SANDISK CORP
Form 10-Q
July 30, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)
R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________________ to ________________

Commission file number: 000-26734

SANDISK CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	77-0191793 (I.R.S. Employer Identification No.)
951 SanDisk Drive Milpitas, California (Address of principal executive offices)	95035 (Zip Code)

(408) 801-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes R No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes R No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer R Accelerated filer ¨ Non accelerated filer ¨ Smaller reporting company ¨

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No R

Number of shares outstanding of the issuer’s common stock, $0.001 par value, as of June 30, 2013: 240,389,588.

SanDisk Corporation
Index

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

SANDISK CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2013	December 30, 2012
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$1,054,131	$995,470
Short-term marketable securities	1,533,898	1,880,034
Accounts receivable, net	636,093	626,025
Inventory	723,403	750,075
Deferred taxes	95,423	93,877
Other current assets	251,931	260,879
Total current assets	4,294,879	4,606,360
Long-term marketable securities	2,766,474	2,835,931
Property and equipment, net	674,249	665,542
Notes receivable and investments in Flash Ventures	1,204,740	1,460,112
Deferred taxes	115,789	168,718
Goodwill	202,336	201,735
Intangible assets, net	210,883	246,919
Other non-current assets	149,646	153,810
Total assets	$9,618,996	$10,339,127
LIABILITIES		
Current liabilities:		
Accounts payable trade	$269,829	$254,459
Accounts payable to related parties	168,019	214,806
Convertible short-term debt	—	906,708
Other current accrued liabilities	413,471	257,539
Deferred income on shipments to distributors and retailers and deferred revenue	256,664	248,155
Total current liabilities	1,107,983	1,881,667
Convertible long-term debt	809,626	789,913
Non-current liabilities	356,581	407,947
Total liabilities	2,274,190	3,079,527
Commitments and contingencies (see Note 11)		
EQUITY		
Stockholders' equity:		
Preferred stock	—	—
Common stock	240	241
Capital in excess of par value	5,124,289	5,027,271
Retained earnings	2,235,001	2,071,268
Accumulated other comprehensive income (loss)	(11,686)	165,121
Total stockholders' equity	7,347,844	7,263,901
Non-controlling interests	(3,038)	(4,301)
Total equity	7,344,806	7,259,600
Total liabilities and equity	$9,618,996	$10,339,127

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

1

SANDISK CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
	(In thousands, except per share amounts)			
Revenues	$1,476,263	$1,032,255	$2,816,992	$2,237,816
Cost of revenues	789,614	742,297	1,588,997	1,517,617
Amortization of acquisition-related intangible assets	9,830	9,181	19,660	22,912
Total cost of revenues	799,444	751,478	1,608,657	1,540,529
Gross profit	676,819	280,777	1,208,335	697,287
Operating expenses:				
Research and development	172,041	152,397	343,166	293,354
Sales and marketing	63,601	52,261	122,728	101,296
General and administrative	46,877	37,692	91,981	70,283
Amortization and write-off of acquisition-related intangible assets	1,742	2,244	4,111	4,307
Total operating expenses	284,261	244,594	561,986	469,240
Operating income	392,558	36,183	646,349	228,047
Interest income	12,751	15,004	25,656	29,993
Interest (expense) and other income (expense), net	(21,852)	(32,201)	(54,654)	(72,506)
Total other income (expense), net	(9,101)	(17,197)	(28,998)	(42,513)
Income before income taxes	383,457	18,986	617,351	185,534
Provision for income taxes	121,668	6,017	189,333	58,180
Net income	$261,789	$12,969	$428,018	$127,354
Net income per share:				
Basic	$1.08	$0.05	$1.77	$0.53
Diluted	$1.06	$0.05	$1.74	$0.52
Shares used in computing net income per share:				
Basic	241,519	242,276	242,019	242,579
Diluted	245,815	244,570	245,569	246,026

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

SANDISK CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
	(In thousands)			
Net income	$261,789	$12,969	$428,018	$127,354
Other comprehensive income (loss), before tax:				
Unrealized holding gain (loss) on marketable securities	(20,302)	3,028	(14,075)	11,762
Reclassification adjustment for realized gain on marketable securities included in net income	(865)	(679)	(551)	(1,202)
Net unrealized holding gain (loss) on marketable securities	(21,167)	2,349	(14,626)	10,560
Foreign currency translation adjustments	(60,815)	55,938	(176,994)	(47,043)
Unrealized holding gain (loss) on derivatives qualifying as cash flow hedges	(7,263)	30,141	(37,893)	(38,920)
Reclassification adjustment for realized (gain) loss on derivatives qualifying as cash flow hedges included in net income	17,933	1,529	19,374	(4,785)
Net unrealized holding gain (loss) on derivatives qualifying as cash flow hedges	10,670	31,670	(18,519)	(43,705)
Total other comprehensive income (loss), before tax	(71,312)	89,957	(210,139)	(80,188)
Income tax expense (benefit) related to items of other comprehensive income (loss)	(17,074)	8,194	(33,332)	(3,008)
Total other comprehensive income (loss), net of tax	(54,238)	81,763	(176,807)	(77,180)
Comprehensive income	$207,551	$94,732	$251,211	$50,174

