

2000 Annual Report



SanDisk ®

Founded in 1988, SanDisk Corporation is the world's largest supplier of flash data storage systems. Today SanDisk designs, manufactures and markets industry-standard, solid-state data, digital imaging and audio storage products using its patented, high-density flash memory and controller technologies. SanDisk sells its growing array of products to original equipment manufacturers and to end-users through more than 20,000 retail outlets worldwide.

The SanDisk logo consists of the word "SNDK" in a bold, yellow, serif font, centered within a red rectangular background. The letters are closely spaced and have a classic, slightly ornate appearance.

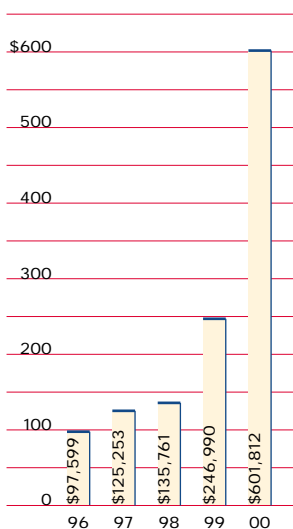
Financial Highlights

(In thousands, except per share data)

Year Ended December 31,	2000	1999	1998
Revenues			
Product	\$ 526,359	\$ 205,770	\$ 103,190
License and royalty	75,453	41,220	32,571
Total revenues	601,812	246,990	135,761
Net income	\$ 298,672	\$ 26,550	\$ 11,836
Diluted net income per share	\$ 4.11	\$ 0.43	\$ 0.21
Shares used in per share calculations	72,651	61,433	55,344
At December 31,			
Working capital	\$ 525,950	\$ 482,793	\$ 138,471
Total assets	1,107,907	657,724	255,741
Total stockholders' equity	863,058	572,127	207,838

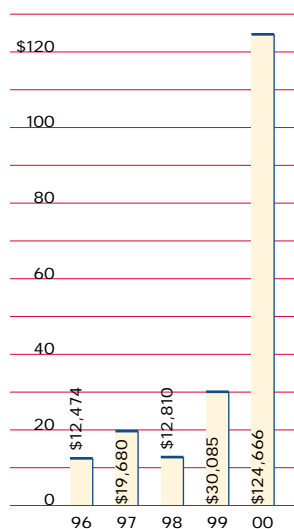
Revenues

(in thousands)



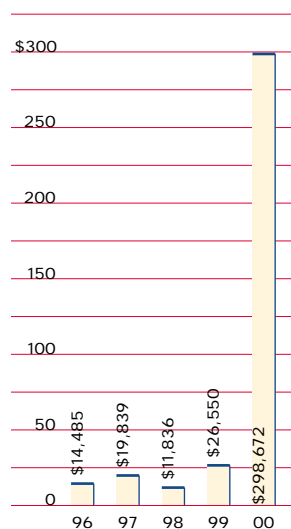
Operating Income

(in thousands)



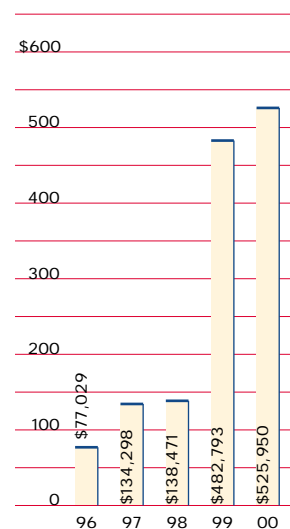
Net Income

(in thousands)



Working Capital

(in thousands)





A Letter from the President

FY 2000 - A Banner Year for SanDisk.
FY 2001 - A Challenge and an Opportunity.

Fiscal 2000 was a year of phenomenal growth for SanDisk. During the year we saw our hard work and investments of the past several years translate into booming sales and growing profitability. This was our seventh consecutive year of revenue growth. The financial performance numbers are outstanding; revenues grew to \$601.8 million, up 144% from 1999. Product revenues grew 156% to \$526.4 million and product gross margins increased 6% over the prior year, to 32%. Total units sold in fiscal 2000 exceeded 13 million, compared to just under 5 million in the prior year. Pricing was stable for most of the year, and we experienced a relatively moderate decline of 22% in the price per megabyte shipped in 2000 compared to 1999. Net income was \$94.7 million, up 256% from 1999, excluding the one time after tax gain on the UMC investment of \$204 million. License and royalty revenues grew 83% to \$75.5 million in fiscal 2000, and we received a strong boost to our patent portfolio from the successful settlement with Lexar of our '987 patent infringement case. We also renewed our patent cross license with Hitachi and signed a patent cross license with TDK.

During the first three calendar quarters of 2000 we were under severe production capacity constraints, resulting in product allocations to our customers as the digital consumer markets for our products began to grow at an accelerating pace. Our challenge throughout

most of the year was to ramp up our production output as quickly as possible. To achieve the maximum output of flash memory we accelerated our technology transition from 128 megabit .28 micron single bit per cell flash memory to 256 megabit D2 cell flash, first at .28 micron, then at .24 micron. By the fourth quarter we were running the 256 megabit D2 .24 micron design at three UMC fabs, up from one fab in the first quarter. We were also running the majority of our card assembly and test at our subcontractors in China, Taiwan and the Philippines. Unfortunately, the US economy took a sudden turn for the worse late in the year, and we exited fiscal 2000 having to deal with a completely different set of challenges for fiscal 2001.

Our vision is the same as it was on the first day at SanDisk almost 13 years ago. The post PC era presents us enormous opportunities for flash memory storage with the convergence of digital consumer electronics, wireless communications devices and Internet appliances. The key to unleashing these opportunities is supplying reliable flash memory that can be manufactured at an affordable cost which enables new mega-markets, such as digital cameras and wireless Internet appliances. The path to affordability is our passionate focus on rapid development of leading edge flash memory technology and controllers. With our strategic partner Toshiba and our allies in Taiwan, SanDisk has an extremely aggressive roadmap for the development and future mass production of advanced flash memories and low-cost high-performance controllers. For example, SanDisk and Toshiba are currently the only suppliers shipping monolithic 512 megabit flash chips, manufactured for both companies at Toshiba's Yokkaichi wafer fab in Japan. In mid 2001 this technology is expected to begin production at the FlashVision joint venture fab in Virginia. Joint development activities are proceeding on track to introduce higher capacity and lower cost flash memory and controller chips in 2002.

In 2001, we also expect our investments of the past 18 months in the Secure Digital Card standard to begin to pay off as numerous platforms supporting the Secure Digital Card enter the market. There are currently 225 members in the SD Association and the pace

of new designs for Secure Digital Card platforms is accelerating. For example on March 19, 2001, Palm announced the introduction of the new Palm computers that will employ Secure Digital Cards supplied by SanDisk, for removable storage. SanDisk has been a leading participant in the PDA market since its inception, and believes that Palm's decision is an acknowledgement of the growing consumer demand for digital music and other electronic content on their mobile devices. We believe that the same pattern for the adoption of Secure Digital Cards will repeat itself in next generation (3G) cell phones and Internet appliances, which, over the next 3 to 5 years will create an explosive demand for flash memory cards. According to market projections, in 2003 more Internet enabled cell phones will be sold than PCs, and by 2005 the vast majority of cell phones sold will be Internet appliances. We also believe that NAND flash memory components are rapidly becoming the standard for embedded storage applications and that this trend will open up for SanDisk major new market opportunities selling flash chips, in addition to removable flash memory cards.

During 2000 we also undertook several strategic initiatives to expand our future market opportunities. We formed the DigitalPortal Inc. joint venture with Photo-Me International, Plc. to develop and market self vending photo kiosks employing a superb high-resolution, low-cost silver halide printing process. The DigitalPortal photo kiosks will allow digital camera users to quickly and easily get top quality prints from their digital film. We expect the rollout of these kiosks to commence in the second half of 2001. We made a strategic investment in Tower Semiconductor to participate in their future advanced wafer foundry where we expect to produce some of our future advanced programmable controller designs, starting in late 2002. We made a strategic investment in Divio, Inc., a Silicon Valley startup that is developing MPEG4 video compression chips for future solid state digital camcorders where flash memory is expected to replace tape. We expect Divio to launch their first product within the next year. We also announced a joint development

and cooperation agreement with Zoran Microelectronics, Ltd. to develop MPEG4 compression for future digital cameras, to allow movie clips of several minutes duration, up from the current limit of 5 to 20 seconds. We are also working closely with the leading DSP and controller host providers, Microsoft and others, to help promote the widespread acceptance of removable flash memory card standards, as well as copyright protection of content stored on our cards.

The current market conditions at the end of the first quarter of 2001 are quite challenging. Bookings visibility is unusually low and is not expected to improve materially while our customers continue to work down their excess inventories. Competition is fierce and prices are coming down more rapidly than we have seen for several years, putting downward pressure on our gross margins. These conditions are difficult for all competitors. At SanDisk we view them as an opportunity for us to gain market share through good execution under adversity. SanDisk is fortunate to have a very strong balance sheet, which will allow us to continue our strategic programs for advanced technology and products, as well as our strategic investments in FlashVision in 2001. We are confident that these investments will position SanDisk to be the long-term market leader once the current slow-down comes to an end. At the same time we have taken strict measures in Q1 2001 to manage our operating spending to reflect the current business environment.

More than at any time in recent years, we are seeing our people, our number one asset, stepping up to the challenges, and putting forth tremendous dedication and hard work to achieve SanDisk's vision. We are deeply indebted to our employees. We are also encouraged by the support from our long-term investors, who share our vision for renewed growth and profitability in the next up-cycle.



Eli Harari
President and Chief Executive Officer



CompactFlash™

Invented by SanDisk and introduced in 1994, CompactFlash memory cards are now the primary storage medium for more than 250 products, including digital cameras, handheld computers, digital music players, medical monitors, and audio recorders. Matchbook-size CompactFlash cards come in capacities ranging from 8MB - 512MB.



MultiMediaCard

SanDisk co-invented this postage-stamp-sized solid-state storage card to meet the unique requirements of digital music players, smart phones, cellular phones, camcorders and pagers. MultiMediaCards are available in capacities ranging from 8MB - 128MB.

Flash data storage – pioneered by SanDisk in 1988 – has come of age. Digital cameras and camcorders. Digital music players. Smart phones. PDAs and handheld computers. Voice recorders. SanDisk flash data storage products provide the enabling technology for them all.

Building a Retail Brand

SanDisk answers consumer demand for rugged, portable, high-performance, non-volatile data storage with a broad array of flash memory cards and connectivity solutions.

Available at leading retail stores, SanDisk memory cards offer unmatched compatibility and performance that consumers can buy with confidence.

What's more, the convergence of digital consumer electronics, wireless communications devices and Internet appliances is creating a host of multimedia applications that offer new market opportunities for SanDisk flash memory cards.

As consumers discover the convenience of portable electronic devices such as digital cameras and digital music players, they are seeking greater memory capacity to store more pictures, music and data. SanDisk removable flash data storage solutions make it easy for consumers to increase capacity as their needs change. Today more than 20,000 major retail stores worldwide, including leading office supply chains, e-tailers and discount retailers, carry SanDisk's high-capacity flash memory products – and that is just the beginning.

Well-known and respected among original equipment manufacturers, the SanDisk name is gaining brand recognition among retail shoppers. SanDisk is reinforcing this visibility with new packaging and advertising aimed at mainstream consumer markets. The demographics for removable flash memory cards now range from grandparents to pre-teens. Our goal is to build brand preference and make SanDisk a product line that shoppers ask for by name.



SmartMedia™
This semiconductor-based memory card offers high performance and high capacity and is appropriate for all SmartMedia devices. It is available in capacities ranging from 8MB - 128MB.



ImageMate™ Drive and FlashPath™ Adapter
The ImageMate external drive is a fast and convenient way to transfer data between a memory card and a computer. FlashPath is an adapter that lets users read and write data to memory cards using a floppy disk drive.

SanDisk brings to the retail market the largest flash memory storage offering of any single company. Not only have we developed the industry standard for removable flash memory cards, we have created different formats to meet the needs of emerging applications and have introduced accessories that allow users to move data efficiently from our flash memory cards to PCs in a variety of ways.

The unsurpassed compatibility of our products gives us universal access to emerging mega-markets. SanDisk data storage products are truly plug-and-play. They are compatible with today's major operating systems and applications as well as forward and backward compatible between generations. What's more, they give users unprecedented flexibility for storing any type of file – data,

voice, video clips, email, and photographs, all on a portable card small enough to fit into your pocket.

Unsurpassed Compatibility

Current growth is most dynamic in the retail market where sophisticated digital cameras and digital music players have found widespread acceptance with consumers. Mega-pixel digital cameras are now able to produce pictures of exceptionally high-resolution. Similarly, digital music players will let users carry an entire library of music with them. As capabilities increase so does the need for greater data storage capacity. SanDisk is meeting this demand with flash data products that come in a range of storage capacities. New generation cellular phones, PDAs, and smart phones that combine a cell phone and palm-PC in a single unit are also recognizing the advantages of flash memory cards.

All of these product categories offer tremendous opportunities for SanDisk's family of flash data storage solutions. SanDisk is not only exceptionally well-positioned to benefit from the proliferation of portable digital devices, we are dedicated to being the global market leader in flash memory storage in the post-PC consumer era.

SanDisk helps to bring about revolutionary new applications for consumer electronic devices through our commitment to continuous technology innovations. Over the years, we have proactively worked with original equipment manufacturers to solve their memory storage needs in portable devices that have become smaller and more sophisticated. Our support of Secure Digital technology that protects artistic properties, for example, has encouraged the growth of digital music players and paved the way for other copyright-protected materials to be sold in downloadable digital form. SanDisk has also taken a pioneering role in creating new retail venues for the digital photo market. In this way, we are not only participating in mega-markets, we are helping to spur their growth.



SanDisk® FlashDrive
Designed to replace traditional rotating disk drives, SanDisk FlashDrives are used in a growing number of applications including networking, industrial computers, telecommunications, gaming, military, avionics and point-of-sale systems.



SanDisk® DigitalPortal™
Industry analysts predict that 20 billion photographs will be created digitally by 2002. To address this vast emerging market, SanDisk has joined forces with Photo-Me International, Plc. to form DigitalPortal Inc., a venture created to develop and operate digital photo-processing kiosks in convenient retail locations in the United States and Canada. These self-service vending machines will let users download images from flash memory cards, CDs, floppy disks or the Internet and print out high-quality, low-cost photographs. In the future, DigitalPortal plans to integrate multimedia capabilities that will tap new application opportunities for flash card sales through retail partners.



Secure Digital (SD) Memory Card.
Designed by the consortium of Matsushita Electric, SanDisk and Toshiba, the Secure Digital memory card meets the demand for increased security in a wide range of emerging audio and video consumer electronics devices such as digital music players, global positioning systems, electronic books and personal video players. Its design complies with both current and future SDMI (Secure Digital Music Initiative) portable device requirements. The Secure Digital memory card's I/O functionality also offers enormous possibilities for extending functionality in a variety of consumer and telecommunications products. SanDisk began shipping Secure Digital cards to retail markets in spring 2001.



SanDisk® PC Card
SanDisk Type II PC Cards are ideal for storage, data backup and data transport applications. This removable ATA industry-standard memory card is available in capacities ranging from 8 megabytes to 1.0 gigabyte.



TriFlash™
An embedded chip product, TriFlash can be seamlessly integrated with removable MultiMediaCards or Secure Digital Cards for incremental storage. TriFlash is ideally suited for storing audio, video, data and images on small portable devices such as cell phones and digital music players.

