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UPDATE: SanDisk To Buy M-Systems For \$1.5 Billion

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By Matt Andrejczak

SAN FRANCISCO (Dow Jones) -- SanDisk over the weekend agreed to buy rival M-Systems Ltd. in a bid to accelerate its push in the market for NAND flash, a fast-growing memory-chip technology used in portable electronics.

SanDisk late Sunday said it would pay \$1.5 billion for M-Systems, a 13% premium based on Friday's closing prices. It's offering 0.76368 of its own shares for each M-Systems share, valuing the company at \$36 a share. If the deal closes, SanDisk shareholders will own 86% of the combined company.

SanDisk (SNDK) said the deal is a 26% premium over the average close for M-Systems (FLSH) shares over the last 30 days.

In late morning trading, M-Systems shares shot up 13%, or \$4.06, to \$35.85. SanDisk fell 28 cents to \$46.86.

In a conference call Monday, SanDisk Chairman and Chief Executive Eli Harari explained that "the strategic rationale for this transaction is quite simple. It's all about growth."

Technology companies want to capitalize on the NAND flash boom. The technology is widely prevalent in digital cameras and hand-held music players, such as Apple Computer Inc.'s iPod music player. SanDisk makes its own music player too, called the Sansa.

Semico Research Corp. analyst Jim Handy estimates global NAND flash sales will hit \$16 billion in 2006, up 40% from 2005, a year in which industry sales grew at a 62% clip.

NAND flash is gaining traction in cell phones as phones add more built-in features that let consumers snap pictures, listen to music and download videos. This has increased the need for more data storage in portable devices.

"This will be seen as an offensive deal," wrote Caris & Co. analyst Rick Whittington, who called the deal a "good strategic move" by SanDisk. He rates the shares above average.

Laptop computers are another budding market. In May, Samsung Electronics Co. launched a laptop that uses NAND flash for its storage, instead of a hard disk drive.

SanDisk has been ramping up its output of NAND flash through a joint venture with Toshiba Corp. The companies are expanding manufacturing lines at one plant, while constructing another factory set to open in late 2007.

The deal extends recent consolidation in the NAND flash industry.

In June, Micron Technology, a relative newcomer in the NAND market, closed its \$850 million purchase of Lexar Media, the sole supplier of flash cards used in Kodak's digital cameras.

Micron (MU) is looking to grab a bigger share of the NAND market through a joint venture it formed with Intel Corp. (INTC) late last year.

Based in Israel, M-Systems makes flash drives that stores digital-data content in mobile phones. Its top customers include LG Corp., Motorola, Inc., Palm, Inc., Samsung Corp. and Sony Ericsson Mobile Communications. It also makes USB flash drives.

M-Systems recently had to restate six years of financial results due to its accounting for stock options. That issued forced the company to delay a secondary stock offering, a deal in which it

planned to sell 8.7 million shares.

The SanDisk deal needs the approval of M-Systems shareholders and Israeli courts. It's expected to close in the fourth quarter, at which time M-Systems will become a wholly-owned subsidiary of SanDisk.