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

SANDISK CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30, 2013	July 1, 2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$428,018	$127,354
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred taxes	65,494	5,963
Depreciation	108,212	69,703
Amortization	121,246	132,280
Provision for doubtful accounts	1,142	(1,724)
Share-based compensation expense	46,395	39,333
Excess tax benefit from share-based plans	(15,661)	(11,021)
Impairment and other	(5,516)	(9,871)
Other non-operating	(360)	9,440
Changes in operating assets and liabilities:		
Accounts receivable, net	(11,210)	194,509
Inventory	27,507	(183,715)
Other assets	21,573	60,274
Accounts payable trade	15,370	(3,410)
Accounts payable to related parties	(46,787)	(41,432)
Other liabilities	109,021	(301,394)
Total adjustments	436,426	(41,065)
Net cash provided by operating activities	864,444	86,289
Cash flows from investing activities:		
Purchases of short and long-term marketable securities	(1,997,087)	(1,362,066)
Proceeds from sales of short and long-term marketable securities	1,847,659	1,173,180
Proceeds from maturities of short and long-term marketable securities	506,905	407,430
Acquisition of property and equipment, net	(119,849)	(240,294)
Investment in Flash Ventures	—	(50,439)
Notes receivable issuances to Flash Ventures	—	(142,316)
Notes receivable proceeds from Flash Ventures	73,388	211,786
Purchased technology and other assets	(3,908)	(222)
Acquisitions, net of cash acquired	(142)	(69,204)
Net cash provided by (used in) investing activities	306,966	(72,145)
Cash flows from financing activities:		
Repayment of debt financing	(928,061)	—
Proceeds from employee stock programs	163,016	50,672
Distribution to non-controlling interests	(87)	—
Excess tax benefit from share-based plans	15,661	11,021
Share repurchase program	(369,994)	(154,075)
Net cash received (paid) for share repurchase contracts	—	(18,858)
Net cash used in financing activities	(1,119,465)	(111,240)
Effect of changes in foreign currency exchange rates on cash	6,716	54
Net increase (decrease) in cash and cash equivalents	58,661	(97,042)
Cash and cash equivalents at beginning of period	995,470	1,167,496
Cash and cash equivalents at end of period	$1,054,131	$1,070,454

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

Table of Contents

SANDISK CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Organization

These interim Condensed Consolidated Financial Statements are unaudited but reflect, in the opinion of management, all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly the financial position of SanDisk Corporation and its subsidiaries (the "Company") as of June 30, 2013, the Condensed Consolidated Statements of Operations and the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and July 1, 2012, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and July 1, 2012. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States ("U.S.") generally accepted accounting principles ("GAAP") have been omitted in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). These Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's most recent Annual Report on Form 10–K filed with the SEC on February 19, 2013. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results to be expected for the entire fiscal year.

Basis of Presentation. The Company's fiscal year ends on the Sunday closest to December 31, and its fiscal quarters consist of 13 weeks and generally end on the Sunday closest to March 31, June 30, and September 30. The second quarters of fiscal years 2013 and 2012 ended on June 30, 2013 and July 1, 2012, respectively. For accounting and disclosure purposes, the exchange rates of 99.07, 85.99 and 79.53 at June 30, 2013, December 30, 2012 and July 1, 2012, respectively, were used to convert Japanese yen to U. S. dollars. Certain prior period amounts have been reclassified in the financial statements and footnotes to conform to the current period presentation, including line items within current assets in the Condensed Consolidated Balance Sheets and Note 4, "Balance Sheet Information," as well as cash flows from operating activities in the Condensed Consolidated Statement of Cash Flows. Beginning in the first quarter of fiscal year 2013, the Company reports only total revenues, which include product revenues and license and royalty revenues. Throughout the Notes to Condensed Consolidated Financial Statements, unless otherwise indicated, references to Net income refer to Net income attributable to common stockholders.

Organization and Nature of Operations. The Company was incorporated in Delaware on June 1, 1988. The Company designs, develops, markets and manufactures data storage solutions in a variety of form factors using its flash memory, controller and firmware technologies. The Company operates in one segment, flash memory storage products.