Selected Financial Data

(In thousands, except per share data)

Year Ended December 31,	2000	1999	1998	1997	1996
Revenues					
Product	\$ 526,359	\$ 205,770	\$ 103,190	\$ 105,675	\$ 89,599
License and royalty	75,453	41,220	32,571	19,578	8,000
Total revenues	601,812	246,990	135,761	125,253	97,599
Cost of revenues	357,017	152,143	80,311	72,280	58,707
Gross profits	244,795	94,847	55,450	52,973	38,892
Operating income	124,666	30,085	12,810	19,680	12,474
Net income	\$ 298,672	\$ 26,550	\$ 11,836	\$ 19,839	\$ 14,485
Net income per share					
Basic	\$ 4.47	\$ 0.48	\$ 0.23	\$ 0.43	\$ 0.33
Diluted	\$ 4.11	\$ 0.43	\$ 0.21	\$ 0.40	\$ 0.30
Shares used in per share calculations					
Basic	66,861	55,834	52,596	45,760	44,324
Diluted	72,651	61,433	55,344	49,940	48,412
At December 31,	2000	1999	1998	1997	1996
Working capital	\$ 525,950	\$ 482,793	\$ 138,471	\$ 134,298	\$ 77,029
Total assets	1,107,907	657,724	255,741	245,467	108,268
Total stockholders' equity	863,058	572,127	207,838	191,374	87,810

See Notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Supplementary Quarterly Data

(Unaudited. In thousands except per share data)	1st	2nd	3rd	4th
Quarterly/2000				
Revenues				
Product	\$ 97,249	\$ 122,572	\$ 151,817	\$ 154,721
License and royalty	12,120	21,377	19,022	22,934
Total revenues	109,369	143,949	170,839	177,655
Gross profits	41,611	59,435	68,965	74,784
Operating income	17,551	30,852	35,535	40,728
Net income*	219,271	24,269	25,602	29,530
Net income per share				
Basic	\$ 3.32	\$ 0.36	\$ 0.38	\$ 0.44
Diluted**	\$ 3.00	\$ 0.33	\$ 0.35	\$ 0.41
Quarterly/1999				
Revenues				
Product	\$ 35,926	\$ 42,300	\$ 57,624	\$ 69,920
License and royalty	8,210	10,249	9,910	12,851
Total revenues	44,136	52,549	67,534	82,771
Gross profits	17,627	21,691	23,637	31,892
Operating income	4,848	7,033	6,956	11,248
Net income	4,323	5,694	6,505	10,028
Net income per share				
Basic	\$ 0.08	\$ 0.11	\$ 0.12	\$ 0.17
Diluted	\$ 0.07	\$ 0.10	\$ 0.11	\$ 0.15

* On January 3, 2000, the USIC foundry was merged into the UMC parent company. We had invested \$51.2 million in USIC. In exchange for our USIC shares, we received 111 million UMC shares. These shares were valued at approximately \$396 million at the time of the merger, resulting in a pretax gain of \$344.2 million (\$203.9 million after-tax) in the first quarter of 2000.

** Quarterly earnings per share figures may not total to yearly earnings per share, due to rounding and the fluctuations in the number of options included or omitted from diluted calculations based on the stock price or option strike prices.

See Notes to the Consolidated Financial Statement and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Management's Discussion and Analysis of Financial Conditions and Results of Operations

Certain statements in this discussion and analysis are forward looking statements based on current expectations, and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward looking statements. Such risks and uncertainties are set forth in "Factors That May Affect Future Results" and elsewhere in this report. The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto.

Overview

SanDisk was founded in 1988 to develop and market flash data storage systems. We sell our products to the consumer electronics and industrial/communications markets. In fiscal 2000, approximately 77% of our product sales were attributable to the consumer electronics market, particularly sales of CompactFlash and MultiMediaCard products for use in digital camera applications. Our CompactFlash products have lower average selling prices and gross margins than our higher capacity FlashDisk and FlashDrive products. In addition, a substantial portion of our CompactFlash and MultiMediaCard products are sold into the retail channel, which usually has shorter customer order lead-times than our other channels. A majority of our sales to the retail channel are turns business, with orders received and fulfilled in the same quarter, thereby decreasing our ability to accurately forecast future production needs. We believe sales to the consumer market will continue to represent a majority of our sales, and increase as a percentage of sales in future years, as the popularity of consumer applications, including digital cameras, increases.

Our operating results are affected by a number of factors including the volume of product sales, competitive pricing pressures, availability of foundry capacity, variations in manufacturing cycle times, fluctuations in manufacturing yields and manufacturing utilization, the timing of significant orders, our ability to match supply with demand, changes in product and customer mix, market acceptance of new or enhanced versions of our products, changes in the channels through which our products are distributed, timing of new product announcements and introductions by us and our competitors, the timing of license and royalty revenues, fluctuations in product costs, increased research and development expenses, and exchange rate fluctuations. We have experienced seasonality in the past. As the proportion of our products sold for use in consumer electronics applications increases, our revenues may become subject to seasonal declines in the first quarter of each year. See "Factors That May Affect Future Results – Our Operating Results May Fluctuate Significantly Which May Adversely Affect Our Stock Price" and "– There is Seasonality in Our Business."

Beginning in late 1995, we adopted a strategy of licensing our flash technology, including our patent portfolio, to third party manufacturers of flash products. To date, we have entered into patent cross-license agreements with several companies, and intend to pursue opportunities to enter into additional licenses. Under our current license agreements, licensees pay license fees, royalties, or a combination thereof. In some cases, the compensation to us may be partially in the form of guaranteed access to flash memory manufacturing capacity from the licensee company. The timing and amount of royalty payments and the recognition of license fees can vary substantially from quarter to quarter depending on the terms of each agreement and, in some cases, the timing of sales of products by the other parties. As a result, license and royalty revenues have fluctuated significantly in the past and are likely to continue to fluctuate in the future. Given the relatively high gross margins associated with license and royalty revenues, gross margins and net income are likely to fluctuate more with changes in license and royalty revenues than with changes in product revenues.

We market our products using a direct sales organization, distributors, manufacturers' representatives, private label partners, OEMs and retailers. We expect that sales through the retail channel will comprise an increasing share of our product revenues in the future, and that a substantial portion of our sales into the retail channel will be made to participants that will have the right to return unsold products. Our policy is to defer recognition of revenues from these sales until the products are sold to the end customers.

Historically, a majority of our sales have been to a limited number of customers. Sales to our top 10 customers accounted for approximately 48%, 57%, and 59%, respectively, of our product revenues for 2000, 1999, and 1998. In 2000, no single customer accounted for greater than 10% of our total revenues. In 1999 and 1998, revenues from one customer exceeded 10% of total revenues. We expect that sales of our products to a limited number of customers will continue to account for a substantial portion of our product revenues for the foreseeable future. We have also experienced significant changes in the composition of our customer base from year to year and expect this pattern to continue as market demand for our customers' products fluctuates. The loss of, or a significant reduction in purchases by any of our major customers, could harm our business, financial condition and results of operations. See "Factors That May Affect Future Results – Sales to a Small Number of Customers Represent a Significant Portion of Our Revenues."

All of our products require silicon wafers, the majority of which are currently manufactured for us by UMC in Taiwan. Industry-wide demand for semiconductors increased significantly in 1999 and the first nine

months of 2000, due to increased demand in the consumer electronics and cellular phone markets. This increased demand caused supply constraints for most of 2000. However, semiconductor manufacturers, including UMC and Toshiba have been adding new advanced wafer fab capacity. This additional capacity, along with slowing economic conditions experienced late in the fourth quarter of 2000 and into 2001, has resulted in excess supply and intense pricing pressure. If industry-wide demand for our products continues to be below the industry-wide available supply, our product prices could decrease further causing our revenues and profits to decline significantly. Under our wafer supply agreements, there are limits on the number of wafers we can order and our ability to change that quantity, either up or down, is restricted. Accordingly, our ability to react to significant fluctuations in demand for our products is limited. If customer demand falls below our forecast and we are unable to reschedule or cancel our orders for wafers or other long lead-time items such as controller chips or printed circuit boards, we may end up with excess inventories, which could result in higher operating expenses and reduced gross margins. If customer demand exceeds our forecasts, we may be unable to obtain an adequate supply of wafers to fill customer orders, which could result in lost sales and lower revenues. If we are unable to obtain adequate quantities of flash memory wafers with acceptable prices and yields from our current and future wafer foundries, our business, financial condition and results of operations could be harmed.

We have from time to time taken write-downs for excess inventories, and may be forced to do so again if the current deterioration in market demand for our products continues and our inventory levels exceed customer orders. In addition, we may have to write-down our inventories if continued pricing pressure results in a net realizable value that is lower than our cost, or if part of the inventory becomes obsolete. Due to the current market demand for our products changing so rapidly, we ended the fourth quarter with significant amounts of excess inventory. Although we are working to reduce this inventory in line with the current level of business, we are obligated to honor existing purchase orders, which we have placed with our suppliers. Furthermore, to assure favorable future business relations with our major suppliers, we may choose not to shut down their production of our products. In the case of FlashVision manufacturing at Dominion in Virginia, both Toshiba and SanDisk are obligated to purchase their share of the production output, which may make it more difficult for us to reduce our inventory.

Excess inventory not only ties up our cash, but also can result in substantial losses if such inventory, or large portions thereof, has to be revalued due to lower market pricing or product obsolescence. These inventory adjustments decrease gross margins and have resulted, and could in the future result in, fluctuations in gross margins and net earnings in the quarter in which

they occur. See "Factors That May Affect Future Results – Our Operating Results May Fluctuate Significantly."

Export sales are an important part of our business, representing 57%, 53% and 56% of our total revenues in 2000, 1999, and 1998, respectively. Our sales may be impacted by changes in economic conditions in our international markets. Economic conditions in our international markets, including Asia and the European Union, may adversely affect our revenues to the extent that demand for our products in these regions declines. Given the recent economic conditions in Asia and the European Union and the weakness of the Euro, Yen and other currencies relative to the United States dollar, our products may be relatively more expensive in these regions, which could result in a decrease of our sales in these regions. While most of our sales are denominated in U.S. Dollars, we invoice certain Japanese customers in Japanese Yen and are subject to exchange rate fluctuations on these transactions which could affect our business, financial condition and results of operations. See "Factors That May Affect Future Results – Our international operations make us vulnerable to changing conditions and currency fluctuations."

For the foreseeable future, we expect to realize a significant portion of our revenues from recently introduced and new products. Typically, new products initially have lower gross margins than more mature products because the manufacturing yields are lower at the start of manufacturing each successive product generation. In addition, manufacturing yields are generally lower at the start of manufacturing any product at a new foundry. To remain competitive, we are focusing on a number of programs to lower manufacturing costs, including development of future generations of D2 flash and advanced technology wafers. There can be no assurance that we will successfully develop such products or processes or that development of such processes will lower manufacturing costs. If the current industry-wide and worldwide economic slowdown continues for the rest of fiscal 2001, we may be unable to efficiently utilize the NAND flash wafer production from FlashVision, which would force us to amortize the fixed costs of the fabrication facility over a reduced wafer output, making these wafers significantly more expensive. See "Factors That May Affect Future Results – We must achieve acceptable manufacturing yields."

Results of Operations

Product Revenues. In 2000, our product revenues increased 156% to \$526.4 million from \$205.8 million in 1999. The increase consisted of an increase of 173% in unit sales, which was partially offset by a 7% decline in average selling prices per unit. In 2000, the largest increase in unit volume came from sales of CompactFlash Products that represented 47% of product revenues and MultiMediaCard products that represented 21% of product revenues. The continuing move towards higher capacity cards in 2000 partially offset a decline in the average selling price per megabyte of

capacity shipped. In 2000, the average megabyte capacity per unit shipped increased 17% while the average selling price per megabyte of flash memory shipped declined 22% compared to the prior year. The mix of products sold varies from quarter to quarter and may vary in the future, affecting our overall average selling prices and gross margins.

In 1999, our product revenues were \$205.8 million, an increase of 99% from \$103.2 million in 1998. In 1999 the largest increase in unit volume came from sales of CompactFlash which represented 61% of product revenues, and MultiMediaCard products which represented 7% of product revenues. A shift in product mix to higher capacity cards in 1999 partially offset a decline in the average selling price per megabyte of capacity shipped. In 1999, the average megabyte capacity per unit shipped increased 65% while the average selling price per megabyte of flash memory shipped declined 52% compared to the prior year.

Our backlog as of December 31, 2000 was \$63.3 million compared to \$157.2 million in 1999 and \$13.4 million in 1998. See "Factors That May Affect Future Results - Our Operating Results May Fluctuate Significantly" and "- There is Seasonality in Our Business." Bookings visibility declined significantly late in the fourth quarter of 2000, and we experienced material order cancellations and rescheduling of existing purchase orders from some of our customers. Visibility remains low in the first quarter of 2001 due to the current economic uncertainty in our markets. Since orders constituting our current backlog are subject to changes in delivery schedules or cancellations, backlog is not necessarily an indication of future revenue. Retail sales are typically booked and shipped in the same quarter.

In the first quarter of 2001, demand from our major OEM customers has been substantially below forecast, as these customers continue to try to reduce their inventories. In addition, retail channel orders have been lower than the levels we experienced in the fourth quarter of 2000. Due to this continuing weakness of economic conditions and ongoing customer inventory corrections, we expect first quarter 2001 revenues to be significantly below our revenues in the fourth quarter of 2000.

License and Royalty Revenues. We currently earn patent license fees and royalties under nine cross-license agreements with Hitachi, Intel, Lexar, Sharp, Samsung, SmartDisk, SST, TDK and Toshiba. License and royalty revenues from patent cross-license agreements was \$75.5 million in 2000, up from \$41.2 million in 1999 and \$32.6 million in 1998. The increase in license and royalty revenues in 2000 was primarily due to patent royalties from increased sales by certain of our licensees, and the revenue of \$4.7 million recognized in conjunction with the settlement of the Lexar litigation. The increase in license and royalty revenues in 1999, as compared to 1998, was primarily due to an increase in patent royalty revenues. Revenues from licenses and royalties were 13% of total revenues in 2000, 17% in 1999 and 24% in 1998.

Our income from patent licenses and royalties can fluctuate significantly from quarter to quarter. A substantial portion of this income comes from royalties based on the actual sales by our licensees. Given the current market outlook for 2001, sales of licensed flash products by our licensees may be substantially lower than the corresponding sales in recent quarters, which may cause a substantial drop in our royalty revenues.

Gross Profits. In fiscal 2000, gross profits increased to \$244.8 million, or 41% of total revenues from \$94.8 million, or 38% of total revenues in 1999 and \$55.5 million, or 41% of total revenues in 1998. Product gross margins increased to 32% in 2000 from 26% in 1999 and 22% in 1998. The increases in 2000 were primarily due to the lower cost per megabyte of our 256 megabit flash memory products, which represented the majority of our product sales in 2000. The increases in 1999 were due to the lower cost per megabyte of our 256 megabit and 128 megabit flash memory products, which began shipping in volume in the second half of 1999.

Due to weak economic conditions, excess supply in the markets for our products, and lower demand from customers as they continue to reduce their inventories, we are experiencing intense pricing pressures. Due to these factors, we expect our average selling prices per megabyte to decline significantly in the first quarter of 2001. Our average selling prices will continue to be negatively impacted in future quarters throughout 2001 and possibly beyond, until market supply and demand for our products returns to equilibrium. Although we are taking significant steps to lower our product costs, given the current market conditions, we expect our selling prices to decline more quickly than our product cost, resulting in a decline in our product gross margins in 2001.

Research and Development. Research and development expenses consist principally of salaries and payroll-related expenses for design and development engineers, prototype supplies and contract services. Research and development expenses increased to \$46.1 million in 2000 from \$26.9 million in 1999 and \$18.2 million in 1998. As a percentage of revenues, research and development expenses were 8% in 2000, 11% in 1999 and 13% in 1998. In 2000 and 1999, the increase in research and development expenses was primarily due to an increase in salaries and payroll-related expenses associated with additional personnel and higher project related expenses. Increased depreciation due to capital equipment additions also contributed to the growth in research and development expenses in both years. The additional project expenses in 2000 were to support the development of new generations of flash data storage products including the 512 megabit and 1 gigabit flash memory co-development with Toshiba. We expect our research and development expenses to continue to increase in future quarters to support the development and introduction of new generations of flash data storage products, including the joint venture with Toshiba and the development of advanced controller chips.

Sales and Marketing. Sales and marketing expenses include salaries, sales commissions, benefits and travel expenses for our sales, marketing, customer service and applications engineering personnel. These expenses also include other selling and marketing expenses, such as independent manufacturer's representative commissions, advertising and tradeshow expenses. Sales and marketing expenses increased to \$49.3 million in 2000 from \$25.3 million in 1999 and \$16.9 million in 1998. The increases in both 2000 and 1999 were primarily due to increased salaries and payroll-related expenses and increased commission expenses due to higher product revenues and increased marketing expenses. Sales and marketing expenses represented 8% of total revenues in 2000 compared to 10% in 1999 and 12% in 1998. We expect sales and marketing expenses to continue to increase as sales of our products grow, as we continue to develop the retail channel and brand awareness for our products and as we increase our marketing activities for our Secure Digital Card products.

General and Administrative. General and administrative expenses include the cost of our finance, information systems, human resources, shareholder relations, legal and administrative functions. General and administrative expenses were \$24.8 million in 2000 compared to \$12.6 million in 1999 and \$7.5 million in 1998. The increases for both 2000 and 1999 were primarily due to increased salary and related expenses associated with additional personnel, increased legal fees and an increase in the allowance for doubtful accounts related to higher trade accounts receivable balances from increased revenues. General and administrative expenses represented 4% of total revenues in 2000 compared to 5% in 1999 and 6% in 1998. We expect general and administrative expenses to increase as we expand and develop our infrastructure to support our anticipated future growth. General and administrative expenses could also increase substantially in the future if we pursue additional litigation to defend our patent portfolio. See "Factors That May Affect Future Results - Risks Associated with Patents, Proprietary Rights and Related Litigation."

