growth momentum in 2016. Our full year 2015 revenue forecast is now $5.4 billion to $5.7 billion. This represents a substantial year-over-year revenue decline and a significant reduction from our previous 2015 outlook. The largest driver of our forecasted year-over-year revenue decline is the loss of the Client SSD program with a large customer. The other key contributors are expected higher price decline than in 2014 coupled with limited supply due to rebuilding inventory levels as we have previously discussed.

When we provided a 2015 forecast in January, we had expected that our enterprise sales would generate significantly more growth in 2015 and provide a significant offset to the loss of the client SSD program. Since January, the biggest changes in our outlook for the year are reduced enterprise growth, higher price decline, and delay in the qualification of an embedded component for a client SSD application. From a petabyte perspective, our expected revenue bit growth is now well below 30%. We will purchase fewer non-captive petabytes than previously planned and we have adjusted our wafer nodal and die mix to align to our latest forecasts.

Turning to gross margin, we expect our Q2 gross margin to be adversely impacted by a sequential decline in enterprise revenue, an increased mix of multi-chip package products within embedded sales, a reduction in overall sales volume and the full quarter impact of lower market prices late in Q1. Partially offsetting these factors is a benefit in our wafer cost from a weaker yen, which we expect will be at a rate of approximately 117 in our Q2 cost of sales. We are forecasting our Q2 non-GAAP gross margin to be in the range of 37% to 40%. In the second half of the year, we expect positive impact to gross margins from a higher mix of X3 memory, improving sales volume and likely some further positive impact from the yen, although we expect a partial offsetting impact to gross margin from an increased mix of embedded and client SSD products which tend to carry lower than corporate average gross margins. We expect our non-GAAP gross margin for the second half to be in the range of 40% to 43%.

We are taking actions to minimize our expenses while still making the important technology and product investments for the future. We expect Q2 non-GAAP operating expenses to be between $355 million and $365 million, inclusive of restructuring expenses related to our expense reduction measures. We now expect total 2015 non-GAAP operating expenses to be approximately $1.4 billion, down from our previous forecast of $1.5 billion, and the $1.4 billion forecast is inclusive of 'restructuring and other' expenses. For the remainder of 2015, we expect our non-GAAP Other Income & Expense to be approximately break-even and our non-GAAP tax rate to remain at approximately 32%.

Our fab and non-fab capital investment forecast remains at $1.4 billion, and we expect cash usage to be approximately $500 million, with the remainder funded by joint venture working capital and joint venture equipment leases.

We are disappointed that we will not achieve the operating margin in our target financial model in 2015, but we remain committed to our target model of 25% to 30% non-GAAP operating margin as the right profitability level for our company. The actions we have underway to improve our performance are targeted at restoring revenue growth and getting us back to our target financial model. We remain confident in the significant opportunity ahead of us and we have the breadth of products, expertise and capability to capitalize on it. Now I'll turn the call back to Sanjay for his further remarks.

<u>SANJAY MEHROTRA, PRESIDENT & CHIEF EXECUTIVE OFFICER</u>

Thanks Judy. To summarize, I want to assure you that we are acting quickly and decisively to address the issues that have caused our recent underperformance. We understand the fundamental reasons behind our challenges. We have confidence that the initiatives we are working on will significantly improve our execution and we are working to better anticipate and react more quickly to changes in the market – and indeed, lead the market with breakthrough products.

SanDisk's fundamentals remain strong with a solid growth strategy aimed at creating shareholder value. We remain a global leader in retail with a great brand and strong consumer preference for our products. We believe the supply challenges that affected our retail products late in 2014 and early in Q1 are behind us, with execution in retail back to normal. Our iNAND® portfolio for the embedded market is solid, with very good progress achieved in qualifying our new 1Y X3 technology-based products, including our iNand® 7132 high performance platform that was launched in the first quarter. We expect volume shipments of our 7132 to begin in the second half of 2015. Our 15 nanometer X3 embedded product qualifications are underway and we expect to ramp volume shipments in the second quarter. In client SSDs, we are shipping X3 based solutions to both the channel and OEM markets, signaling strong shift of these markets to X3, where we have proven advantages. We have also released a 15 nanometer client SSD to retail and expect to begin OEM qualifications in the third quarter. We are seeing a continued increase in the attach rates of SSDs to laptops, which is a trend that bodes well for the broadening adoption of client SSDs beyond 2015. Our efforts to diversify our client SSD revenue are proceeding well, including greater traction with tier one OEMs and in the channel. As we had mentioned in our January call, we expect to return to year over year growth in our client SSD revenue in 2016.

In enterprise, we are strengthening our product roadmap and execution and expect to regain our momentum and continue to drive enterprise revenue growth in 2016 and beyond. Despite the near term issues in enterprise which we are addressing, SanDisk remains one of the largest enterprise storage solutions providers in the highest growth portion of the flash industry. We believe that our unique ability to design solutions from the memory cell design to software that accelerates application performance has been a key enabler for us to bring innovative solutions such as our 4 terabyte SAS SSD and the InfiniFlash platform to market. InfiniFlash, an industry first, is a massively scalable, highest density storage solution, underscoring SanDisk's strong capabilities to innovate, and differentiate our offerings with high-value solutions in the enterprise market. We believe that when it comes to the breadth of solutions and depth of our expertise and capabilities in the enterprise market, we are a clear leader in high-value enterprise solutions and expect to continue to improve our position in this important market over time.

From a fab manufacturing perspective, the output challenges that we discussed on our Q4 call are behind us. Regarding 15 nanometer technology, production ramp continues to go well with excellent yields. We remain on track for our 15 nanometer technology to achieve greater than 50 percent of our second half bit sales. We have also begun gearing up for the pilot production of 48-layer 3D NAND technology, which is an industry first. This breakthrough memory architecture utilizes numerous process and device innovations and demonstrates our strength in introducing industry leading memory technologies. Our 48-layer 3D NAND technology provides an exciting combination of increased density, higher performance and lower power, which will be used in a broad range of solutions from removable products to enterprise

SSDs. Our 3D NAND pilot production will commence in the second half of the year and will be introduced for commercial use in 2016.

Given our expectations to return to stronger performance in 2016 and our confidence in our long-term prospects, we remain committed to our capital return program. In Q1, we returned $750M through share repurchases, a 50% increase over Q4. We expect to return another $750M through share repurchase before the end of the fiscal year. This would result in total 2015 share repurchase of $1.50 billion, and combined with our dividend, total 2015 capital return of approximately $1.75 billion. This is more than we returned in 2014 and is significantly higher than our expected 2015 free cash flow.

I have described in somewhat excruciating detail the rare convergence of several issues that are impacting our business in 2015. I have every confidence that we will emerge stronger from this setback, as we improve our execution and continue to evolve the company to remain at the forefront of the flash industry. I am energized by the capabilities and deep expertise we have created to continue to bring industry-leading innovative solutions to customers. I look forward to sharing our progress with you over the next several months as we work towards our goals and return to sequential growth in the second half of 2015.

With that, we will open the line for your questions.

JAY IYER, INVESTOR RELATIONS

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