Principles of Consolidation. The Condensed Consolidated Financial Statements include the accounts of the Company and its majority-owned subsidiaries. All intercompany balances and transactions have been eliminated. Non-controlling interests represents the minority shareholders' proportionate share of the net assets and results of operations of the Company's majority-owned subsidiaries. The Condensed Consolidated Financial Statements also include the results of companies acquired by the Company from the date of each acquisition.

Use of Estimates. The preparation of Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. The estimates and judgments affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer programs and incentives, intellectual property claims, product returns, allowance for doubtful accounts, inventories and inventory reserves, valuation and impairments of marketable securities and investments, impairments of goodwill and long-lived assets, income taxes, warranty obligations, restructurings, contingencies, share-based compensation and litigation. The Company bases its estimates on historical experience and on other assumptions that its management believes are reasonable under the circumstances. These estimates form the basis for making judgments about the carrying value of assets and liabilities when those values are not readily apparent from other sources. Actual results could materially differ from these estimates.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Investments and Fair Value Measurements

The Company's total cash, cash equivalents and marketable securities was as follows (in thousands):

	June 30, 2013	December 30, 2012
Cash and cash equivalents	$1,054,131	$995,470
Short-term marketable securities	1,533,898	1,880,034
Long-term marketable securities	2,766,474	2,835,931
Total cash, cash equivalents and marketable securities	$5,354,503	$5,711,435

For certain of the Company's financial instruments, including cash held in banks, accounts receivable and accounts payable, the carrying amounts approximate fair value due to their short maturities, and are therefore excluded from the fair value tables below.

Financial assets and liabilities measured and recorded at fair value on a recurring basis consisted of the following types of instruments (in thousands):

	June 30, 2013				December 30, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Money market funds	$613,718	$—	$—	$613,718	$582,743	$—	$—	$582,743
Fixed income securities	128,805	4,370,162	—	4,498,967	27,386	4,917,939	—	4,945,325
Derivative assets	—	7,754	—	7,754	—	20,058	—	20,058
Total financial assets	$742,523	$4,377,916	$—	$5,120,439	$610,129	$4,937,997	$—	$5,548,126
Derivative liabilities	$—	$10,351	$—	$10,351	$—	$13,584	$—	$13,584
Total financial liabilities	$—	$10,351	$—	$10,351	$—	$13,584	$—	$13,584

Financial assets and liabilities measured and recorded at fair value on a recurring basis were presented on the Company's Condensed Consolidated Balance Sheets as follows (in thousands):

	June 30, 2013				December 30, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash equivalents[(1)]	$662,517	$149,796	$—	$812,313	$582,743	$229,360	$—	$812,103
Short-term marketable securities	66,912	1,466,986	—	1,533,898	16,589	1,863,445	—	1,880,034
Long-term marketable securities	13,094	2,753,380	—	2,766,474	10,797	2,825,134	—	2,835,931
Other current assets and other	—	7,754	—	7,754	—	20,058	—	20,058

non-current assets								
Total financial assets	$742,523	$4,377,916	$—	$5,120,439	$610,129	$4,937,997	$—	$5,548,126
Other current accrued liabilities and non-current liabilities	$—	$10,351	$—	$10,351	$—	$13,584	$—	$13,584
Total financial liabilities	$—	$10,351	$—	$10,351	$—	$13,584	$—	$13,584

(1) Cash equivalents exclude cash of $241.8 million and $183.4 million included in Cash and cash equivalents on the Condensed Consolidated Balance Sheets as of June 30, 2013 and December 30, 2012, respectively.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the six months ended June 30, 2013, the Company had no transfers of financial assets or liabilities between Level 1 and Level 2. As of June 30, 2013 and December 30, 2012, the Company had no financial assets or liabilities categorized as Level 3 and had not elected the fair value option for any financial assets and liabilities for which such an election would have been permitted.

Available-for-Sale Investments. Available-for-sale investments were as follows (in thousands):

	June 30, 2013				December 30, 2012			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
U.S. Treasury securities	$128,798	$8	$(1)	$128,805	$27,377	$9	$—	$27,386
U.S. government-sponsored agency securities	17,599	17	(23)	17,593	28,339	41	(1)	28,379
International government securities	10,210	1	(24)	10,187	153,936	13	(3)	153,946
Corporate notes and bonds	894,157	2,184	(1,159)	895,182	864,170	3,890	(938)	867,122
Asset-backed securities	174,920	62	(332)	174,650	179,356	453	—	179,809
Mortgage-backed securities	1,533	—	(25)	1,508	1,872	8	(14)	1,866
Municipal notes and bonds	3,261,133	17,044	(7,135)	3,271,042	3,665,032	22,697	(912)	3,686,817
Total available-for-sale investments	$4,488,350	$19,316	$(8,699)	$4,498,967	$4,920,082	$27,111	$(1,868)	$4,945,325

The fair value and gross unrealized losses on the available-for-sale securities that have been in a continuous unrealized loss position, aggregated by type of investment instrument, are summarized in the following table (in thousands). As of June 30, 2013, no securities have been in a continuous unrealized loss position for more than twelve months. Available-for-sale securities that were in an unrealized gain position have been excluded from the table.