Given the current market conditions and expected decline in product revenues in the first quarter of 2001, we have instituted strict expense control measures. These measures in the first quarter of 2001 included a reduction in our work force and significant cuts in discretionary spending. However, we are continuing to invest in research and development of advanced technologies and future products.

Interest Income. Interest income was \$22.8 million in 2000 compared to \$8.3 million in 1999 and \$5.3 million in 1998. The increase in 2000 is primarily due to a full year of higher interest income resulting from the investment of the proceeds from the sale of common stock in our November 1999 follow-on public offering, as well as increased cash flows as a result of the increase in revenue and operating margin. The increase in 1999 is primarily due to higher interest income in the fourth quarter due to the investment of

the proceeds from the sale of common stock in our November 1999 follow-on public offering. We expect interest income to decline in 2001 relative to 2000 due to lower cash and investment balances resulting from our investments in FlashVision and Tower, combined with the drop in risk-free interest rates due to recent actions taken by the U.S. Federal Reserve Board.

Gain on investment in foundry. In the first quarter of 2000, we recognized a gain of \$344.2 million as a result of the exchange of our investment of \$51.2 million in United Silicon, Inc., or USIC, for an investment in United Microelectronics Corporation, or UMC. We received 111 million shares of UMC in exchange for our USIC shares. These shares were valued at \$396 million at the time of the exchange and were subject to trading restrictions imposed by UMC and the Taiwan Stock Exchange. The trading restrictions expired on one-half of the shares on July 3, 2000. The remaining shares will become available for sale over a two-year period beginning in January 2002. When the shares are ultimately sold, it is likely that we will recognize additional gains or losses. In May 2000, we received a stock dividend of 200 UMC shares for every 1,000 shares of UMC owned, resulting in our ownership of 22 million additional UMC shares.

At December 31, 2000, the market value of both our short-term and long-term investment in UMC had declined \$201.9 million below its carrying basis. It was determined that this decline was related to the downturn in the semiconductor industry as a whole and was temporary in nature due to the historically cyclical nature of the industry. The available-for-sale portion of our investment was marked-to-market through other comprehensive income as required by SFAS 115.

As of March 22, 2001, the market value of our investment in UMC remained significantly below our cost. The downturn in the semiconductor industry and the economy in general appears to be more severe than previously anticipated. There is a great deal of uncertainty regarding when the semiconductor industry will recover from this down cycle. Because of the continued downturn in the economy, we believe that the decline in the market value of our investment in UMC at March 22, 2001 is other than temporary, and we will report a loss in other income and expense in the first quarter of 2001. This loss will be based upon the fair market value of the investment at the end of the first quarter of fiscal 2001, as compared to the investment's cost basis.

Other Income, Net. Other income, net was \$572,000 in 2000 compared to \$1.3 million in 1999 and \$374,000 in 1998. The fluctuations largely relate to foreign currency transaction gains. In 2000, 1999, and 1998 we had net foreign currency transaction gains of \$428,000, \$1.1 million and \$412,000, respectively.

Provision for Income Taxes. Our 2000, 1999 and 1998 effective tax rates were approximately 39%, 33% and 36%, respectively. Our 2000 effective tax rate was higher than our 1999 rate due primarily to effects of state income taxes on significantly increased income and a reduced proportional rate benefit from federal

and state credits and tax exempt interest income due to the significant increase in taxable income over 1999. Our 1999 effective tax rate was lower than our 1998 rate due to the proportional rate benefits from federal and state tax credits.

Liquidity and Capital Resources

As of December 31, 2000, we had working capital of \$526.0 million, which included \$106.3 million in cash and cash equivalents and \$373.3 million in short-term investments. Operating activities provided \$84.9 million of cash in 2000 primarily from net income, increases in deferred taxes of \$114.5 million largely due to the gain on UMC, income taxes payable of \$39.8 million as a result of higher taxable income than in 1999, accounts payable of \$36.4 million primarily from increased inventories, and deferred revenue of \$21.4 million related to license fees, which were partially offset by an increase in inventory of \$60.9 million and an increase in accounts receivable of \$52.2 million associated with higher revenues. Cash provided by operations was \$17.0 million in 1999 and \$15.1 million in 1998.

Net cash used in investing activities of \$137.9 million in 2000 included \$134.7 million invested in FlashVision LLC, our foundry joint venture with Toshiba, \$26.6 million of capital equipment purchases, a \$20.0 million deposit in an escrow account for our investment in Tower Semiconductor, and our \$7.2 million investment in Divio, partially offset by proceeds from net sales of investments of \$51.5 million. In 1999, net cash used in investing activities of \$214.4 million consisted \$21.4 million of capital equipment purchases and net purchases of investments of \$193.0 million. In 1998, net cash used in investing activities of \$23.0 million consisted of a second investment in the USIC foundry of \$10.9 million, \$7.5 million of capital equipment purchases and net purchases of investments of \$4.6 million.

In 2000, financing activities provided \$13.6 million, primarily from the sale of common stock through the our stock option and employee stock purchase plans. During 1999, cash provided by financing activities of \$328.2 million was primarily from \$320.3 million from the net proceeds of the sale of common stock in our November 1999 follow-on stock offering and \$7.9 million from the sale of common stock through the SanDisk stock option and employee stock purchase plans. During 1998, cash provided by financing activities of \$2.4 million was primarily from the sale of common stock through the SanDisk stock option and employee stock purchase plans.

On June 30, 2000, we closed a transaction with Toshiba providing for the joint development and manufacture of 512 megabit and 1 gigabit flash memory chips and Secure Digital Card controllers. As part of this transaction, SanDisk and Toshiba formed FlashVision LLC, a joint venture to equip and operate a silicon wafer manufacturing line at Dominion Semiconductor in Virginia. The cost of equipping the Virginia wafer manufacturing line is estimated at between \$700 million and \$800 million. As part of our

50% ownership of the joint venture we had invested \$134.7 million as of December 31, 2000, and in January 2001, we invested the remaining \$15.3 million. We have also guaranteed up to \$215 million in equipment lease lines to equip Toshiba's Dominion Semiconductor manufacturing clean room with advanced wafer processing equipment. As of January 26, 2001, \$20 million of this amount had been borrowed by FlashVision.

On July 4, 2000, we entered into a share purchase agreement to make a \$75 million investment in Tower Semiconductor, or Tower, in Israel, representing approximately 10% ownership of Tower. In exchange for our investment, we received one seat on the board of directors of Tower and a guaranteed portion of the wafer output from the advanced fabrication facility Tower has started to build in Migdal Haemek, Israel. Under the terms of the agreement, we will make our investment over a period of approximately 18 months if key milestones related to the construction, equipping and wafer production at the new wafer fabrication facility are met. On January 26, 2001, Tower satisfied the closing conditions of the share purchase agreement, and we transferred the first \$20 million of our investment from an escrow account to purchase 866,551 ordinary shares and obtain \$8.8 million in pre-paid wafer credits. On March 1, 2001, we paid Tower \$11 million upon its completion of milestone one, to purchase 366,690 ordinary shares and obtain additional prepaid wafer credits. Additional contributions will take the form of mandatory warrant exercises for ordinary shares at an exercise price of \$30.00 per share if other milestones are met. The warrants will expire five years from the date of grant, and in the event the key milestones are not achieved, the exercise of these warrants will not be mandatory. We expect first wafer production to commence at the new fabrication facility in late 2002.

On August 9, 2000, we entered into a joint venture, Digital Portal Inc., or DPI, with Photo-Me International, or PMI, for the manufacture, installation, marketing and service of self-service, digital photo printing labs, or kiosks, bearing the SanDisk brand name in locations in the U.S. and Canada. These kiosks employ high-quality, low-cost, silver halide photo processing technology developed by PMI. Under the agreement, SanDisk and PMI will each make an initial investment of \$4 million in the DPI joint venture, and secure lease financing for the purchase of the kiosks. The total value of the lease financing will depend on the number of kiosks deployed by the joint venture. We estimate that we will guarantee equipment lease arrangements of approximately \$40 million over the first two years of the agreement. PMI will manufacture the kiosks for the joint venture and will install and maintain the kiosks under contract with the joint venture. We expect to deploy the first kiosks in pilot programs in selected retail stores in the United States starting in the first half of 2001.

On November 2, 2000, we made a strategic investment of \$7.2 million in Divio, Inc. Divio is a privately-held manufacturer of digital imaging

compression technology and products for future digital camcorders that will be capable of using our flash memory cards to store home video movies, replacing the magnetic tape currently used in these systems. Under the agreement, we own approximately 10% of Divio and are entitled to one board seat.

Depending on the demand for our products, we may decide to make additional investments, which could be substantial, in assembly and test manufacturing equipment or foundry capacity to support our business in the future. Our operating expenses may increase as a result of the need to hire additional personnel to support our sales and marketing efforts and research and development activities, including our proposed collaboration with Toshiba for the joint development of 512 megabit and 1 gigabit flash memory chips. We believe the existing cash and cash equivalents and short-term investments will be sufficient to meet our currently anticipated working capital and capital expenditure requirements for the next twelve months.

In January 2000, the USIC foundry was merged into the UMC parent company. In exchange for our USIC shares, we received 111 million UMC shares. These shares were valued at approximately \$396 million at the time of the merger, resulting in a pretax gain of \$344.2 million (\$203.9 million after-tax) in the first quarter of 2000. All of the UMC shares we received as a result of the merger were subject to trading restrictions imposed by UMC and the Taiwan Stock Exchange. The trading restrictions expired on one-half of the shares six months after the date of the merger, on July 3, 2000. The remaining shares will become available for sale over a two-year period beginning in January 2002. When the shares are ultimately sold, it is likely that we will recognize additional gains or losses due to fluctuations in the price of the UMC shares. While we do not anticipate the need for such funds in the current year, we may liquidate a portion of the UMC shares that are available for sale, and use the proceeds to support our operations and capital expenditures.

Impact of Currency Exchange Rates

A portion of our revenues are denominated in Japanese Yen. We enter into foreign exchange forward contracts to hedge against changes in foreign currency exchange rates. No forward contracts were outstanding at December 31, 2000. At December 31, 1999, two forward contracts with notional amounts of \$8.2 million were outstanding. Future exchange rate fluctuations could have a material adverse effect on our business, financial condition and results of operations.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement 133, Accounting for Derivative Instruments and Hedging Activities, which we are required to adopt in fiscal 2001. Historically, we have had a minimal use of derivatives and do not anticipate that the adoption of the new Statement will have a significant effect on our earnings or financial position.

In December 1999, The Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements." SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. All registrants are expected to apply the accounting and disclosures described in SAB 101. Our implementation of SAB 101 did not have a material impact on our consolidated results of operations, financial position and cash flows.

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation-an Interpretation of APB Opinion No. 25." FIN 44 clarifies the application of APB Opinion 25 and, among other issues clarifies the following: the definition of an employee for the purposes of applying APB Opinion No. 25; the criteria for determining whether a plan qualifies as a noncompensatory plan; the accounting consequences of various modifications to the terms for the previously fixed stock options or awards; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 became effective July 1, 2000 and did not have a material impact on our consolidated results of operations, financial position, and cash flows.

Factors That May Affect Future Results

Our operating results may fluctuate significantly, which may adversely affect our stock price.

Our quarterly and annual operating results have fluctuated significantly in the past and we expect that they will continue to fluctuate in the future. This fluctuation is a result of a variety of factors, including the following:

- unpredictable demand for our products;
- decline in the average selling prices of our products due to competitive pricing pressures;
- seasonality in sales of our products;
- excess capacity of flash memory from our competitors and our own new flash wafer capacity;
- difficulty of forecasting and management of inventory levels; and in particular, building a large inventory of unsold product due to non-cancelable contractual obligations to purchase materials such as flash wafers, controllers, printed circuit boards and discrete components; and
- expenses related to obsolescence or devaluation of unsold inventory, or reserves necessary to protect us against future write-offs of such unsold inventory.
- adverse changes in product and customer mix;
- slower than anticipated market acceptance of new or enhanced versions of our products;
- competing flash memory card standards which displace the standards used in our products;
- changes in our distribution channels;
- timing of license and royalty revenue;
- fluctuations in product costs, particularly due to fluctuations in manufacturing yields and utilization;
- availability of sufficient silicon wafer foundry capacity to meet customer demand;

- shortages of components such as capacitors and printed circuit boards required for the manufacturing of our products;
- significant yield losses which could affect our ability to fulfill customer orders and could increase our costs;
- manufacturing flaws affecting the reliability, functionality or performance of our products which could increase our product costs, reduce demand for our products or require product recalls;
- lengthening in manufacturing cycle times due to our suppliers operating at peak capacity;
- increased research and development expenses;
- exchange rate fluctuations, particularly the U.S. dollar to Japanese yen exchange rate;
- changes in general economic conditions, particularly in Japan and the European Union;
- natural disasters affecting the countries in which we conduct our business, particularly Taiwan, Japan and the United States;

Difficulty of estimating silicon wafer needs

When we order silicon wafers from our foundries, we have to estimate the number of silicon wafers needed to fill product orders several months into the future. If we overestimate this number, we will build excess inventories, which could harm our gross margins and operating results. Bookings visibility declined significantly late in the fourth quarter of 2000, and remains low in 2001 due to the current economic uncertainty in our markets. On the other hand, if we underestimate the number of silicon wafers needed to fill product orders, we may be unable to obtain an adequate supply of wafers, which could harm our product revenues. Because our largest volume products, CompactFlash and MultiMediaCard, are sold into emerging consumer markets, it has been difficult to accurately forecast future sales. A substantial majority of our quarterly sales have historically been from orders received and fulfilled in the same quarter, which makes accurate forecasting very difficult. In addition, our product order backlog may fluctuate substantially from quarter to quarter.

Anticipated growth in expense levels

We significantly increased our expense levels in 2000 to support our growth. We may need to hire additional personnel or increase our operating expenses in 2001 to support our sales and marketing efforts and research and development activities, including our joint venture with Toshiba providing for the development of 512 megabit and 1 gigabit flash memory chips. We have significant fixed costs and we cannot readily reduce these expenses over the short term. If our revenues do not increase proportionately to our operating expenses, or if revenues decrease or do not meet expectations for a particular period, such as we are forecasting for the first quarter of 2001, our business, financial condition and results of operations will be harmed.

Variability of average selling prices and gross margin

Our product mix varies quarterly, which affects our overall average selling prices and gross margins. Our CompactFlash and MultiMediaCard products, which currently represent the majority of our product revenues, have lower average selling prices and gross margins than our higher capacity FlashDisk and FlashDrive products. We believe that sales of CompactFlash and MultiMediaCard products will continue to represent a significant percentage of our product revenues as consumer applications, such as digital cameras and digital music players, become more popular. In fiscal 2000, average selling prices per megabyte decreased 22% compared to fiscal 1999, reflecting the Flash memory supply shortages that prevailed during the first nine months of the year, which helped to keep selling prices in 2000 more stable than in 1999. Average selling prices per megabyte declined 52% in 1999 compared to 1998. Due to recent increases in flash memory foundry capacity and the economic slow-down in the first quarter of 2001, we expect that the decline in our average selling prices in 2001 will be more severe than in 2000. If we cannot reduce our product manufacturing costs in 2001 to offset these reduced prices, our gross margins and net profitability will suffer.

Variability of license fees and royalties

Our intellectual property strategy consists of cross-licensing our patents to other manufacturers of flash products. Under these arrangements, we earn license fees and royalties on individually negotiated terms. The timing of revenue recognition from these payments is dependent on the terms of each contract and on the timing of product shipments by the third parties. Our income from patent licenses and royalties can fluctuate significantly from quarter to quarter. A substantial portion of this income comes from royalties based on the actual sales by our licensees. Given the current market outlook for 2001, sales of licensed flash products by our licensees may be substantially lower than the corresponding sales in recent quarters, which may cause a substantial drop in our royalty revenues. Because these revenues have higher gross margins than product revenues, gross margins and net income fluctuate significantly with changes in license and royalty revenues.

Continuing declines in our average sales prices may result in declines in our gross margins.

In 2000, the average price per megabyte shipped declined 22% compared to 1999. Flash data storage markets are intensely competitive and accordingly, price reductions for our products are necessary to meet consumer price points. Due to recent increases in flash memory foundry capacity and the worldwide economic slow-down in the first quarter of 2001, we expect that price declines for our products could be significant on an annualized basis. If we cannot reduce our product manufacturing costs in 2001 to offset these reduced prices, our gross margins and net profitability will suffer.

Our selling prices may be affected by excess capacity in the market for flash memory products. In the first nine months of 2000, industry-wide demand for flash memory products exceeded the available supply, driven by an explosion in the growth of cellular phones and the accelerating shift in consumer electronics from analog to digital devices. Flash memory suppliers, including SanDisk, responded to this strong demand by significantly increasing investments in new advanced flash memory production capacity. This has led to a significant increase in worldwide flash memory supply at a time when customer demand has decreased significantly, causing excess supply in the markets for our products and significant declines in average selling prices. If this situation continues throughout 2001, we expect that price declines for our products could be significant on an annualized basis. If we cannot reduce our product manufacturing costs in 2001 to offset these reduced prices, our gross margins and net profitability will suffer.

