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SanDisk acquires Israeli company TO CREATE FLASH-MEMORY CHIP POWERHOUSE

line By Dean Takahashi

Creating a powerhouse in flash memory chips that store data on gadgets from cell phones to iPods, SanDisk has agreed to pay \$1.55 billion in stock to acquire Israel-based msystems.

The deal could help the Israeli company avoid ongoing headaches from its stock price, which dipped in the fallout from an investigation into whether msystems had back-dated stock options.

The deal values msystems stock at about \$36 a share, a 26 percent premium on average value from the last month of trading ended Friday. Each msystems shareholder will receive 0.76 in SanDisk shares if the deal closes as scheduled in the fourth quarter.

While both companies touted the technological and business reasons for the merger, it raised the question of whether acquirers are pursuing companies with deflated stock prices connected to investigations of back-dating. The deal is the second big tech acquisition in a week where the target company being acquired is enmeshed in an stock-option backdating investigation.

“The investigations would seem to make many Silicon Valley companies more interesting to potential buyers who are looking for a lower price,” said Richard Whittington, an analyst at Caris & Co. “You are likely to see mergers pick up. But this deal is very strategic for SanDisk. It creates a powerhouse, and it might have happened anyway.”

Judy Bruner, chief financial officer for SanDisk in Milpitas, said the back-dating investigation didn't serve as a catalyst for the deal. She noted that SanDisk had to assess the potential impact of the options practices at msystems, lengthening the process of sealing the deal.

“We think this is a very strategic, long-term deal,” she said.

SanDisk and msystems are complementary despite being competitors, with each doing well in different parts of the NAND flash memory chip market, Bruner said. SanDisk does well selling its own branded flash chips in universal serial bus packages in retail stores under the SanDisk brand name. By contrast, msystems sells chips to companies that put their own brand names on the USB packages.

Jim Handy, an analyst at Semico Research, estimated that both companies now hold about 30 percent of the USB flash market and they compete with Samsung, Micron Technology, and Toshiba. Micron recently stepped up the pressure on SanDisk by acquiring Fremont-based Lexar Media for \$850 million.

SanDisk is also adding a lot of new factory capacity. Bruner said that converting msystems chips so that they can be made in SanDisk's factories will save money and help fill the factories coming on line.

The combined company will have 850 employees from msystems and 1,350 from SanDisk. Bruner said the combined company will look for cost savings but she said she expects SanDisk will retain most of the msystems work force.

Started by entrepreneur and chief executive Dov Moran, msystems is a 17-year-old spin-off from the Israeli military. SanDisk, also started by another Israeli entrepreneur, Eli Harari, is a year older than msystems.

``It's like these companies were separated at birth," Whittington said.

Earlier this month, msystems said the Securities and Exchange Commission was investigating whether the company backdated its stock option awards to days when its stock price was low in order to inflate executive compensation. The Israeli company had to postpone a planned stock offering and said it would restate four years of financial results.

Bruner said that SanDisk thought about the security risk of buying an Israeli company at a time when Israel is at war with its neighbors. But she noted that msystems is located in Kfar Saba, a short drive from Tel Aviv and well away from the Lebanon or Gaza borders.

Analysts say tech companies with backdating investigations may be more attractive acquisitions because their stock prices have fallen, but that isn't a major factor in determining an acquisition.

``I'm surprised that SanDisk got this company for such a low purchase price, but I'm also surprised this deal didn't happen much earlier," said Satya Chillara, an analyst at American Technology Research.

Shares of msystems rose \$4.21, or 13.2 percent, to close Monday at \$36 on the Nasdaq. SanDisk shares fell 48 cents, or 1 percent, to \$46.66.