	Fair Value	Gross Unrealized Loss
U.S. Treasury securities	$24,294	$(1)
U.S. government-sponsored agency securities	5,763	(23)
International government securities	2,976	(24)
Corporate notes and bonds	334,887	(1,159)
Asset-backed securities	120,003	(332)
Mortgage-backed securities	1,508	(25)
Municipal notes and bonds	897,226	(7,135)
Total	$1,386,657	$(8,699)

The gross unrealized loss related to U.S. Treasury and government-sponsored agency securities, international government securities, corporate and municipal notes and bonds, and asset-backed and mortgage-backed securities was primarily due to changes in interest rates. The gross unrealized loss on all available-for-sale fixed income securities at June 30, 2013 was considered temporary in nature. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company’s intent and ability to hold an investment for a period of time sufficient to allow for any anticipated recovery in market value. For debt security investments, the Company considered additional factors including the Company’s intent to sell the investments or whether it is “more likely than not” the Company will be required to sell the investments before the recovery of its amortized cost.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table shows the gross realized gains and (losses) on sales of available-for-sale securities (in thousands).

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Gross realized gains	$967	$949	$1,685	$2,024
Gross realized losses	(102)	(270)	(1,134)	(822)

Fixed income securities by contractual maturity as of June 30, 2013 are shown below (in thousands). Actual maturities may differ from contractual maturities because issuers of the securities may have the right to prepay obligations or the Company has the option to demand payment.

	Amortized Cost	Fair Value
Due in one year or less	$1,450,513	$1,455,297
After one year through five years	2,823,465	2,829,301
After five years through ten years	32,293	32,288
After ten years	182,079	182,081
Total	$4,488,350	$4,498,967

For those financial instruments where the carrying amounts differ from fair value, the following table represents the related carrying values and the fair values, which are based on quoted market prices (in thousands). These financial instruments were categorized as Level 1 as of both June 30, 2013 and December 30, 2012. See Note 6, “Financing Arrangements,” regarding maturity of the 1% Sr. Convertible Notes due 2013.

	June 30, 2013		December 30, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
1% Sr. Convertible Notes due 2013	$—	$—	$906,708	$927,820
1.5% Sr. Convertible Notes due 2017	809,626	1,345,260	789,913	1,159,370
Total	$809,626	$1,345,260	$1,696,621	$2,087,190

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. Derivatives and Hedging Activities

The Company uses derivative instruments primarily to manage exposures to foreign currency. The Company’s primary objective in holding derivative instruments is to reduce the volatility of earnings and cash flows associated with changes in foreign currency. The program is not designated for trading or speculative purposes. The Company’s derivative instruments expose the Company to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company seeks to mitigate such risk by limiting its counterparties to major financial institutions and by spreading the risk across several major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored by the Company on an ongoing basis.

The Company recognizes derivative instruments as either assets or liabilities on the balance sheet at fair value and provides qualitative disclosures about objectives and strategies for using derivative instruments, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. Changes in fair value (i.e., gains or losses) of the derivatives are recorded as cost of revenues or other income (expense), or as other comprehensive income (“OCI”). The Company does not offset or net the fair value amounts of derivative instruments and separately discloses the fair value amounts of the derivative instruments as either assets or liabilities.

Cash Flow Hedges. The Company uses forward contracts designated as cash flow hedges to hedge a portion of future forecasted purchases in Japanese yen. The gain or loss on the effective portion of a cash flow hedge is initially reported as a component of accumulated other comprehensive income (“AOCI”) and subsequently reclassified into cost of revenues in the same period or periods in which the cost of revenues is recognized, or reclassified into other income (expense) if the hedged transaction becomes probable of not occurring. Any gain or loss after a hedge is no longer designated, because it is no longer probable of occurring or it is related to an ineffective portion of a cash flow hedge, as well as any amount excluded from the Company’s hedge effectiveness, is recognized as other income (expense) immediately. As of June 30, 2013, the Company had forward contracts in place to hedge future purchases of approximately 24.5 billion Japanese yen, or approximately $247 million based upon the exchange rate as of June 30, 2013, and the net unrealized loss on the effective portion of these cash flow hedges was ($7.4) million. The forward contracts on the Company’s future Japanese yen wafer purchases will settle in fiscal year 2013.