Our business depends upon consumer products. In 2000, we continued to receive more product revenue and ship more units of products for consumer electronics applications, principally digital cameras, compared to other applications. The consumer market is intensely competitive and is more price sensitive than our other target markets. In addition, we must spend more on marketing and promotion in consumer markets to establish brand name recognition and drive demand.

A significant portion of our sales to the consumer electronics market is made through distributors and to retailers. Sales through these channels typically include rights to return unsold inventory. As a result, we do not recognize revenue until after the product has been sold through to the end user. If our distributors and retailers are not successful in this market, there could be substantial product returns, which would harm our business, financial condition and results of operations.

There is seasonality in our business.

Sales of our products, in particular the sale of CompactFlash and MultiMediaCard products, in the consumer electronics market may be subject to seasonality. As a result, product sales may be impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of each year. In addition, in the past we have experienced a decrease in orders in the first quarter from our Japanese OEM customers primarily because most customers in Japan operate on a fiscal year ending in March and prefer to delay purchases until the beginning of their next fiscal year. Although we did not experience seasonality in 2000, we cannot assure you that we will not experience seasonality in 2001 or future years.

In transitioning to new processes and products, we face production and market acceptance risks.
General

Successive generations of our products have incorporated semiconductor devices with greater memory capacity per chip. Two important factors have enabled us to decrease the cost per megabyte of our flash

data storage products: the development of higher capacity semiconductor devices and the implementation of smaller geometry manufacturing processes. A number of challenges exist in achieving a lower cost per megabyte, including:

- lower yields often experienced in the early production of new semiconductor devices;
- manufacturing flaws with new processes including manufacturing processes at our subcontractors which may be extremely complex;
- problems with design and manufacturing of products that will incorporate these devices; and
- production delays.

Because our products are complex, we periodically experience significant delays in the development and volume production ramp up of our products. Similar delays could occur in the future and could harm our business, financial condition and results of operations.

D2 flash technology

We have developed new products based on D2 flash technology, a flash architecture designed to store two bits in each flash memory cell. High density flash memory, such as D2 flash, is a complex technology that requires strict manufacturing controls and effective test screens. Problems encountered in the shift to volume production for new flash products could impact both reliability and yields, and result in increased manufacturing costs and reduced product availability. We may not be able to manufacture future generations of our D2 products with yields sufficient to result in lower costs per megabyte. If we are unable to bring future generations of our 256 and 512 megabit flash memory into full production as quickly as planned or if we experience unplanned yield or reliability problems, our revenues and gross margins will decline.

Secure Digital Card products

SanDisk, along with Matsushita and Toshiba, jointly developed and will promote the Secure Digital Card. The Secure Digital Card is an enhanced version of our MultiMediaCard that incorporates advanced security and copyright protection features required by the emerging markets for the electronic distribution of music, video and other copyrighted works. We began shipping our Secure Digital Card products in the first quarter of 2001, and expect to begin high-volume production in the first half of 2001.

The Secure Digital Card incorporates a number of new features, including SDMI compliant security and copy protection, a mechanical write protect switch and a high data transfer rate. We have never before built products incorporating these features. Any problems or delays in establishing production capabilities or ramping up production volumes of our Secure Digital Card products could result in lost sales or increased manufacturing costs in 2001 and beyond. In addition, we cannot be sure that manufacturers of consumer electronic products will develop new products that use the Secure Digital Card or that content providers such as music studios will agree to distribute their copyrighted content for storage on Secure Digital Cards. For example, in 2000 the major U.S. based content

providers have had significant success in U.S. courts in their litigation with Napster.Com and MP3.Com, and this may have slowed down the widespread distribution of digital music on the internet. Although the Secure Digital Card is designed specifically to address the copy protection rights of the content providers, there can be no assurance that these content providers will find these measures sufficient or will agree to support them. Furthermore, there is no assurance that consumers will widely adopt Secure Digital Cards, as they only operate with copyrighted content. Conversely, broad acceptance of our Secure Digital Card by consumers may reduce demand for our MultiMediaCard and CompactFlash card products. See “– The success of our business depends on emerging markets and new products.”

We depend on third party foundries for silicon wafers.

All of our products require silicon wafers. We rely on UMC in Taiwan and Toshiba in Yokkaichi, Japan to supply the majority of our silicon wafers. We depend on UMC to allocate a portion of its capacity to meet our needs, produce acceptable quality wafers with acceptable manufacturing yields and deliver our wafers on a timely basis at a competitive price. If UMC is unable to satisfy these requirements, our business, financial condition and operating results may suffer. Any disruption in supply from UMC due to natural disaster, power failure or other causes could significantly harm our business, financial condition and results of operations.

Under the terms of our wafer supply agreements with UMC, we are obligated to provide a rolling forecast of anticipated purchase orders for the next six calendar months. Generally, the estimates for the first three months of each forecast are binding commitments. The estimates for the remaining months may only be changed by a certain percentage from the previous month's forecast. This limits our ability to react to fluctuations in demand for our products. For example, if customer demand falls below our forecast and we are unable to reschedule or cancel our wafer orders, we may end up with excess wafer inventories, which could result in higher operating expenses and reduced gross margins. Conversely, if customer demand exceeds our forecasts, we may be unable to obtain an adequate supply of wafers to fill customer orders, which could result in dissatisfied customers, lost sales and lower revenues. In addition, in February 2000, we entered into a capacity and reservation deposit agreement with UMC. To reserve additional foundry capacity under this agreement, we paid UMC a reservation deposit. This deposit will be refunded to us on a quarterly basis, over the agreement term, if we purchase the full wafer capacity reserved for us. We may forfeit part of our deposit if we are unable to utilize our reserved capacity within four quarters of the end of the agreement term. If we are unable to obtain scheduled quantities of wafers with acceptable price and yields from any foundry, our business, financial condition and results of operations could be harmed. In 2000, 1999, and 1998, we purchased wafers from

UMC, a foundry in which we have ownership, totaling approximately \$161.6 million, \$22.8 million and \$11.6 million, respectively.

In the third quarter of 2000, we completed qualifications and began volume production of the 256 megabit D2 0.24 micron technology in two UMC fabs. We now have three UMC fabs producing our 0.24 micron wafers. The yields on these wafers vary from fab to fab due to the relative stage of start-up or production ramp. The third UMC fab to begin production is a new UMC fab and we have been experiencing lower yields than the two other fabs. There can be no assurances that we will not experience delays in wafer availability, low yields, or undetected manufacturing flaws which may adversely impact the reliable operation of our products. Any such difficulties may adversely impact our product supply and gross margins.

Our investment in new flash memory wafer production may result in increased expenses and fluctuations in operating results.

On June 30, 2000, we closed a transaction with Toshiba providing for the joint development and manufacture of 512 megabit and 1 gigabit flash memory chips and Secure Digital Card controllers. Under this agreement, we had invested \$134.7 million as of December 31, 2000 and in January 2001 invested the remaining \$15.3 million. We have also guaranteed up to \$215 million in equipment lease lines entered into by FlashVision LLC, which is jointly owned by us and Toshiba, million in equipment lease lines to equip Toshiba's Dominion Semiconductor manufacturing clean room with advanced wafer processing equipment. As of January 26, 2001, \$20 million of this amount had been borrowed by FlashVision. Toshiba is obligated to invest and guarantee an equal amount and each of us will equally share the startup expenses and the wafer output. We will use the new production capacity at Dominion to manufacture primarily NAND flash memory wafers with minimum lithographic feature size of 0.16 micron initially, moving to 0.13 micron in the future. Such minimum feature sizes are considered today to be among the most advanced for mass production of silicon wafers and have never been used for the high volume manufacture of flash memory chips. Therefore, it is difficult to predict how long it will take to equip and commence production at the new facility and achieve adequate yields, reliable operation, and economically attractive product costs based on our new designs. We have not operated our own wafer fabrication facility in the past and therefore we rely on Toshiba to address these challenges. With our investments in the Dominion facility, we are now exposed to the adverse financial impact of any delays or manufacturing problems associated with the wafer production line. Any problems or delays in commencing production at the new Dominion facility could adversely impact our operating results in 2001 and beyond.

We expect to incur substantial start up expenses related to the hiring and training of manufacturing personnel, facilitating the clean room and installing equipment. During the ramp-up period, currently expected to

begin in the middle of 2001, equipment depreciation begins and line operating expenses increase substantially. While the wafer output is still relatively low, the cost of wafers from the Dominion facility is expected to be significantly higher than the cost of wafers from our other suppliers. This may negatively impact our overall product gross margins until flash wafer output from Dominion reaches an optimum level, which may never occur. Under our agreement with Toshiba, we are committed to purchase 50% of the output from the Dominion facility. We will incur startup costs and pay our share of ongoing operating activities even if we do not utilize our full share of the Dominion output. Should customer demand for NAND flash products be less than our available supply, we may suffer from reduced revenues and increased expenses, and increased inventory of unsold NAND flash wafers, which could adversely affect our operating results. We cannot assure you that we or Toshiba will be able to secure sufficient funding to support this manufacturing line. Furthermore, in order for us to sell NAND based CompactFlash, MultiMediaCards and SD Cards, we will have to develop new controllers, printed circuit boards and test algorithms because the architecture of NAND flash is significantly different from our current NOR flash designs. Any delays in the development of these elements could prevent us from taking advantage of the available NAND output and could adversely affect our results of operations.

On July 4, 2000, SanDisk entered into a share purchase agreement to make a \$75 million investment in Tower Semiconductor, or Tower, in Israel, representing approximately 10% ownership of Tower. In exchange for our investment, we received one seat on the board of directors of Tower and a guaranteed portion of the wafer output from the advanced fabrication facility Tower is starting to build in Migdal Haemek, Israel. Under the terms of the agreement, we will make our investment over a period of approximately 18 months if key milestones related to the construction, equipping and wafer production at the new wafer fabrication facility are met. On January 26, 2001, Tower satisfied the closing conditions of the share purchase agreement, and we transferred the first \$20 million of our investment from an escrow account to Tower in exchange for 866,551 ordinary shares and obtain \$8.8 million in pre-paid wafer credits. On March 1, 2001, we paid Tower \$11 million upon its completion of milestone one, to purchase 366,690 ordinary shares and obtain additional prepaid wafer credits. Additional contributions will take the form of mandatory warrant exercises for ordinary shares at an exercise price of \$30.00 per share if other milestones are met. The warrants will expire five years from the date of grant, and in the event the key milestones are not achieved, the exercise of these warrants will not be mandatory. We expect first wafer production to commence at the new fabrication facility in late 2002.

Although we do not believe the current political unrest in Israel represents a major security problem for Tower, in which we recently invested, since Migdal

Haemek, Israel is in a secure geographic location, the unrest may nevertheless cause scheduling delays. We cannot assure you that the Tower facility will be completed or will begin production as scheduled, or that the processes needed to fabricate our wafers will be qualified at the new facility. Moreover, we cannot assure you that this new facility will be able to achieve acceptable yields or deliver sufficient quantities of wafers on a timely basis at a competitive price.

The success of our business depends on emerging markets and new products.

In order for demand for our products to grow, the markets for new products that use CompactFlash, the MultiMediaCard, and Secure Digital Card such as portable digital music players and smart phones, must develop and grow. If sales of these products do not grow, our revenues and profit margins could level off or decline.

Because we sell our products for use in many new applications, it is difficult to forecast demand. During the third quarter of 2000, the U.S. Courts ruled against Napster.Com and MP3.Com in two cases involving unlicensed distribution of copyrighted digital music over the Internet. This action is being carefully studied by the original equipment manufacturers, or OEMs, who have been developing MP3 players using Flash memory cards such as our MultiMediaCards for storage of music. If these OEMs reduce their production of digital music players in response to these recent court decisions or other factors, demand for our products will decrease. In addition, we believe that these OEMs may redesign their platforms to work with our Secure Digital Card, which we began shipping in the first quarter of 2001. Accordingly, we may experience a drop in demand from our MultiMediaCard customers before the new anticipated demand for our Secure Digital Card materializes.

Secure Digital Card products

As part of our June 2000 joint venture with Toshiba, we will jointly develop the Secure Digital Card, an enhanced version of our MultiMediaCard, which will incorporate advanced security and copyright protection features required by the emerging markets for the electronic distribution of music, video and other copyrighted works. We began shipping our Secure Digital Card products in 32 and 64 megabyte capacities in the first quarter of 2001. The Secure Digital Card is slightly thicker and uses a different interface than our MultiMediaCard. Because of these differences, the Secure Digital Card will not work in current products that include a MultiMediaCard slot. In order for the market for our Secure Digital Card to develop, manufacturers of digital audio/video and portable computing products must include a Secure Digital Card compatible slot in their products and acquire a license to the security algorithms. If OEMs do not incorporate Secure Digital Card slots in their products or do not buy our Secure Digital Cards, our business, financial condition and results of operations may be harmed. In addition, consumers may postpone or altogether forego buying

products that utilize our MultiMediaCard in anticipation of new products such as MP3 players and digital camcorders that will incorporate the Secure Digital Card. If this occurs, sales of our MultiMediaCard products may be harmed. The main competition for the Secure Digital Card is expected to come from the Sony Memory Stick. Sony has substantially greater financial and other resources than we do and extensive marketing and sales channels and brand recognition. We cannot assure you that our Secure Digital Card will be successful in the face of such competition.

In addition, the market for portable digital music players is very new and it is uncertain how quickly consumer demand for these players will grow. If this market does not grow as quickly as anticipated or our customers are not successful in selling their portable digital music players to consumers, our revenues could be adversely affected. In addition, it is often the case with new consumer markets that after an initial period of new market formation and initial acceptance by early adopters, the market enters a period of slow growth as standards emerge and infrastructure develops. In the event that this occurs in the portable digital music player market or other emerging markets, sales of our products would be harmed.

The success of our new product strategy will depend upon, among other things, the following:

- our ability to successfully develop new products with higher memory capacities and enhanced features at a lower cost per megabyte;
- the development of new applications or markets for our flash data storage products;
- the adoption by the major content providers of the copy protection features offered by our Secure Digital Card products;
- the extent to which prospective customers design our products into their products and successfully introduce their products; and
- the extent to which our products or technologies become obsolete or noncompetitive due to products or technologies developed by others.

512 megabit and 1 gigabit flash memory card products

On June 30, 2000, we closed a transaction with Toshiba providing for the joint development and manufacture of 512 megabit and 1 gigabit flash memory chips and Secure Digital Card controllers. As part of this collaboration, we and Toshiba plan to employ Toshiba's 0.16 micron and future 0.13 micron NAND flash integrated circuit manufacturing technology and SanDisk's multilevel cell flash and controller system technology. During the third quarter of 2000, we announced with Toshiba the completion of the joint development of the 512 Megabit NAND flash chip employing Toshiba's .16 micron manufacturing process technology. We expect cards employing the 512 megabit technology to be shipped in significant quantities in the second half of 2001, and cards employing the 1 gigabit technology to be shipped in 2002. The development of 512 megabit and 1 gigabit flash

memory chips and Secure Digital Card controllers is expected to be complex and incorporates SanDisk and Toshiba technology that is still under development. We cannot assure you that we and Toshiba will successfully develop and bring into full production with acceptable yields and reliability these new products or the underlying technology, or that any development or production ramp will be completed in a timely or cost-effective manner. If we are not successful in any of the above, our business, financial condition and results of operations could suffer.

We may be unable to maintain market share.

During periods of excess supply in the market for our flash memory products, such as we are experiencing in the first half of 2001, we may lose market share to competitors who aggressively lower their prices. Conversely, under conditions of tight flash memory supply, we may be unable to increase our production volumes at a sufficiently rapid rate so as to maintain our market share. Ultimately, our growth rate depends on our ability to obtain sufficient flash memory wafers and other components to meet demand. If we are unable to do so in a timely manner, we may lose market share to our competitors.

Our international operations make us vulnerable to changing conditions and currency fluctuations.

Political risks

Currently, the majority of our flash memory wafers are produced by three UMC foundries in Taiwan. We also use a third-party subcontractor in Taiwan for the assembly and testing of our MultiMediaCard products. We may therefore be affected by the political, economic and military conditions in Taiwan. Taiwan is currently engaged in various political disputes with China and in the past both countries have conducted military exercises in or near the other's territorial waters and airspace. The Taiwanese and Chinese governments may escalate these disputes, resulting in an economic embargo, a disruption in shipping routes or even military hostilities. This could harm our business by interrupting or delaying the production or shipment of flash memory wafers or MultiMediaCard products by our Taiwanese foundries and subcontractor. See "- We depend on our suppliers and third party subcontractors."

