

SanDisk's memory sticks it to competition

By Sunil Vidyarthi

It has taken more than two decades, but America is finally learning how to succeed in businesses where prices are dropping.

Many of us boomers started our careers when inflation was not just an economic theory but a reality that you had to deal with, whether you were planning to buy a car or a house. More important, it was an essential part of business planning.

The entire concept of present value and internal rates of return was spawned in this era, and you couldn't imagine a world where prices would actually be dropping for years, even decades. Thanks to technology, that is precisely what has happened.

Back in 1982, when I was designing a project to build a plastics factory in Toronto, the idea that I should be using a declining raw material price and, worse yet, a declining price of the output, would have seemed ridiculous. Yet nearly all technology project engineers today must include such a declining fortunes scenario.

Some are successful at this game, while others have gone out of business. Just recently Dell announced stellar earnings, while key executives at Hewlett Packard got the boot for dismal sales.

The story is the same if you talk about how Microsoft started giving away Internet Explorer, or how Wal-Mart decided to cut the price of toys by one-third, making competition futile.

The tool used in nearly all successes (and failures) in the last few decades has been price cutting.



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No wonder there was so much deflationary talk as early as last year.

So, while you're busy trying to find the nearest gas station that will sell you premium at under a dollar a litre, another industry springs up where deflation is rampant. Price busting is being championed here by **SanDisk Corp.** (SNDK-NASDAQ, \$22.29, 408-542-0500, www.sandisk.com) and the product is memory for your electronic devices.

Not the old clunky hard drives or CD ROMs, but the plethora of memory devices used in digital cameras, MP3 players and cellphones. SanDisk designs, develops, manufactures and markets flash storage card products.

The company's storage products are high-capacity, solid-state, non-volatile flash memory devices, such as the PC Card ATA and/or IDE MultiMediaCard, SD cards, miniSD cards and Memory Sticks. Think of flash memory storage as the next big thing after CDs and DVDs.

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The company recently said that so-called NAND flash memory is poised to go into products such as cellphones with camcorder capability, phones that double as digital music players and portable

storage devices that hold textbook material for students.

The price for one gigabyte of flash memory — enough to hold an hour of compressed video — will drop from about \$200 to less than \$30 in 2007.

The company does face competition. There are a number of technologies in the research stage — such as so-called magnetic random access memory, which, like flash memory, continues to store data even after its host computer is turned off.

And the hard-disk drive makers also are gunning for emerging markets in the realm of digital consumer electronics, and have scored big hits with small-size drives for Apple Computer's iPod and iPod Mini music players.

A key advantage of hard drives is their low price compared to flash memory. For example, a Dell music player using a hard drive holds 15 gigabytes of music and sells for just \$199.

Already, digital music players relying on flash memory are on the market. And phones could take on the role of music players, thanks partly to higher bandwidth allowing for faster song downloads.

School children can lug 20 pounds of books home even though they need to refer to just a few pages on a particular night. What they need to carry is an electronic version of their textbooks.

The throw-away version of these flash cards is already available for digital cameras, selling for nearly the price of old 35-millimetre film. Many photo shops will take those cards and convert them into glossy or matte prints for you.

Do you see where all of this is going? How about cheap? How about deflation in yet another

sector? And SanDisk is right in the midst of it.

Some analysts (nine of the 13 rate it a "buy" or better) believe that the company will succeed in its effort to drive out most of the little guys and have nearly all of the market for itself.

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If by now you haven't come to realize that analysts are the last ones to know the truth, you should get professional help. I don't know how many corrections your portfolio can take.

And yes, just after the first-quarter results came out and as most analysts were getting bullish on the stock, SanDisk reported that the price war was fierce and that it will have trouble meeting the overly aggressive earnings growth target, even though the revenue numbers were outstanding.

Price competition does have a nasty repercussion of reducing your gross margin, as one analyst concluded. Investors bailed out and have not come back to any degree as the stock traded nearer to its 52-week low of \$19 and nearly half the high set earlier in the year, even though sales were up by more than 100 per cent over last report and earnings were nowhere near as bad. The market works in mysterious ways, or perhaps in foolish ways at times.

At 13 times earnings and sales growth in the triple digits over the next year or so, we could do much worse by, say, buying an oil stock at the top or betting that gold will hit \$1,000 even while most other stuff is in a deflationary cycle.

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