Other Derivatives. Other derivatives that are non-designated consist primarily of forward and cross currency swap contracts to minimize the risk associated with the foreign exchange effects of revaluing monetary assets and liabilities. Monetary assets and liabilities denominated in foreign currencies and the associated outstanding forward and cross currency swap contracts were marked-to-market at June 30, 2013 with realized and unrealized gains and losses included in other income (expense). As of June 30, 2013, the Company had foreign currency forward contracts hedging exposures in European euros, British pounds and Japanese yen. Foreign currency forward contracts were outstanding to buy and sell U.S. dollar equivalents of approximately $107.9 million and ($72.5) million in foreign currencies, respectively, based upon the exchange rates at June 30, 2013.

The Company currently has a cross currency swap contract to exchange Japanese yen for U.S. dollars that requires the Company to comply with certain covenants, the strictest of which is to maintain a minimum liquidity of $1.0 billion. Liquidity is defined as the sum of the Company’s cash and cash equivalents and short and long-term marketable securities. This cross currency swap contract was outstanding to sell U.S. dollar equivalents of approximately $29.3 million based upon the exchange rate at June 30, 2013. Should the Company fail to comply with these covenants, the Company may be required to settle the unrealized gain or loss on the foreign exchange contract prior to the original maturity date. The Company was in compliance with these covenants as of June 30, 2013.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amounts in the tables below include fair value adjustments related to the Company's own credit risk and counterparty credit risk.

Fair Value of Derivative Contracts. Fair value of derivative contracts as of June 30, 2013 and December 30, 2012 were as follows (in thousands):

	Derivative assets reported in Other Current Assets		Other Non-current Assets	
	June 30, 2013	December 30, 2012	June 30, 2013	December 30, 2012
Foreign exchange contracts designated	$72	$—	$—	$—
Foreign exchange contracts not designated	7,682	19,064	—	994
Total derivatives	$7,754	$19,064	$—	$994

	Derivative liabilities reported in Other Current Accrued Liabilities		Non-current Liabilities	
	June 30, 2013	December 30, 2012	June 30, 2013	December 30, 2012
Foreign exchange contracts designated	$7,454	$7,058	$—	$—
Foreign exchange contracts not designated	2,897	6,526	—	—
Total derivatives	$10,351	$13,584	$—	$—

Foreign Exchange and Equity Market Risk Contracts Designated as Cash Flow Hedges. The impact of the effective portion of designated cash flow derivative contracts on the Company's results of operations for the three and six months ended June 30, 2013 and July 1, 2012 was as follows (in thousands):

	Three months ended				Six months ended			
	Amount of gain (loss) recognized in OCI		Amount of gain (loss) reclassified from AOCI to earnings		Amount of gain (loss) recognized in OCI		Amount of gain (loss) reclassified from AOCI to earnings	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Foreign exchange contracts	$(7,263)	$30,141	$(17,933)	$(1,529)	$(37,893)	$(38,920)	$(19,374)	$4,785

Foreign exchange contracts designated as cash flow hedges relate primarily to wafer purchases in Japanese yen. Gains and losses associated with foreign exchange contracts designated as cash flow hedges are expected to be recorded in cost of revenues when reclassified out of AOCI. The Company expects to realize the majority of the AOCI balance related to foreign exchange contracts within the next twelve months.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table includes the ineffective portion of designated cash flow derivative contracts and the forward points excluded for the purposes of cash flow hedging designation recognized in other income (expense) (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Foreign exchange contracts	$(139)	$(799)	$(446)	$(5,246)

Effect of Non-Designated Derivative Contracts on the Condensed Consolidated Statements of Operations. The effect of non-designated derivative contracts on the Company's results of operations recognized in other income (expense) was as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Gain (loss) on foreign exchange contracts including forward point income	$(3,194)	$(2,376)	$6,465	$2,586
Gain (loss) from revaluation of foreign currency exposures hedged by foreign exchange contracts	1,975	2,242	(9,408)	(1,969)

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4. Balance Sheet Information

Accounts Receivable, net. Accounts receivable, net was as follows (in thousands):

	June 30, 2013	December 30, 2012
Accounts receivable from product revenues	$763,246	$766,583
Accounts receivable from license and royalty revenues	42,737	37,638
Allowance for doubtful accounts	(7,536)	(6,627)
Price protection, promotions and other activities	(162,354)	(171,569)
Total accounts receivable, net	$636,093	$626,025