We use a third-party subcontractor in China for the assembly and testing of our CompactFlash products. As a result, our business could be harmed by the effect of political, economic, legal and other uncertainties in China. Under its current leadership, the Chinese government has been pursuing economic reform policies, including the encouragement of foreign trade and investment and greater economic decentralization. The Chinese government may not continue to pursue these policies and, even if it does continue, these policies may not be successful. The Chinese government may also significantly alter these policies from time to time. In addition, China does not currently have a comprehensive and highly developed legal system, particularly with respect to the protection of intellectual

property rights. As a result, enforcement of existing and future laws and contracts is uncertain, and the implementation and interpretation of such laws may be inconsistent. Such inconsistency could lead to piracy and degradation of our intellectual property protection.

In addition, while the political unrest in Israel has not yet posed a direct security risk to our engineering design center or our foundry investment in Tower Semiconductor due to their geographic location, it may nevertheless cause unforeseen delays in the development of our products or the construction of the Tower wafer foundry.

Economic risks

We price our products primarily in U.S. dollars. Given the recent economic conditions in Asia and the European Union and the weakness of the Euro, Yen and other currencies relative to the United States dollar, our products may be relatively more expensive in these regions, which could result in a decrease in our sales. While most of our sales are denominated in U.S. Dollars, we invoice certain Japanese customers in Japanese Yen and are subject to exchange rate fluctuations on these transactions which could harm our business, financial condition and results of operations.

Our sales are also highly dependent upon global economic conditions. An example of this is our sales to Japan, which declined to 21% of product revenue in 2000, from 22% of product revenue in 1999. In 1998 our sales to Japan were 32% of total product revenue, down from 38% in 1997. We believe these declines were primarily due to the ongoing Japanese recession.

General risks

Our international business activities could also be limited or disrupted by any of the following factors:

- the need to comply with foreign government regulation;
- general geopolitical risks such as political and economic instability, potential hostilities and changes in diplomatic and trade relationships;
- natural disasters affecting the countries in which we conduct our business, such as the earthquake experienced in Taiwan in 1999;
- imposition of regulatory requirements, tariffs, import and export restrictions and other barriers and restrictions, particularly in China;
- longer payment cycles and greater difficulty in accounts receivable collection, particularly as we increase our sales through the retail distribution channel;
- adverse tax rules and regulations;
- weak protection of our intellectual property rights; and
- delays in product shipments due to local customs restrictions.

We depend on our suppliers and third party subcontractors.

We rely on our vendors, some of which are sole source suppliers, for several of our critical components. We do not have long-term supply agreements

with some of these vendors. Our business, financial condition and operating results could be significantly harmed by delays or reductions in shipments if we are unable to develop alternative sources or obtain sufficient quantities of these components. For example, we rely on UMC for the majority of our flash memory wafers and NEC to supply 100% of certain designs of microcontrollers.

We also rely on third-party subcontractors for a substantial portion of wafer testing, packaged memory final testing, card assembly and card testing, including Silicon Precision Industries Co., Ltd. in Taiwan, Celestica, Inc. in China, and Amkor, in the Philippines. These three subcontractors will also be assembling and testing a majority of our mature, high-volume products. We began transferring portions of our testing and assembly operations to these subcontractors in the second half of 1999 and are still continuing this transition. We will continue operations at our Sunnyvale production facility for new products and special customer requirements. However, we do not have sufficient duplicative production testing equipment at Sunnyvale and at our subcontractors. Any problems in this complex transition may result in a disruption of production and a shortage of product to meet customer demand. We have no long-term contracts with these subcontractors and cannot directly control product delivery schedules. Any significant problems that occur at our subcontractors, or their failure to perform at the level we expect could lead to product shortages or quality assurance problems, which could increase the manufacturing costs of our products and have adverse effects on our operating results. Furthermore, we are moving to turnkey manufacturing with some of our subcontract suppliers, which may reduce our visibility and control of their inventories of purchased parts necessary to build our products.

Our markets are highly competitive.

Flash memory manufacturers and memory card assemblers

We compete in an industry characterized by intense competition, rapid technological changes, evolving industry standards, declining average selling prices and rapid product obsolescence. Our competitors include many large domestic and international companies that have greater access to advanced wafer foundry capacity, substantially greater financial, technical, marketing and other resources, broader product lines and longer standing relationships with customers.

Our primary competitors include companies that develop and manufacture storage flash chips, such as Hitachi, Samsung, Micron Technology and Toshiba. In addition, we compete with companies that manufacture other forms of flash memory and companies that purchase flash memory components and assemble memory cards. Companies that manufacture socket flash, linear flash and components include Advanced Micro Devices, Atmel, Intel, Macronix, Mitsubishi, Fujitsu, Sharp Electronics and ST Microelectronics. Companies that combine controllers and flash memory chips developed by others into flash storage cards

include Lexar Media, M-Systems, Pretec, Simple Technology, Sony Corporation, Kingston Technology, Panasonic, Silicon Storage Technology, TDK Corporation, Matsushita Battery, Delkin Devices, Inc., Feiya Technology Corporation, Dane-Elec Manufacturing, Silicon Tek, Infineon Technologies and Viking Components.

In addition, many companies have been certified by the CompactFlash Association to manufacture and sell their own brand of CompactFlash. We believe additional manufacturers will enter the CompactFlash market in the future.

We have announced an agreement with Matsushita and Toshiba to jointly develop and promote a next generation flash memory card called the Secure Digital Card. Under this agreement, Secure Digital Card royalty-bearing licenses will be granted to other flash memory card manufacturers, which will increase the competition for our Secure Digital Card, CompactFlash and MultiMediaCard products. In addition, Matsushita and Toshiba have commenced selling Secure Digital Cards that will compete directly with our products. While other flash card manufacturers will be required to pay the SD Association license fees and royalties which will be shared between Matsushita, Toshiba and SanDisk, there will be no royalties or license fees payable among the three companies for their respective sales of the Secure Digital Card. Thus, we will forfeit potential royalty income from Secure Digital Card sales by Matsushita and Toshiba.

In addition, we and Toshiba will each separately market and sell any 512 megabit and 1 gigabit flash memory chips and Secure Digital Card controllers developed and manufactured under our relationship. Accordingly, we will compete directly with Toshiba for sales of these advanced chips and controllers.

We have entered into patent cross-license agreements with several of our leading competitors including Hitachi, Lexar, Samsung, Toshiba, Intel, SST, Sharp, SmartDisk and TDK. Under these agreements, each party may manufacture and sell products that incorporate technology covered by the other party's patents related to flash memory devices. As we continue to license our patents to certain of our competitors, competition will increase and may harm our business, financial condition and results of operations. Currently, we are engaged in licensing discussions with several of our competitors. There can be no assurance that we will be successful in concluding licensing agreements under terms, which are favorable to us.

Alternative storage media

Competing products have been introduced that promote industry standards that are different from our CompactFlash and MultiMediaCard products including Toshiba's SmartMedia, Sony Corporation's Memory Stick, Sony's standard floppy disk used for digital storage in its Mavica digital cameras, Panasonic's Mega Storage cards, Iomega's Clik drive, a miniaturized, mechanical, removable disk drive, and M-Systems' Diskonchip for embedded storage applications and the

Secure MultiMediaCard from Hitachi and Infineon. Each competing standard is mechanically and electronically incompatible with CompactFlash and MultiMediaCard. If a manufacturer of digital cameras or other consumer electronic devices designs in one of these alternative competing standards, CompactFlash or MultiMediaCard will be eliminated from use in that product.

IBM's microdrive, a rotating disk drive in a Type II CompactFlash format competes directly with our Type II CompactFlash memory cards for use in high-end professional digital cameras. M-Systems' Diskonchip 2000 Millennium product competes against our Flash ChipSet products in embedded storage applications such as set top boxes and networking appliances.

According to independent industry analysts, Sony's Mavica digital camera captured a considerable portion of the U.S. market for digital cameras from 1998 to 2000. The Mavica uses a standard floppy disk to store digital images and therefore uses no CompactFlash, or any other flash cards. Our sales prospects for CompactFlash cards have been adversely impacted by the success of the Mavica. Recently, Sony has shifted its focus to the use of its flash Memory Stick in its latest digital camera models.

Our MultiMediaCard products also have faced significant competition from Toshiba's SmartMedia flash cards and we expect to face similarly significant competition from Sony's Memory Stick. Sony has licensed its proprietary Memory Stick to other companies. If it is adopted and achieves widespread use in future products, sales of our MultiMediaCard and CompactFlash products may decline. Recently, Hitachi, Infineon, Sanyo and Fujitsu have proposed their Secure MultiMediaCard which provides the copy protection function that is included in our Secure Digital Card. Should this initiative gain industry wide acceptance, it may reduce the widespread adoption of the Secure Digital Card.

In the first quarter of 2000, Sanyo announced that it is developing a miniature magneto-optical storage device for use in future digital cameras, music players and camcorders. There can be no assurance that this device will not be adopted by some of our OEM customers.

Alternative flash technologies

We also face competition from products based on multilevel cell flash technology from Intel and Hitachi. These products compete with our D2 multilevel cell flash technology. Multilevel cell flash is a technological innovation that allows each flash memory cell to store two bits of information instead of the traditional single bit stored by the industry standard flash technology.

Furthermore, we expect to face competition from existing competitors and from other companies that may enter our existing or future markets that have similar or alternative data storage solutions which may be less costly or provide additional features. Price is an important competitive factor in the market for consumer products. Increased price competition could lower gross margins if our average selling prices decrease faster than our costs and could also result in lost sales.

Sales to a small number of customers represent a significant portion of our revenues.

Approximately one-half of our revenues come from a small number of customers. For example, sales to our top 10 customers accounted for approximately 48%, 57%, and 59%, respectively, of our product revenues for 2000, 1999, and 1998. In 2000, no single customer accounted for greater than 10% of our total revenues. In 1999 and 1998, revenues from one customer exceeded 10% of our total revenues. If we were to lose one of our major customers or experience any material reduction in orders from any of these customers, our revenues and operating results would suffer. Our sales are generally made by standard purchase orders rather than long-term contracts. In addition, the composition of our major customer base changes from year to year as the market demand for our customers' products changes.

Our multiple sales channels may compete for a limited number of customer sales.

Web based sales of our products today represent a small but growing portion of our overall sales. Sales on the Internet tend to undercut traditional distribution channels and may dramatically change the way our consumer products are purchased in future years. We cannot assure you that we will successfully develop the Internet sales channel or successfully manage the inherent conflict between the Internet and our traditional sales channels.

We must achieve acceptable wafer manufacturing yields.

The fabrication of our products requires wafers to be produced in a highly controlled and ultra clean environment. Semiconductor companies that supply our wafers sometimes have experienced problems achieving acceptable wafer manufacturing yields.

Semiconductor manufacturing yields are a function of both our design technology and the foundry's manufacturing process technology. Low yields may result from design errors or manufacturing failures. Yield problems may not be determined or improved until an actual product is made and can be tested. As a result, yield problems may not be identified until the wafers are well into the production process. The risks associated with yields are even greater because we rely exclusively on independent offshore foundries for our wafers which increases the effort and time required to identify, communicate and resolve manufacturing yield problems. If the foundries cannot achieve planned yields, we will experience higher costs and reduced product availability, which could harm our business, financial condition and results of operations.

In addition, we cannot assure you that the Dominion fabrication facility we are co-developing with Toshiba, will produce satisfactory quantities of wafers with acceptable prices, reliability and yields. Any failure in this regard could materially harm our business, financial condition and results of operations. In addition, the construction and operation of this line will cause us to incur significant expense and may result in

the diversion of resources from other important areas of our business. In addition, we have no experience in operating a wafer manufacturing line and we intend to rely on the existing manufacturing organization at the Dominion facility. This organization will be trained in NAND flash manufacturing by Toshiba, but we cannot assure you that they will be successful in manufacturing these advanced NAND flash products on a cost-effective basis or at all.

Risks associated with patents, proprietary rights and related litigation.

General

We rely on a combination of patents, trademarks, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. In the past, we have been involved in significant disputes regarding our intellectual property rights and claims that we may be infringing third parties' intellectual property rights. We expect that we may be involved in similar disputes in the future. We cannot assure you that:

- any of our existing patents will not be invalidated;
- patents will be issued for any of our pending applications;
- any claims allowed from existing or pending patents will have sufficient scope or strength;
- our patents will be issued in the primary countries where our products are sold in order to protect our rights and potential commercial advantage; or
- any of our products may infringe on the patents of other companies.

In addition, our competitors may be able to design their products around our patents.

We intend to vigorously enforce our patents but we cannot be sure that our efforts will be successful. If we were to have an adverse result in any litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to the infringing technology. Any litigation is likely to result in significant expense to us, as well as divert the efforts of our technical and management personnel. For example, our recent Litigation with Lexar lasted for two and one-half years and resulted in cumulative litigation expenses of approximately \$6.0 million.

Cross-licenses and indemnification obligations

If we decide to incorporate third party technology into our products or if we are found to infringe on others' intellectual property, we could be required to license intellectual property from a third party. We may also need to license some of our intellectual property to others in order to enable us to obtain cross-licenses to third party patents. Currently, we have patent cross-license agreements with several companies, including Hitachi, Intel, Lexar, Samsung, Sharp, SST, SmartDisk, TDK and Toshiba and we are in discussions with other companies regarding potential cross-license agree-

ments. We cannot be certain that licenses will be offered when we need them, or that the terms offered will be acceptable. If we do obtain licenses from third parties, we may be required to pay license fees or royalty payments. In addition, if we are unable to obtain a license that is necessary to the manufacture of our products, we could be required to suspend the manufacture of products or stop our wafer suppliers from using processes that may infringe the rights of third parties. We cannot assure you that we would be successful in redesigning our products or that the necessary licenses will be available under reasonable terms.

We have historically agreed to indemnify various suppliers and customers for alleged patent infringement. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorney's fees. We may periodically engage in litigation as a result of these indemnification obligations. We are not currently engaged in any such indemnification proceedings. Our insurance policies exclude coverage for third party claims for patent infringement. Any future obligation to indemnify our customers or suppliers could harm our business, financial condition or results of operations.

Litigation risks associated with our intellectual property

From time to time, it may be necessary to initiate litigation against third parties to preserve our intellectual property rights. These parties could in turn bring suit against us. On March 21, 2000, Mitsubishi Denki Co. Ltd. (Mitsubishi Electric) filed a complaint in Tokyo District Court against SanDisk K.K., our wholly owned subsidiary in Japan. The complaint alleges that SanDisk K.K., based in Yokohama, Japan, infringes on three Mitsubishi Japanese patents. The Mitsubishi patents in question are #JP2099342, #JP2129071 and #JP2138047, which are related primarily to the mechanical construction of memory cards. In the complaint, Mitsubishi asked the court for a preliminary injunction halting the sale of SanDisk CompactFlash and flash ATA memory cards in Japan. Mitsubishi has since dropped patents #JP2129071 and #JP2138047 from the suit. We and SanDisk K.K. are vigorously defending against Mitsubishi's remaining claims.

Our rapid growth may strain our operations.

We have experienced rapid growth, which has placed a significant strain on our personnel and other resources. To accommodate future growth, we must continue to hire, train, motivate and manage our employees. We have experienced difficulty hiring the necessary engineering, sales and marketing personnel to support our growth. In addition, we must make a significant investment in our existing internal information management systems to support increased manufacturing, as well as accounting and other management related functions. Our systems, procedures and controls may not be adequate to support rapid growth, which could in turn harm our business, financial condition and results of operations.

California energy crisis

In recent months, California has been experiencing a shortage of energy supply. This shortage is expected to continue throughout 2001 and possibly into future years. Although the majority of our product assembly and testing is done outside of California, we may experience some hardship due to rolling blackouts and the need for reduced power consumption, as well as increased power costs.

Our success depends on key personnel, including our executive officers, the loss of whom could disrupt our business.

Our success greatly depends on the continued contributions of our senior management and other key research and development, sales, marketing and operations personnel, including Dr. Eli Harari, our founder, President and Chief Executive Officer. Our success will also depend on our ability to recruit additional highly skilled personnel. We cannot assure you that we will be successful in hiring or retaining such key personnel, or that any of our key personnel will remain employed with us.

Anti-takeover provisions in our charter documents, stockholder rights plan and in Delaware law could prevent or delay a change in control and, as a result, negatively impact our stockholders.

We have taken a number of actions that could have the effect of discouraging a takeover attempt. For example, we have adopted a stockholder rights plan that would cause substantial dilution to a stockholder, and substantially increase the cost paid by a stockholder, who attempts to acquire us on terms not approved by our board of directors. This could prevent us from being acquired. In addition, our certificate of incorporation grants the board of directors the authority to fix the rights, preferences and privileges of and issue up to 4,000,000 shares of preferred stock without stockholder action. Although we have no present intention to issue shares of preferred stock, such an issuance could have the effect of making it more difficult and less attractive for a third party to acquire a majority of our outstanding voting stock. Preferred stock may also have other rights, including economic rights senior to our common stock that could have a material adverse effect on the market value of our common stock. In addition, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law. This section provides that a corporation shall not engage in any business combination with any interested stockholder during the three-year period following the time that such stockholder becomes an interested stockholder. This provision could have the effect of delaying or preventing a change of control of SanDisk.

