

MarketWatch

DUE DILIGENCE

Highflying SanDisk faces inventory glut

By Matt Andrejczak, MarketWatch

1:13 PM ET May 1, 2006

<http://www.marketwatch.com/news/default.asp?siteid=mktw>

SAN FRANCISCO (MarketWatch) -- Six months ago, SanDisk Corp. was flying high. The largest maker of the tiny memory cards that save data on handheld consumer devices had seen its profit surge 45% in 2005 to \$345 million. SanDisk's sales rose by nearly a third to \$2.3 billion last year, while its share price more than doubled.

SanDisk (SNDK) was benefiting from booming demand and tight supplies for a type of flash-memory technology, known as NAND flash, used in digital cameras, cellular phones and handheld music players.

Now, though, the company's prospects have become clouded, as it slashes prices to reduce record-high inventory. SanDisk's inventory ballooned 25% during the first quarter to \$414 million -- even though the company began cutting prices by a third in January.

The swollen inventories come at the same time SanDisk and several much bigger rivals, including Intel Corp. (INTC), Micron Technology Inc. (MU) and Samsung Electronics Co., are ramping up production of NAND flash chips to meet demand.

SanDisk's stock is down 20% since hitting a 52-week high in early January as some investors think the product glut spells trouble ahead. The company said it will cut prices by another 20% -- more than it expected in January.

"Now, why is this price cut going to have any more impact than last time? The answer is, it's not," said Fred Hickey, editor of the High Tech Strategist newsletter.

In the past, rising first-half inventories have torpedoed chip-stock prices when the excess supplies were not absorbed in the second half of the year -- when consumers typically buy more electronic gear.

"SanDisk is in a world of hurt," said Hickey, who owns put options on the company's shares, which are bets that the stock will fall.

Standing by SanDisk

To be sure, not all investors hold such a dour view of SanDisk's stock, which was recently added to the S&P 500 Index. Despite its recent drop, the shares are still up about 150% during the past 12 months.

Global sales of NAND flash-memory chips are one reason for optimism. They're on pace to rise again this year. Sales are projected to climb as high as \$16 billion, up from \$11 billion in 2005, according to varying projections from industry analysts.

One big SanDisk investor said he is standing by the stock despite the inventory issue. "It's a volatile market -- inventories will fluctuate," said Ron Juvonen, managing director of Downtown Associates LLC, a hedge fund based in Kennett Square, Penn. His firm's latest regulatory filing showed it owning 3.6 million SanDisk shares at the end of 2005.

And SanDisk isn't the only chip company grappling with an inventory glut. SigmaTel Inc. (SGTL) said some of its customers are holding too much product. The company supplies audio chips for Apple's

(AAPL) iPod Shuffle music player and other media players. SigmaTel has suffered as some of its customers have lost market share to Apple's iPod nano music player and because of declining NAND prices.

Intel Corp. (INTC), the world's largest chip manufacturer, is also saddled with the highest level of inventory it's had since the Internet bubble burst five years ago. Faced with sluggish demand for its computer chips amid stiffer competition from Advanced Micro Devices Inc., Intel said it aims to burn off the excess supply by the end of June.

SanDisk admits its inventory is likely to stay at the same dollar level even after what it expects will be a strong second quarter. This is partly due to increased output at the Japan factory that it jointly operates with Toshiba Corp. It is boosting production to meet anticipated orders.

"The business is growing really quickly right now," said Lori Barker, the company's director of investor relations.

Last month SanDisk reported that first-quarter sales rose 38% to \$623 million from a year earlier. Net income fell to \$35 million, or 17 cents a share, down from \$75 million, or 39 cents a share, a year earlier. Its latest profit was hurt by charges related to stock-option expensing and the acquisition of Matrix Semiconductor Inc.

SanDisk is addressing its inventory glut by curbing its purchases of NAND flash from other suppliers such as Samsung, Barker added. "We are growing into our inventory. ... We'll be working through it over the next couple quarters."

While NAND is still in oversupply, prices are firming, said Jim Handy, flash-memory analyst at Semico.

"The spot NAND price market has slowed its descent, and prices aren't falling like they were [in early April]," Handy said. "This is giving everybody hope that the worst of it is over."

Matt Andrejczak is a reporter for MarketWatch in San Francisco.

Copyright © 2006 MarketWatch, Inc. All rights reserved.