Inventory. Inventory was as follows (in thousands):

	June 30, 2013	December 30, 2012
Raw material	$400,078	$404,634
Work-in-process	110,509	102,249
Finished goods	212,816	243,192
Total inventory	$723,403	$750,075

Other Current Assets. Other current assets were as follows (in thousands):

	June 30, 2013	December 30, 2012
Tax-related receivables	$189,059	$186,223
Other non-trade receivable	11,668	—
Prepayment to Flash Forward Ltd.	15,433	20,577
Derivative contract receivables	7,754	19,064
Prepaid expenses	13,118	13,221
Other current assets	14,899	21,794
Total other current assets	$251,931	$260,879

Notes Receivable and Investments in Flash Ventures. Notes receivable and investments in Flash Partners Ltd., Flash Alliance Ltd. and Flash Forward Ltd. (collectively referred to as “Flash Ventures”) were as follows (in thousands):

	June 30, 2013	December 30, 2012
Notes receivable, Flash Partners Ltd.	$156,455	$180,254
Notes receivable, Flash Alliance Ltd.	343,192	476,800
Notes receivable, Flash Forward Ltd.	141,314	162,810
Investment in Flash Partners Ltd.	202,796	232,547
Investment in Flash Alliance Ltd.	302,285	342,048
Investment in Flash Forward Ltd.	58,698	65,653
Total notes receivable and investments in Flash Ventures	$1,204,740	$1,460,112

Equity-method investments and the Company’s maximum loss exposure related to Flash Ventures are discussed further in Note 11, “Commitments, Contingencies and Guarantees – Flash Ventures” and Note 12, “Related Parties and Strategic Investments.”

The Company assesses financing receivable credit quality through financial and operational reviews of the borrower and creditworthiness, including credit rating agency ratings, of significant investors of the borrower, where material or known. Impairments, when required for credit worthiness, are recorded in other income (expense). The Company makes or will make

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

long-term loans to Flash Ventures to fund new process technologies and additional wafer capacities. The Company aggregates its Flash Ventures notes receivable into one class of financing receivables due to the similar ownership interest and common structure in each Flash Venture entity. For all reporting periods presented, no loans were past due and no loan impairments were recorded.

Other Non-current Assets. Other non-current assets were as follows (in thousands):

	June 30, 2013	December 30, 2012
Prepaid tax on intercompany transactions	$39,932	$42,118
Prepayment to Flash Forward Ltd.	—	5,144
Convertible note issuance costs	7,767	8,708
Long-term prepaid income tax	63,008	63,008
Other non-current assets	38,939	34,832
Total other non-current assets	$149,646	$153,810

Other Current Accrued Liabilities. Other current accrued liabilities were as follows (in thousands):

	June 30, 2013	December 30, 2012
Accrued payroll and related expenses	$139,927	$102,269
Derivative contract payables	10,351	13,584
Taxes payable	116,062	25,476
Other accrued liabilities	147,131	116,210
Total other current accrued liabilities	$413,471	$257,539

Non-current Liabilities. Non-current liabilities were as follows (in thousands):

	June 30, 2013	December 30, 2012
Deferred tax liabilities	$10,178	$28,672
Income tax liabilities	197,202	208,629
Deferred credits on intercompany transactions	50,147	58,548
Other non-current liabilities	99,054	112,098
Total non-current liabilities	$356,581	$407,947

Warranties. The liability for warranty expense is included in Other current accrued liabilities and Non-current liabilities in the accompanying Condensed Consolidated Balance Sheets and the activity was as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Balance, beginning of period	$38,972	$32,119	$38,787	$26,957
Additions and adjustments to cost of revenues	6,040	3,073	10,918	13,479
Usage	(6,657)	(3,552)	(11,350)	(8,796)
Balance, end of period	$38,355	$31,640	$38,355	$31,640

The majority of the Company’s products have a warranty of less than three years, with a small number of products having a warranty ranging up to ten years or more. For warranties ten years or greater, including lifetime warranties, the Company uses the estimated useful life of the product to calculate the warranty exposure. A provision for the estimated future cost related to warranty expense is recorded at the time of customer invoice. The Company’s warranty liability is affected by customer and consumer returns, product failures, number of units sold and repair or replacement costs incurred. Should actual product failure rates, or repair or replacement costs, differ from the Company’s estimates, increases or decreases to its warranty liability would be required.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accumulated Other Comprehensive Income (Loss). AOCI presented in the accompanying Condensed Consolidated Balance Sheets consists of unrealized gains and losses on available-for-sale investments, foreign currency translation and hedging activities, net of tax, for all periods presented (in thousands):