Our stock price has been, and may continue to be, volatile.

The market price of our stock has fluctuated significantly in the past and is likely to continue to fluctuate in the future. For example, in 2000 our stock price fluctuated significantly from a low of \$27.50 to a high

of \$169.63, and has recently traded as low as \$18.63. We believe that such fluctuations will continue as a result of future announcements concerning us, our competitors or principal customers regarding technological innovations, new product introductions, governmental regulations, litigation or changes in earnings estimates by analysts. In addition, in recent years the stock market has experienced significant price and volume fluctuations and the market prices of the securities of high technology companies have been especially volatile, often for reasons outside the control of the particular companies. These fluctuations as well as general economic, political and market conditions may have an adverse affect on the market price of our common stock.

Market Risk Disclosure Information

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in widely diversified short-term investments, consisting primarily of investment grade securities, substantially all of which either mature within the next twelve months or have characteristics of short-term investments. A hypothetical 50 basis point increase in interest rates would result in an approximate \$731,000 decline (less than 0.28%) in the fair value of our available-for-sale debt securities.

Foreign Currency Risk. A substantial majority of our revenue, expense and capital purchasing activity are transacted in U.S. dollars. However, we do enter into transactions in other currencies, primarily the Japanese Yen. To protect against reductions in value and the volatility of future cash flows caused by changes in foreign exchange rates, we have established a hedging program. Currency forward contracts are utilized in these hedging programs. Our hedging programs reduce, but do not always entirely eliminate, the impact of foreign currency exchange rate movements. An adverse change of 10% in exchange rates would result in a decline in income before taxes of approximately \$294,000.

All of the potential changes noted above are based on sensitivity analyses performed on our financial positions at December 31, 2000.

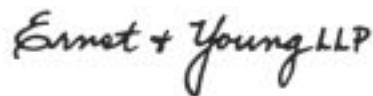
Report of Independent Auditors

The Board of Directors and Stockholders
SanDisk Corporation

We have audited the accompanying consolidated balance sheets of SanDisk Corporation as of December 31, 2000 and 1999, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SanDisk Corporation at December 31, 2000 and 1999 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.



San Jose, California
January 23, 2001

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

December 31,	2000	1999
Assets		
Current assets:		
Cash and cash equivalents	\$ 106,277	\$ 146,170
Short-term investments	373,316	311,049
Accounts receivable, net of allowance for doubtful accounts of \$5,010 in 2000 and \$1,871 in 1999	104,617	52,434
Inventories	96,600	35,679
Deferred tax assets	7,066	17,000
Prepaid expenses and other current assets	9,431	6,058
Total current assets	697,307	568,390
Property and equipment, net	41,095	31,788
Investment in foundry	197,688	51,208
Investment in joint venture	134,730	-
Deposits and other non-current assets	37,087	6,338
Total assets	\$ 1,107,907	\$ 657,724
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 67,112	\$ 30,734
Accrued payroll and related expenses	16,215	8,259
Income taxes payable	16,427	5,843
Other accrued liabilities	20,863	11,378
Deferred revenue	50,740	29,383
Total current liabilities	171,357	85,597
Deferred taxes and other liabilities	73,492	-
Total liabilities	244,849	85,597
Stockholders' equity:		
Preferred stock, \$0.001 par value		
Authorized shares: 4,000,000		
Issued: none	-	-
Common stock, \$0.001 par value		
Authorized shares: 125,000,000		
Issued and outstanding: 67,464,000 in 2000 and 65,248,000 in 1999	67	65
Capital in excess of par value	566,934	524,066
Retained earnings	346,469	47,797
Accumulated other comprehensive income (loss)	(50,412)	199
Total stockholders' equity	863,058	572,127
Total liabilities and stockholders' equity	\$ 1,107,907	\$ 657,724

The accompanying notes are an integral part of these consolidated financial statements

Consolidated Statements of Income

(In thousands, except per share data)

Years Ended December 31,	2000	1999	1998
Revenues			
Product	\$ 526,359	\$ 205,770	\$ 103,190
License and royalty	75,453	41,220	32,571
Total revenues	601,812	246,990	135,761
Cost of revenues	357,017	152,143	80,311
Gross profits	244,795	94,847	55,450
Operating expenses			
Research and development	46,057	26,883	18,174
Sales and marketing	49,286	25,294	16,933
General and administrative	24,786	12,585	7,533
Total operating expenses	120,129	64,762	42,640
Operating income	124,666	30,085	12,810
Interest income	22,786	8,280	5,307
Gain on investment in foundry	344,168	-	-
Other income, net	572	1,261	374
Income before taxes	492,192	39,626	18,491
Provision for income taxes	193,520	13,076	6,655
Net income	\$ 298,672	\$ 26,550	\$ 11,836
Net income per share			
Basic	\$ 4.47	\$ 0.48	\$ 0.23
Diluted	\$ 4.11	\$ 0.43	\$ 0.21
Shares used in computing net income per share			
Basic	66,861	55,834	52,596
Diluted	72,651	61,433	55,344

The accompanying notes are an integral part of these consolidated financial statements

Consolidated Statements of Stockholders' Equity

(In thousands)	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 1997	51,730	\$ 52	\$ 181,869	\$ 9,411	\$ 42	\$ 191,374
Net income	-	-	-	11,836	-	11,836
Unrealized gain on available for sale securities	-	-	-	-	429	429
Comprehensive income						12,265
Exercise of stock options for cash	1,260	1	929	-	-	930
Issuance of stock pursuant to employee stock purchase plan	260	1	1,474	-	-	1,475
Net exercise of common stock warrants	6	-	-	-	-	-
Income tax benefit from stock options exercised	-	-	1,761	-	-	1,761
Compensation expense related to modification of stock options	-	-	33	-	-	33
Balance at December 31, 1998	53,256	54	186,066	21,247	471	207,838
Net income	-	-	-	26,550	-	26,550
Unrealized loss on available for sale securities	-	-	-	-	(272)	(272)
Comprehensive income						26,278
Exercise of stock options for cash	1,766	2	6,107	-	-	6,109
Issuance of stock pursuant to employee stock purchase plan	268	-	1,807	-	-	1,807
Net exercise of common stock warrants	58	-	-	-	-	-
Sale of common stock, net of issuance costs	9,900	9	320,277	-	-	320,286
Income tax benefit from stock options exercised	-	-	9,809	-	-	9,809
Balance at December 31, 1999	65,248	65	524,066	47,797	199	572,127
Net income	-	-	-	298,672	-	298,672
Unrealized loss on available for sale securities	-	-	-	-	(343)	(343)
Unrealized loss on investments	-	-	-	-	(50,268)	(50,268)
Comprehensive income						248,061
Exercise of stock options for cash	2,147	2	10,370	-	-	10,372
Issuance of stock pursuant to employee stock purchase plan	69	-	2,815	-	-	2,815
Compensation expense related to modification of stock options	-	-	425	-	-	425
Sale of common stock, net of issuance costs	-	-	-	-	-	-
Income tax benefit from stock options exercised			29,258			29,258
Balance at December 31, 2000	67,464	\$ 67	\$ 566,934	\$ 346,469	\$ 50,412	\$ 863,058

The accompanying notes are an integral part of these consolidated financial statements

Consolidated Statements of Cash Flows

((In thousands))

Years Ended December 31,

	2000	1999	1998
Cash flows from operating activities:			
Net income	\$ 298,672	\$ 26,550	\$ 11,836
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred taxes	114,501	(1,100)	1,160
Gain on investment in foundry	(344,168)		
Depreciation	15,928	7,145	5,839
Loss on disposal of equipment	1,013		
Compensation related to modification of stock option terms	425	-	33
Changes in assets and liabilities:			
Accounts receivable	(52,183)	(33,616)	(247)
Inventories	(60,921)	(26,757)	6,726
Prepaid expenses and other current assets	(3,373)	2,959	(6,089)
Deposits and other assets	(3,545)	(5,721)	283
Accounts payable	36,378	23,796	(7,174)
Accrued payroll and related expenses	7,956	4,491	(906)
Income taxes payable	39,842	10,984	2,617
Other accrued liabilities	9,485	6,301	1,548
Deferred revenue	21,357	1,931	(515)
Other non-current liabilities	3,485	-	-
Total adjustments	(213,820)	(9,587)	3,275
Net cash provided by operating activities	84,852	16,963	15,111
Cash flows from investing activities:			
Purchases of short-term investments	(593,146)	(332,379)	(137,822)
Proceeds from short-term investments	643,734	139,391	133,214
Acquisition of property and equipment	(26,586)	(21,391)	(7,489)
Investment in joint venture	(134,730)	0	0
Investment in equity securities	(7,200)	0	0
Deposit in escrow account for investment in equity securities	(20,004)	0	(10,923)
Net cash used in investing activities	(137,932)	(214,379)	(23,020)
Cash flows from financing activities:			
Sale of common stock and warrants	13,187	328,202	2,405
Net cash provided by financing activities	13,187	328,202	2,405
Net increase (decrease) in cash and cash equivalents	(39,893)	130,786	(5,504)
Cash and cash equivalents at beginning of year	146,170	15,384	20,888
Cash and cash equivalents at end of year	\$ 106,277	\$ 146,170	\$ 15,384
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	\$ 37,260	\$ 4,306	\$ 8,277

The accompanying notes are an integral part of these consolidated financial statements

Notes to Consolidated Financial Statements

Note 1:

Organization and Summary of Significant Accounting Policies

Organization and Nature of Operations

SanDisk Corporation (the Company) was incorporated in Delaware on June 1, 1988, to design, manufacture, and market industry-standard, solid-state mass storage products using proprietary, high-density flash memory technology. The Company operates in one segment and serves customers in the consumer electronics, industrial, communications and highly portable computing markets. Principal geographic markets for the Company's products include the United States, Japan, Europe and the Far East.

Supplier and Customer Concentrations

A limited number of customers historically have accounted for a substantial portion of the Company's revenues. In 2000, no single customer accounted for more than 10% of total revenues. In 1999 and 1998, revenues from one customer exceeded 10% of total revenues. Sales of the Company's products will vary as a result of fluctuations in market demand. Further, the flash data storage markets in which the Company competes are characterized by rapid technological change, evolving industry standards, declining average selling prices and rapid technological obsolescence.

Certain of the raw materials used by the Company in the manufacture of its products are available from a limited number of suppliers. For example, all of the Company's products require silicon wafers, the majority of which are currently supplied by United Microelectronics Corporation ("UMC") in Taiwan and Toshiba, through its Yokkaichi facility in Japan. The Company is dependent on its foundries to allocate to the Company a portion of their foundry capacity sufficient to meet the Company's needs, to produce wafers of acceptable quality and with acceptable manufacturing yields and to deliver those wafers to the Company on a timely basis. On occasion, the Company has experienced difficulties in each of these areas.

Under each of the Company's wafer supply agreements, the Company is obligated to provide a monthly rolling forecast of anticipated purchase orders. Except in limited circumstances and subject to acceptance by the foundries, the estimates for the first three months of each forecast constitute a binding commitment and the estimates for the remaining months may not increase or decrease by more than a certain percentage from the previous month's forecast. These restrictions limit the Company's ability to react to significant fluctuations in demand for its products. As a result, the Company has not been able to match its purchases of wafers to specific customer orders, and therefore the

Company has taken write downs for potential excess inventory purchased prior to the receipt of customer orders and may be required to do so in the future. These adjustments decrease gross margins in the quarter reported and have resulted, and could in the future result in fluctuations in gross margins on a quarter to quarter basis. To the extent the Company inaccurately forecasts the number of wafers required, it may have either a shortage or an excess supply of wafers, either of which could have a material adverse effect on the Company's business, financial condition and results of operations. Additionally, if the Company is unable to obtain scheduled quantities of wafers from any foundry with acceptable yields, the Company's business, financial condition and results of operations could be negatively impacted.

In addition, certain key components are purchased from single source vendors for which alternative sources are currently not available. Shortages could occur in these essential materials due to an interruption of supply or increased demand in the industry. If the Company were unable to procure certain of such materials, it would be required to reduce its manufacturing operations that could have a material adverse effect upon its results of operations. We also rely on third-party subcontractors to assemble and test the memory components for our products. We have no long-term contracts with these subcontractors and cannot directly control product delivery schedules. This could lead to product shortages or quality assurance problems that could increase the manufacturing costs of our products and have adverse effects on our operating results.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Basis of Presentation

The Company's fiscal year ends on the Sunday closest to December 31. Fiscal year 2000 ended on December 31, 2000 and was 52 weeks in length. Fiscal year 1999 ended on January 2, 2000 and was 53 weeks in length. Fiscal year 1998 ended on December 27, 1998 and was 52 weeks in length. For ease of presentation, the accompanying financial statements have been shown as ending on the last day of the calendar month.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Foreign Currency Transactions

Foreign operations are measured using the U.S. dollar as the functional currency. Accordingly, monetary accounts (principally cash, accounts receivable and liabilities) are remeasured using the foreign exchange rate at the balance sheet date. Operations accounts and nonmonetary balance sheet accounts are remeasured at the rate in effect at the date of transaction. The effects of foreign currency remeasurement are reported in current operations. See Note 2.

Cash Equivalents and Short-Term Investments

Cash equivalents consist of short-term, highly liquid financial instruments with insignificant interest rate risk that are readily convertible to cash and have maturities of three months or less from the date of purchase. Cash equivalents and short-term investments consist of money market funds, taxable commercial paper, U.S. government agency obligations, corporate / municipal notes and bonds with high-credit quality, money market preferred stock and auction rate preferred stock. Short-term investments also include 50% of the UMC shares referred to below ("Investment in Foundry"). The fair market value, based on quoted market prices, of cash equivalents and short-term investments is substantially equal to their carrying value at December 31, 2000 and 1999.

Under FAS 115, management classifies investments as available-for-sale at the time of purchase and periodically reevaluates such designation. Debt securities classified as available-for-sale are reported at fair value. Unrecognized gains or losses on available-for-sale securities are included, in equity until their disposition. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in other income (expense). The cost of securities sold is based on the specific identification method.

All cash equivalents and short-term investments as of December 31, 2000 and 1999 are classified as available-for-sale securities and consist of the following (in thousands):

December 31,	2000	1999
Cash equivalents:		
Money market fund	\$ 2,921	\$ 21,853
Commercial paper	60,505	117,769
Corporate notes / bonds	12,492	-
Total	\$ 75,918	\$ 139,622
Short term investments:		
U.S. government agency obligations	\$ 10,004	\$ 2,969
Municipal notes / bonds	136,580	133,462
Corporate notes / bonds	47,795	58,969
Commercial paper	6,115	4,009
Auction rate preferred stock	59,967	111,640
Marketable equity securities *	112,855	-
Total	\$ 373,316	\$ 311,049

* Investment in UMC. No such amounts were recorded in fiscal 1999.

Unrealized gain and losses on available-for-sale securities at December 31, 2000 and 1999 were (\$50.4 million) and \$199,000, respectively. The unrealized loss as of December 31, 2000 includes \$50.3 million of unrealized loss on the current portion of the Company's investment in UMC (see "Investment in Foundry" below). Fair value of available-for-sale securities is based upon quoted market prices. Gross realized gains and losses on sales of available-for-sale securities during the years ended December 31, 2000 and 1999 were immaterial.

Debt securities at December 31, 2000 and 1999, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers of the securities may have the right to prepay obligations.

(In thousands)	2000	1999
December 31,		
Short-term investments:		
Due in one year or less	\$ 94,554	\$ 170,097
Due after one year through two years	165,907	140,952
Total	\$ 260,461	\$ 311,049

Long-Term Investments

The Company holds minority equity investments in companies having operations or technology in areas within SanDisk's strategic focus. Certain of the investments carry restrictions on immediate disposition. Investments in public companies with restrictions of less than one year are classified as available-for-sale and are adjusted to their fair market value with unrealized gains and losses recorded as a component of accumulated other comprehensive income. Upon disposition of these investments, the specific identification method is used to determine the cost basis in computing realized gains or losses. Declines in value that are judged to be other than temporary are reported in other income and expense.

Accounts Receivable

The activity in the allowance for doubtful accounts is as follows (in thousands):

For the year ended Dec. 31,	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions (Write-offs)	Balance at End of Period
1998	\$ 756	\$ 345	\$ 32	\$ 1,069
1999	\$ 1,069	\$ 945	\$ 143	\$ 1,871
2000	\$ 1,871	\$ 3,991	\$ 852	\$ 5,010

Inventories

Inventories are stated at the lower of cost or market. Cost is computed on a currently adjusted standard basis (which approximates actual costs on a first-in, first-out basis). Market value is based upon an estimated average selling price reduced by normal gross margins. Inventories are as follows (in thousands):

December 31,	2000	1999
Raw materials	\$ 33,092	\$ 10,387
Work-in-process	53,921	20,708
Finished goods	9,587	4,584
Total	\$ 96,600	\$ 35,679

Given the volatility of the market, the Company writes down inventories to net realizable value based on backlog and forecasted demand. However, backlog is subject to revisions, cancellations and rescheduling. Actual demand may differ from forecasted demand and such differences may have a material effect on the Company's financial position and results of operations.

Property and Equipment

Property and equipment consist of the following (in thousands):

December 31,	2000	1999
Machinery and equipment	\$ 62,310	\$ 47,004
Software	7,435	5,994
Furniture and fixtures	2,103	1,335
Leasehold improvements	5,842	3,772
Property and equipment, at cost	77,690	58,105
Accumulated depreciation and amortization	(36,595)	(26,317)
Property and equipment, net	\$ 41,095	\$ 31,788

Depreciation and Amortization

Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets or the remaining lease term, whichever is shorter, generally two to seven years.

Investment in Foundry

In 1997, the Company invested \$40.3 million in United Silicon, Inc., ("USIC") a semiconductor manufacturing subsidiary of United Microelectronics Corporation in Taiwan ("UMC"). The transaction gave the Company an equity stake of approximately 10% in the facility (which was accounted for on the cost basis) and guaranteed access to approximately 12.5% of the wafer output from the facility. In 1998, the Company increased its investment by \$10.9 million to retain its 10% ownership interest. No changes were made to the production agreement.

In January 2000, the USIC foundry was merged into the UMC parent company. The Company received UMC shares in exchange for its USIC shares. The Company does not have a right to a seat on the board of directors of the combined company.

In exchange for USIC shares, we received 111 million UMC shares. These shares were valued at approximately \$396 million at the time of the merger, resulting in a pretax gain of \$344.2 million (\$203.9 million after-tax) in the first quarter of 2000. All of the UMC shares received by the Company as a result of the merger were subject to trading restrictions imposed by UMC and the Taiwan Stock Exchange. The trading restrictions expired on one-half of the shares on July 3, 2000. The remaining shares will become available for sale over a two-year period beginning in January 2002. When the shares are ultimately sold, it is likely that the Company will recognize additional gains or losses due to fluctuations in the price of the UMC shares.

In May 2000, the Company received a stock dividend from UMC of 200 shares for every 1,000 shares of UMC owned, resulting in its ownership of 22 million additional shares of UMC. The shares received as a stock dividend and the 50% of the shares received as a result of the merger that became unrestricted in July 2000 are treated as available-for-sale securities under Statement of Financial Accounting Standards 115, "Accounting for Certain Investments in Debt and Equity Securities", at December 31, 2000 and are included in short-term investments. These shares were adjusted to market value and the resulting unrealized loss of \$50.3 million in fiscal 2000 is included in accumulated other comprehensive income. In addition, on September 18, 2000, UMC completed its American Depositary Shares ("ADRs") offering. In connection with this offering, SanDisk signed a lock-up agreement that prohibits the sale of all but 5 million of these unrestricted UMC shares for a period of 90 days following the completion of the offering. The remaining 50% of the shares received as a result of the merger, that will be restricted from sale until 2002, are accounted for at their historical cost beginning in the first quarter of 2001. These securities will be marked to market through other comprehensive income when the when the related restrictions lapse.

Revenue Recognition

Product revenue, less a provision for estimated sales returns, is recognized when title passes which is generally at the time of shipment. However, revenue on shipments to distributors and retailers, subject to certain rights of return and price protection, is deferred until the merchandise is sold by the distributors or retailers, or the rights expire.

The Company earns patent license and royalty revenue under patent cross-license agreements with Hitachi Ltd., Intel Corporation, Lexar, Samsung Electronics Company Ltd., Sharp Electronics Corporation, Silicon Storage Technology, Inc., SmartDisk Corporation, TDK and Toshiba Corporation. The Company's current license agreements provide for the payment of license fees, royalties, or a combination thereof, to the Company. The timing and amount of these payments can vary substantially from quarter to quarter, depending on the terms of each agreement and, in some cases, the timing of sales of products by the other parties.

Patent license and royalty revenue is recognized when earned. In 2000, 1999 and 1998, the Company received payments under these cross-license agreements, portions of which were recognized as revenue and portions of which are deferred revenue. Recognition of deferred revenue is expected to occur in future periods over the life of the agreements, as the Company meets certain obligations as provided in the various agreements.

Advertising Expense

The cost of advertising is expensed as incurred. Advertising costs were \$8.2 million, \$3.6 million, and \$2.0 million in 2000, 1999, and 1998, respectively.

Net Income Per Share

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share amounts):

	2000	1999	1998
Numerator:			
Numerator for basic and diluted net income per share – net income	\$ 298,672	\$ 26,550	\$ 11,836
Denominator for basic net income per share:			
Weighted average common shares	66,861	55,834	52,596
Basic net income per share	\$ 4.47	\$ 0.48	\$ 0.23
Denominator for diluted net income per share:			
Weighted average common shares	66,861	55,834	52,596
Incremental common shares attributable to exercise of outstanding employee stock options and warrants (assuming proceeds would be used to purchase common stock)	5,790	5,599	2,748
Shares used in computing diluted net income per share	72,651	61,433	55,344
Diluted net income per share	\$ 4.11	\$ 0.43	\$ 0.21

Options and warrants to purchase 907,380, 190,807, and 1,802,886 shares of common stock were outstanding during 2000, 1999 and 1998, respectively, but have been omitted from the diluted earnings per share calculation because the options' exercise price was greater than the average market price of the common shares and, therefore the effect would be antidilutive.

Stock Based Compensation

The Company accounts for employee stock based compensation under APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Pro forma net income and net income per share disclosures are required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," and are included in Note 4.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement 133, Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted by the Company beginning January 1, 2001. Historically, the Company has had a minimal use of derivatives and do not anticipate that the adoption of the new Statement will have a significant effect on our earnings or financial position; however, we have

studied the actual impact, and have determined that it will be immaterial to our financial position or earnings.

In December 1999, The Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements". SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. All registrants are expected to apply the accounting and disclosures described in SAB 101. The Company's implementation of SAB 101 did not have a material impact on consolidated results of operations, financial position and cash flows.

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation-an Interpretation of APB Opinion No. 25." FIN 44 clarifies the application of APB Opinion 25 and, among other issues clarifies the following: the definition of an employee for the purposes of applying APB Opinion No. 25; the criteria for determining whether a plan qualifies as a noncompensatory plan; the accounting consequences of various modifications to the terms for the previously fixed stock options or awards; and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 became effective July 1, 2000 and did not have a material impact on the Company's consolidated results of operations, financial position, and cash flows.

Note 2:

Financial Instruments

Concentration of Credit Risk

The Company's concentration of credit risk consists principally of cash, cash equivalents, short-term investments and trade receivables. The Company's investment policy restricts investments to high-credit quality investments and limits the amounts invested with any one issuer. The Company sells to original equipment manufacturers, retailers and distributors in the United States, Japan, Europe and the Far East, performs ongoing credit evaluations of its customers' financial condition, and generally requires no collateral. Reserves are maintained for potential credit losses.

Off Balance Sheet Risk

Certain of the Company's balance sheet accounts are denominated in Japanese Yen. The Company enters into foreign exchange contracts to hedge against changes in foreign currency exchange rates. The effects of movements in currency exchange rates on these instruments are recognized when the related operating revenues and expenses are recognized. The Company has a foreign exchange contract line in the amount of \$15.0 million at December 31, 1999. Under this line, the Company may enter into forward exchange contracts that require the Company to sell or purchase foreign currencies. Two forward exchange contracts in the notional amount of \$8.2 million were

outstanding at December 31, 1999. Foreign currency translation gains of \$122,000 were deferred at December 31, 1999 in connection with these contracts as the contracts have been identified as hedging contracts. One forward exchange contract in the amount of \$4.3 million was outstanding at December 31, 1998. Foreign currency translation losses of \$34,000 were deferred at December 31, 1998 in connection with this forward contract.

The impact of movements in currency exchange rates on foreign exchange contracts substantially mitigates the related impact on the underlying items hedged. The Company had net transaction gains of approximately \$428,000, \$1,467,000 and \$412,000 for the years ended December 31, 2000, 1999 and 1998, respectively. These amounts are included in other income (loss), net, in the statement of income.

Note 3:

Commitments and Contingencies

Commitments

The Company leases its headquarters and sales offices under operating leases that expire at various dates through 2006. Future minimum lease payments under operating leases at December 31, 2000 are as follows (in thousands):

Year Ending December 31,	
2001	\$ 2,685
2002	2,411
2003	2,370
2004	2,416
2005	2,251
2006	1,024
<u>Total</u>	<u>\$ 13,157</u>

Rental expense under all operating leases was \$2.5 million, \$2.1 million and \$1.7 million for the years ended December 31, 2000, 1999 and 1998, respectively.

Contingencies

The Company relies on a combination of patents, trademarks, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect its intellectual property rights. There can be no assurance that there will not be any disputes regarding the Company's intellectual property rights. Specifically, there can be no assurance that any patents held by the Company will not be invalidated, that patents will be issued for any of the Company's pending applications or that any claims allowed from existing or pending patents will be of sufficient scope or strength or be issued in the primary countries where the Company's products can be sold to provide meaningful protection or any commercial advantage to the Company. Additionally, competitors of the Company may be able to design around the Company's patents.

To preserve its intellectual property rights, the Company believes it may be necessary to initiate litigation with one or more third parties, including but not

limited to those the Company has notified of possible patent infringement. In addition, one or more of these parties may bring suit against the Company. Any litigation, whether as a plaintiff or as a defendant, would likely result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is ultimately determined in favor of the Company.

For example, in March 1998, the Company sued Lexar in the Northern District of California alleging that Lexar's CompactFlash and PC Cards infringe our U.S. Patent No. 5,602,987 ("987 Patent"). Lexar disputed this claim and asserted various counter claims, including unfair competition, violation of the Lanham Act, patent misuse, interference with prospective economic advantage, trade defamation, unenforceability and fraud. On November 14, 2000, in resolution of these actions, Lexar stipulated that SanDisk's '987 Patent is valid and infringed by Lexar's current CompactFlash and PC Cards. Lexar made a lump sum payment of \$8.0 million in December 2000 for royalties due on the '987 Patent, through March 31, 2001. Subject to Lexar's representations and warranties relating to Lexar's newly designed CompactFlash and PC Cards, SanDisk has stipulated that these designs do not infringe SanDisk's '987 Patent. Lexar entered into a 4% royalty-bearing license agreement for certain Lexar products that may use the '987 Patent beyond March 31, 2001. SanDisk and Lexar have agreed to dismiss with prejudice all pending claims of patent infringement and counterclaims involving claims of false advertising, unfair competition and patent misuse.

In September 2000, Lexar sued SanDisk in the District of Delaware alleging that our SmartMedia products infringe Lexar's United States Patent No. 5,479,638 ("638 Patent"). In resolution of this action, the Company paid Lexar a lump sum payment of \$2.0 million for a fully-paid up license for use of the '638 Patent in SmartMedia products.

Under the settlement, Lexar has provided the Company with an option for a royalty bearing license to its patents for use in certain future products. SanDisk and Lexar have agreed to resolve any future disputes relating to the use by Lexar of the '987 Patent through binding arbitration. We have also agreed that for a period of seven years, neither SanDisk nor Lexar shall seek injunctive relief against the other in any patent lawsuit. However, at all times, we retain the right to seek injunctive relief to enforce the payment of royalties pursuant to an arbitrator's ruling.

On March 21, 2000, Mitsubishi Denki Co. Ltd. (Mitsubishi Electric) filed a complaint in Tokyo District Court against SanDisk K.K., SanDisk's wholly owned subsidiary in Japan. The complaint alleges that SanDisk K.K., based in Yokohama, Japan, infringes on three Mitsubishi Japanese patents. The Mitsubishi patents in question are #JP2099342, #JP2129071 and #JP2138047, which are related primarily to the

mechanical construction of memory cards. In the complaint, Mitsubishi asked the court for a preliminary injunction halting the sale of SanDisk CompactFlash and flash ATA memory cards in Japan. Mitsubishi has since dropped patents #JP2129071 and #JP2138047 from the suit. The Company and SanDisk K.K. are vigorously defending against Mitsubishi's remaining claims.

Compaq Corporation has opposed in several countries, including the United States, our attempting to register CompactFlash as a trademark. We do not believe that our failure to obtain registration for the CompactFlash mark will materially harm our business.

In the event of an adverse result in any such litigation, the Company could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to the infringing technology, or discontinue the use of certain processes.

From time to time the Company agrees to indemnify certain of its suppliers and customers for alleged patent infringement. The scope of such indemnity varies but may in some instances include indemnification for damages and expenses, including attorneys' fees. The Company may from time to time be engaged in litigation as a result of such indemnification obligations. Third party claims for patent infringement are excluded from coverage under the Company's insurance policies. There can be no assurance that any future obligation to indemnify the Company's customers or suppliers, will not have a material adverse effect on the Company's business, financial condition and results of operations.

Litigation frequently involves substantial expenditures and can require significant management attention, even if the Company ultimately prevails. In addition, the results of any litigation matters are inherently uncertain. Accordingly, there can be no assurance that any of the foregoing matters, or any future litigation, will not have a material adverse effect on the Company's business, financial condition and results of operations.

Note 4:

Stockholders' Equity

Stock Benefit Plan

The 1989 Stock Benefit Plan, in effect through August 1995, comprised two separate programs, the Stock Issuance Program and the Option Grant Program. The Stock Issuance Program allowed eligible individuals to immediately purchase the Company's common stock at a fair value as determined by the Board of Directors. Under the Option Grant Program, eligible individuals were granted options to purchase shares of the Company's common stock at a fair value, as determined by the Board of Directors, of such shares on the date of grant. The options generally vest over a four-year period, expiring no later than ten years from the

date of grant. Unexercised options are canceled upon the termination of employment or services. Options that are canceled under this plan will be available for future grants under the 1995 Stock Option Plan. There were no shares available for option grants under the 1989 Stock Benefit Plan at December 31, 2000.

1995 Stock Benefit Plan

The 1995 Stock Option Plan provides for the issuance of incentive stock options and nonqualified stock options. Under this plan, the vesting and exercise provisions of option grants are determined by the Board of Directors. The options generally vest over a four-year period, expiring no later than ten years from the date of grant.

On July 17, 1998, the Board of Directors approved an option cancellation/regrant program. Under the cancellation/regrant program, employees could elect to exchange their stock options with exercise prices in excess of \$6.00 per share for new options priced at \$5.00 per share, the market price of the Company's common stock on the date of implementation, August 21, 1998. Under the new options, shares become exercisable six to twelve months later than under the old higher-priced options. The new options have a maximum term of ten years from the August 21, 1998 grant date. Officers and directors of the Company were not eligible for participation in the option cancellation/regrant program. Options covering a total of approximately 1,806,846 shares were canceled and regranted in connection with the program. The number of options shown as granted and canceled in the table below reflect this exchange of options. Such options had a weighted average exercise price before repricing of \$10.331, and the new options were granted at an exercise price of \$5.00.

In May 1999, the stockholders increased the shares available for future issuance under the 1995 Stock Benefit Plan by 7,000,000 shares and approved an automatic share increase feature pursuant to which the number of shares available for issuance under the plan will automatically increase on the first trading day in January each calendar year, beginning with calendar year 2002 and continuing over the remaining term of the plan, by an amount equal to approximately 4% of the total number of shares outstanding on the last trading day in December in the immediately preceding calendar year, but in no event will any such annual increase exceed 4,000,000 shares.

1995 Non-employee Directors Stock Option Plan

In August 1995, the Company adopted the 1995 Non-employee Directors Stock Option Plan (the Directors' Plan). Under this plan, automatic option grants are made at periodic intervals to eligible non-employee members of the Board of Directors. Initial option grants vest over a four-year period. Subsequent annual grants vest one year after date of grant. All options granted under the Non-employee Directors Stock Option Plan expire ten years after the date of grant. In

May 1999, the stockholders increased the shares available for future issuance under the 1995 Non-Employee Directors Stock Option Plan by 400,000 and approved an automatic share increase feature pursuant to which the number of shares available for issuance under the plan will automatically increase on the first trading day in January each calendar year, beginning with calendar year 2002 and continuing over the remaining term of the plan, by an amount equal to 0.2% of the total number of shares outstanding on the last trading day in December in the immediately preceding calendar year, but in no event will any such annual increase exceed 200,000 shares. At December 31, 2000, the Company had reserved 800,000 shares for issuance under the Directors' Plan and a total of 448,000 options had been granted at exercise prices ranging from \$5.00 to \$70.063 per share.