	June 30, 2013	December 30, 2012
Accumulated net unrealized gain (loss) on:		
Available-for-sale investments	$6,765	$15,919
Foreign currency translation	6,255	155,389
Hedging activities	(24,706)	(6,187)
Total accumulated other comprehensive income (loss)	$(11,686)	$165,121

The amount of income tax (benefit) expense allocated to the unrealized gain (loss) on available-for-sale investments and foreign currency translation was as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Available-for-sale investments	$(7,525)	$841	$(5,472)	$3,834
Foreign currency translation	(9,549)	7,353	(27,860)	(6,842)
	$(17,074)	$8,194	$(33,332)	$(3,008)

The significant amounts reclassified out of each component of AOCI were as follows (in thousands):

	Three months ended		Six months ended		
AOCI Component	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012	Income Statement Line Item
Unrealized gain on available-for-sale investments	$865	$679	$551	$1,202	Interest (expense) and other income (expense), net
Tax impact	(308)	(248)	(483)	(417)	Tax expense
Unrealized gain on available-for-sale investments, net of tax	557	431	68	785	Net of tax
Gain (loss) on hedging activities	(17,933)	(1,529)	(19,374)	4,785	Cost of revenues
Tax impact	—	—	—	—	Tax expense
Gain (loss) on hedging activities, net of tax	(17,933)	(1,529)	(19,374)	4,785	Net of tax
Total reclassifications for the period, net of tax	$(17,376)	$(1,098)	$(19,306)	$5,570	Net of tax

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Goodwill and Intangible Assets

Goodwill. Goodwill balances are presented below (in thousands):

	Carrying Amount
Balance as of December 30, 2012	$201,735
Adjustment	601
Balance as of June 30, 2013	$202,336

Goodwill increased by $0.6 million due to the resolution of a legal contingency matter during the first quarter of fiscal year 2013 related to an acquisition from fiscal year 2012.

Intangible Assets. Intangible asset balances are presented below (in thousands):

	June 30, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed product technology	$200,960	$(87,764)	$113,196
Customer relationships	13,050	(12,784)	266
Trademarks	5,700	(2,499)	3,201
Covenants not to compete	3,100	(2,359)	741
Acquisition-related intangible assets	222,810	(105,406)	117,404
Technology licenses and patents	133,909	(77,955)	55,954
Total intangible assets subject to amortization	356,719	(183,361)	173,358
Acquired in-process research and development	37,525	—	37,525
Total intangible assets	$394,244	$(183,361)	$210,883

	December 30, 2012			
	Gross Carrying Amount	Accumulated Amortization	Adjustments	Net Carrying Amount
Developed product technology	$200,960	$(68,104)	$—	$132,856
Core technology	79,800	(79,800)	—	—
Customer relationships	13,050	(10,043)	—	3,007
Trademarks	5,700	(1,870)	—	3,830
Covenants not to compete	3,100	(1,618)	—	1,482
Acquisition-related intangible assets	302,610	(161,435)	—	141,175
Technology licenses and patents	133,909	(65,690)	—	68,219
Total intangible assets subject to amortization	436,519	(227,125)	—	209,394
Acquired in-process research and development	38,385	—	(860)	37,525
Total intangible assets	$474,904	$(227,125)	$(860)	$246,919

The Company performs tests for impairment of long-lived assets whenever events or circumstances suggest that long-lived assets may be impaired. In the first quarter of fiscal year 2013, due to an increase in overall cost estimates and delays in the development timeline related to an in-process research and development (“IPR&D”) project from the Pliant Technology, Inc. (“Pliant”) acquisition, the Company performed impairment tests on the related amortizable intangible assets and indefinite-lived IPR&D intangible asset and determined that none were impaired. Due to continued project delays, including subsequent to the end of the second quarter of fiscal year 2013, which resulted in the same impairment indicators identified in the first quarter of fiscal year 2013, the Company again tested the recoverability of the amortizable intangible assets and noted that as of the end of the second quarter of fiscal year 2013, the undiscounted cash flows were in excess of the net book value of the amortizable intangible assets, indicating no impairment. In addition, the Company performed a qualitative impairment assessment of the indefinite-lived IPR&D intangible asset and determined that it was not more-than-likely-than-not that the fair value of the

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

indefinite-lived IPR&D intangible asset was lower than its carrying value. Therefore the Company did not proceed to a quantitative impairment analysis of the indefinite-lived intangible asset. While these delays related to the IPR&D project did not indicate that an impairment is required at this time, additional future delays, additional increases in overall cost estimates, program cancellation or other significant events or circumstances affecting the IPR&D project could result in the indefinite-lived IPR&D intangible asset or the amortizable intangible assets being partially or fully impaired. Due to these IPR&D project delays, the Company expects to assess the indefinite-lived IPR&D intangible asset for impairment at the end of the third quarter of fiscal year 2013 and on a quarterly basis until completion of the development of the technology and will continue to monitor any events or circumstances that could indicate the amortizable intangible assets are impaired. As of June 30, 2013, the net book value of the Pliant indefinite-lived IPR&D intangible asset was $36.2 million and the net book value of the related Pliant amortizable intangible assets was $96.8 million, and a potential complete impairment of both would result in a charge of up to $133.0 million.