A summary of activity under all stock option plans follows (shares in thousands):

	Total Available for Future Grant/ Issuance	Total Outstanding	Weighted Average Exercise Price
Balance at December 31, 1997	4,210	7,106	\$ 4.79
Granted	(4,444)	4,444	\$ 5.97
Exercised	-	(1,260)	\$ 0.74
Canceled	2,038	(2,038)	\$ 10.04
Balance at December 31, 1998	1,804	8,252	\$ 4.75
Increase in authorized shares	7,400	-	
Granted	(3,000)	3,000	\$ 31.00
Exercised	-	(1,766)	\$ 3.47
Canceled	308	(308)	\$ 9.69
Balance at December 31, 1999	6,512	9,178	\$ 9.50
Granted	(2,290)	2,290	\$ 53.57
Exercised	-	(2,147)	\$ 4.85
Canceled	469	(469)	\$ 9.69
Balance at December 31, 2000	4,691	8,852	\$ 25.29

At December 31, 2000, options outstanding were as follows:

Options Outstanding				Options Exercisable			
Range of Exercise Prices	Number Outstanding as of December 31, 1999	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable as of December 31, 1999	Weighted Average Exercise Price		
\$ 0.188 - \$ 5.000	1,752,233	6.77	\$ 4.270	1,088,408	\$ 3.963		
\$ 5.094 - \$ 6.250	1,801,785	7.27	\$ 6.122	1,119,848	\$ 6.078		
\$ 6.438 - \$ 15.219	526,006	7.52	\$ 10.304	316,648	\$ 10.563		
\$ 16.750 - \$ 29.919	647,778	8.59	\$ 23.517	172,426	\$ 23.340		
\$ 30.000 - \$ 41.031	3,119,537	9.32	\$ 35.144	485,486	\$ 34.778		
\$ 43.438 - \$ 139.500	1,004,515	9.40	\$ 74.707	90,000	\$ 69.167		
\$ 0.188 - \$ 139.500	8,851,854	8.25	\$ 25.288	3,330,457	\$ 12.858		

Employee Stock Purchase Plan

In August 1995, the Company adopted the Employee Stock Purchase Plan (the Purchase Plan). In May 1999, the stockholders increased the shares available for future issuance under the Employee Stock Purchase Plan by 600,000 and approved an automatic share increase feature pursuant to which the number of shares available for issuance under the plan will automatically increase on the first trading day in January each calendar year, beginning with calendar year 2002 and continuing over the remaining term of the plan, by an amount equal to forty-three hundredths of one percent (0.43%) of the total number of shares outstanding on the last trading day in December in the immediately preceding calendar year, but in no event will any such annual increase exceed 400,000 shares. Under the Purchase Plan, qualified employees are entitled to purchase shares through payroll deductions at 85% of the fair market value at the beginning or end of the offering period, whichever is lower. As of December 31, 2000, the Company had reserved 2,366,666 shares of common stock for issuance under the Purchase Plan and a total of 1,034,293 shares had been issued.

Accounting for Stock Based Compensation

The Company has elected to follow APB 25 and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123

"Accounting for Stock-Based Compensation," requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net income and earnings per share is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of this Statement. For all grants subsequent to December 31, 1994 that were granted prior to the Company's initial public offering in November 1995, the fair value of these options was determined using the minimum value method with a weighted average risk free interest rate of 6.32% and an expected life of 5 years. The fair value for the options granted subsequent to the Company's initial public offering in November 1995 was estimated at the date of grant using a Black-Scholes single option pricing model with the following weighted average assumptions: risk-free interest rates of 6.16%, 5.52% and 4.84% for 2000, 1999 and 1998, respectively; a dividend yield of 0.0%, a volatility factor of the expected market price of the Company's common stock of 0.951, 0.888 and 0.600 for 2000, 1999 and 1998 respectively; and a weighted-average expected life of

the option of approximately 5 years. The weighted average fair value of those options granted were \$39.82, \$22.38 and \$3.325 for 2000, 1999 and 1998, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Under the 1995 Employee Stock Purchase Plan participating employees can choose to have up to 10% of their annual base earnings withheld to purchase the Company's common stock. The purchase price of the stock is 85% of the lower of the subscription date fair market value and the purchase date fair market value. Approximately 78% of eligible employees participated in the plan in 2000 and 79% and 65% in 1999 and 1998, respectively. Under the Plan, the Company sold 69,423, 269,092 and 259,484 shares to employees in 2000, 1999 and 1998, respectively. Pursuant to APB 25 and related interpretations, the Company does not recognize compensation cost related to employee purchase rights under the Plan. To comply with the pro forma reporting requirements of SFAS 123, compensation cost is estimated for the fair value of the employees' purchase rights using the Black-Scholes model with the following assumptions for those rights granted in 2000, 1999 and 1998: dividend yield of 0.0%; and expected life of 6 months; expected volatility factor of 1.56 and 1.18 in 2000, .98 and 1.16 in 1999, and .65 and 1.02 in 1998; and a risk free interest rate ranging from 5.35% to 6.43%. The weighted average fair value of those purchase rights granted in February 1998, August 1998, February 1999, August 1999, February 2000 and August 2000 were \$3.50, \$2.25, \$6.01, \$17.72, \$38.69 and \$29.24, respectively.

Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share amounts):

Years ended December 31,	2000	1999	1998
Pro forma net income	\$ 276,421	\$ 19,625	\$ 7,575
Pro forma net income per share			
Basic	\$ 4.13	\$ 0.35	\$ 0.14
Diluted	\$ 3.80	\$ 0.32	\$ 0.14

Because SFAS 123 is applicable only to options granted subsequent to December 31, 1994, its pro forma effect was not fully reflected until 1999.

Shareholder Rights Plan

On April 21, 1997, the Company adopted a shareholder rights plan (the Rights Agreement). Under the Rights Agreement, rights were distributed as a dividend at the rate of one right for each share of common stock of the Company held by stockholders of record as of the close of business on April 28, 1997. The rights will expire on April 28, 2007 unless redeemed or exchanged. Under the Rights Agreement, each right will initially entitle the registered holder to buy one one-fiftieth of a share of Series A Junior Participating Preferred Stock for \$250.00. The rights will become exercisable only if a person or group acquires beneficial ownership of 15 percent or more of the Company's common stock or commences a tender offer or exchange offer upon consummation of which such person or group would beneficially own 15 percent or more of the Company's common stock.

Stock Split

On January 26, 2000, the Company's board of directors approved a 2-for-1 stock split, in the form of a 100% stock dividend, payable to stockholders of record as of February 8, 2000. The dividend was paid and the split was effected on February 22, 2000. Shares, per share amounts, common stock at par value and capital in excess of par value have been restated to reflect the stock split for all periods presented.

Note 5:

Retirement Plan

Effective January 1, 1992, the Company adopted a tax-deferred savings plan, the SanDisk 401(k) Plan, for the benefit of qualified employees. The plan is designed to provide employees with an accumulation of funds at retirement. Qualified employees may elect to make contributions to the plan on a monthly basis. The Company may make annual contributions to the plan at the discretion of the Board of Directors. The Company contributed \$105,000 for the plan year ended December 31, 1999. No contributions were made by the Company for the years ended December 31, 2000 and 1998.

Note 6:

Income Taxes

The provision for income taxes consists of the following (in thousands):

December 31,	2000	1999	1998
Current:			
Federal	\$ 53,683	\$ 10,354	\$ 1,413
State	13,296	2,117	651
Foreign	10,211	4,105	2,936
	77,190	16,576	5,000
Deferred:			
Federal	94,147	(2,600)	1,305
State	21,683	(400)	350
Foreign	500	(500)	-
	116,330	(3,500)	1,655
Provision for income taxes	\$ 193,520	\$ 13,076	\$ 6,655

The tax benefits associated with stock options reduces taxes currently payable as shown above by \$29,258,000, \$9,809,000, and \$1,761,000 in 2000, 1999 and 1998, respectively. Such benefits are credited to capital in excess of par when realized.

The Company's provision for income taxes differs from the amount computed by applying the federal statutory rates to income before taxes as follows:

December 31,	2000	1999	1998
Federal statutory rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	4.6	2.8	3.5
Research credit	(0.2)	(1.7)	(1.9)
Tax exempt interest income	(0.8)	(3.9)	(6.1)
Other individually immaterial items	0.7	0.8	5.5
	39.3%	33.0%	36.0%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Significant components of the Company's deferred tax assets as of December 31, 2000 and 1999 are as follows (in thousands):

December 31,	2000	1999
Deferred tax assets:		
Inventory writedown reserves	\$ 13,000	\$ 3,400
Deferred revenue	17,100	10,600
Accruals and other reserves	11,400	4,000
Other	1,200	800
Total deferred tax assets	\$ 42,700	\$ 18,800

Deferred tax liabilities:

Unrealized gain receipt on exchange of UMC shares	(105,600)	-
Total deferred tax assets/ (liabilities)	\$ (62,900)	\$ 18,800

Note 7:

Joint Venture, Strategic Manufacturing Relationships and Investments

On June 30, 2000, the Company and Toshiba closed a transaction providing for the joint development and manufacture of 512 megabit and 1 gigabit flash memory chips and Secure Digital Card controllers. As a part of this transaction, the Company and Toshiba formed and contributed initial funding to FlashVision LLC, a joint venture to equip and operate a silicon wafer manufacturing line at Dominion Semiconductor in Virginia. The cost of equipping the Virginia wafer manufacturing line is estimated at between \$700 million and \$800 million. As part of the Company's 50% ownership of the joint venture it had invested \$134.7 million as of December 31, 2000, and in January 2001, we invested the remaining \$15.3 million. The Company has also guaranteed up to \$215 million in equipment lease lines to equip Toshiba's Dominion Semiconductor manufacturing clean room with advanced wafer processing equipment. As of January 26, 2001, \$20 million was guaranteed. In addition, the Company will share certain research and development costs. The Company expects to generate revenues from the sale of products using 512 megabit technology during the second half of 2001, and from the 1 gigabit technology during

2002. The Company accounts for this investment under the equity method, and the Company's of losses on this joint venture through December 31, 2000 are not material.

On July 4, 2000, SanDisk entered into a share purchase agreement to make a \$75 million investment in Tower Semiconductor, or Tower, in Israel, representing approximately 10% ownership of Tower. In exchange for its investment, the Company will receive one seat on the board of directors of Tower and a guaranteed portion of the wafer output from the advanced fabrication facility Tower is starting to build in Migdal Haemek, Israel. Under the terms of the agreement, the Company will make our investment over a period of approximately 18 months if key milestones related to the construction, equipping and wafer production at the new wafer fabrication facility are met. On January 26, 2001, Tower satisfied the closing conditions of the share purchase agreement, and the Company transferred the first \$20 million of its investment from an escrow account to purchase 866,551 shares ordinary shares and obtain \$8.8 million in pre-paid wafer credits. On March 1, 2001, the Company paid Tower \$11 million upon its completion of milestone one, to purchase 366,690 ordinary shares and obtain additional prepaid wafer credits. Additional contributions will take the form of mandatory warrant exercises for ordinary shares at an exercise price of \$30.00 per share if other milestones are met. The warrants will expire five years from the date of grant, and in the event the key milestones are not achieved, the exercise of these warrants will not be mandatory. We expect first wafer production to commence at the new fabrication facility in late 2002. The Company accounts for this investment under the cost method.

On August 9, 2000, SanDisk entered into a joint venture, DigitalPortal Inc., or DPI, with Photo-Me International, or PMI, for the manufacture, installation, marketing and service of self-service, digital photo printing labs, or kiosks, bearing the SanDisk brand name in locations in the U.S. and Canada. These kiosks employ high-quality, low-cost, silver halide photo processing technology developed by PMI. Under the agreement, SanDisk and PMI will each make an initial investment of \$4 million and secure lease financing for the purchase of the kiosks. The total value of the lease financing will depend on the number of kiosks deployed by the joint venture. The Company estimates that it will guarantee equipment lease arrangements of approximately \$40 million over the first two years of the agreement. PMI will manufacture the kiosks for the joint venture and will install and maintain the kiosks under contract with the joint venture. The Company expects the first kiosks to be deployed in pilot programs in select retail stores in the United States starting in the first half of 2001. The Company accounts for this investment under the equity method, and the Company's of losses on this joint venture through December 31, 2000 are not material.

On November 2, 2000, SanDisk made a strategic investment of \$7.2 million in Divio, Inc. Divio is a

privately-held manufacturer of digital imaging compression technology and products for future digital camcorders that will be capable of using our flash memory cards to store home video movies, replacing the magnetic tape currently used in these systems. Under the agreement, SanDisk owns approximately 10% of Divio and is entitled to one board seat. The Company accounts for this investment under the cost method.

In 2000, 1999, and 1998, the Company purchased wafers from USIC/UMC, a foundry in which the Company has ownership, totaling approximately \$161.6 million, \$22.8 million and \$11.6 million, respectively.

Note 8:

Segment Information

The Company applied SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in deciding how to allocate resources and in assessing performance.

The Company operates in one segment, flash memory products. The Company markets its products in the United States and in foreign countries through its sales personnel, dealers, distributors, retailers and its subsidiaries. The Chief Executive Officer has been identified as the Chief Operating Decision Maker ("CODM") because he has final authority over resource allocation decisions and performance assessment. The CODM does not receive discrete financial information about individual components of the market.

Geographic Information:

Information regarding geographic areas for the years ended December 31, 2000, 1999, and 1998 are as follows (in thousands):

Years Ended December 31,	2000	1999	1998
Revenues:			
United States	\$ 258,715	\$ 116,922	\$ 60,113
Japan	178,564	62,176	46,276
Europe	99,352	22,674	9,810
Other foreign countries	65,181	45,218	19,562
Total	\$ 601,812	\$ 246,990	\$ 135,761
Long Lived Assets:			
United States	\$ 174,685	\$ 25,442	\$ 16,779
Japan	520	261	445
Europe	55	20	9
Other foreign countries	198,253	57,273	51,517
Total	\$ 373,517	\$ 82,996	\$ 68,750

Revenues are attributed to countries based on the location of the customers. Long lived assets in other foreign countries includes the long-term investment in UMC of \$197.7 in 2000 and \$51.2 million in 1999 and 1998. Long lived assets in the United States includes the investment in FlashVision of \$134.7 in 2000.

Major Customers

In 2000, there were no customers who accounted for more than 10% of total revenue. In 1999 and 1998, revenues from one customer represented approximately

\$28.0 million and \$14.0 million, respectively, of consolidated revenues.

Note 9:

Accumulated Other Comprehensive Income

Financial Accounting Standards Board Statement No. 130, "Reporting Comprehensive Income", requires unrealized gains or losses on the Company's available-for-sale securities to be included in other comprehensive income. Comprehensive income consists of net income and other comprehensive income.

Accumulated other comprehensive income presented in the accompanying balance sheet consists of the accumulated unrealized gains and losses on available-for-sale marketable securities for all periods presented. The tax effects for other comprehensive income were immaterial for all periods presented (in thousands).

	2000	1999	1998
Accumulated other comprehensive income at beginning of year	\$ 199	\$ 471	\$ 42
Change of accumulated other comprehensive income during the year			
Unrealized loss on investments	\$ (50,268)	-	-
Unrealized gain (loss) on available-for-sale securities	\$ (343)	\$ (272)	\$ 429
Accumulated other comprehensive income at year end	\$ (50,412)	\$ 199	\$ 471

The unrealized loss on investments includes a tax benefit of approximately \$34.6 million.

Note 10:

Subsequent Event (unaudited)

At December 31, 2000, the market value of both our short-term and long-term investment in UMC had declined \$201.9 million below its carrying basis. It was determined that this decline was related to the downturn in the semiconductor industry as a whole and was temporary in nature due to the historically cyclical nature of the industry. The available-for-sale portion of our investment was marked-to-market through other comprehensive income as required by SFAS 115.

As of March 22, 2001, the market value of our investment in UMC remained significantly below our cost. The downturn in the semiconductor industry and the economy in general appears to be more severe than previously anticipated. There is a great deal of uncertainty regarding when the semiconductor industry will recover from this down cycle. Because of the continued downturn in the economy, we believe that the decline in the market value of our investment in UMC at March 22, 2001 is other than temporary, and we will report a loss in other income and expense in the first quarter of 2001. This loss will be based upon the fair market value of the investment at the end of the first quarter in fiscal 2001, as compared to the investment's cost basis.

Corporate Information

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Dr. James D. Meindl
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Alan F. Shugart ⁽¹⁾⁽²⁾
Al Shugart International
President and CEO

Executive Officers

Frank Calderoni
CFO and Senior Vice President,
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Nelson Chan
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Dr. Eli Harari
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