The annual expected amortization expense of intangible assets as of June 30, 2013, excluding acquired IPR&D intangible assets, is presented below (in thousands):

	Estimated Amortization Expense	
	Acquisition-related Intangible Assets	Technology Licenses and Patents
Fiscal year:		
2013 (remaining six months)	$21,156	$11,334
2014	40,545	21,231
2015	40,380	20,056
2016	15,323	3,333
Total intangible assets subject to amortization	$117,404	$55,954

On July 2, 2013, the Company entered into a definitive agreement to acquire SMART Storage Systems, a developer of enterprise solid state drives. Under the terms of the agreement, the Company will pay approximately $307 million in cash and certain equity-based incentive awards to acquire SMART Storage Systems. The transaction, which has been approved by the boards of directors of both companies, is subject to customary closing conditions, including regulatory review and approval, and is expected to close in August 2013.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. Financing Arrangements

The following table reflects the carrying value of the Company's convertible debt (in thousands):

	June 30, 2013	December 30, 2012
1% Notes due 2013	$—	$928,061
Less: Unamortized bond discount	—	(21,353)
Net carrying amount of 1% Notes due 2013	—	906,708
1.5% Notes due 2017	1,000,000	1,000,000
Less: Unamortized bond discount	(190,374)	(210,087)
Net carrying amount of 1.5% Notes due 2017	809,626	789,913
Total convertible debt	809,626	1,696,621
Less: Convertible short-term debt	—	(906,708)
Convertible long-term debt	$809,626	$789,913

1% Convertible Senior Notes Due 2013. On May 15, 2013, the maturity date for the 1% Convertible Senior Notes due May 15, 2013 ("1% Notes due 2013"), the Company settled the 1% Notes due 2013 through an all-cash transaction for principal and accrued interest of $928.1 million and $4.6 million, respectively. As of the date of the redemption, the Company had no further obligations related to the 1% Notes due 2013. In connection with the maturity of the 1% Notes due 2013, the associated convertible bond hedge transaction also terminated, with no shares purchased under the convertible bond hedge agreement. As of June 30, 2013, there were warrants outstanding to purchase up to 11.3 million shares of the Company's common stock which mature on 20 different dates from August 23, 2013 through September 20, 2013 and are exercisable at each respective maturity date at an exercise price of $95.03 per share. At each maturity date, the Company may, at its option, elect to settle the warrants on a net share basis.

The following table presents the amount of interest cost recognized relating to the contractual interest coupon, amortization of bond issuance costs and amortization of the bond discount on the liability component of the 1% Notes due 2013 (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Contractual interest coupon	$1,162	$2,321	$3,481	$4,640
Amortization of bond issuance costs	318	696	1,014	1,392
Amortization of bond discount	6,964	13,276	21,022	26,301
Total interest cost recognized	$8,444	$16,293	$25,517	$32,333

The effective interest rate on the liability component of the 1% Notes due 2013 was 7.4% for each of the three and six months ended June 30, 2013 and July 1, 2012.

1.5% Convertible Senior Notes Due 2017. In August 2010, the Company issued and sold $1.0 billion in aggregate principal amount of 1.5% Convertible Senior Notes due August 15, 2017 ("1.5% Notes due 2017") at par. The 1.5% Notes due 2017 may be converted, under certain circumstances described below, based on an initial conversion rate of 19.0931 shares of common stock per $1,000 principal amount of notes (which represents an initial conversion price of approximately $52.37 per share). The net proceeds to the Company from the sale of the 1.5% Notes due 2017 were

$981.0 million.

The Company separately accounts for the liability and equity components of the 1.5% Notes due 2017. The principal amount of the liability component of $706.0 million as of the date of issuance was recognized at the present value of its cash flows using a discount rate of 6.85%, the Company's borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. As of June 30, 2013, the carrying value of the equity component of $294.0 million was unchanged from the date of issuance.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the amount of interest cost recognized relating to the contractual interest coupon, amortization of bond issuance costs and amortization of the bond discount on the liability component of the 1.5% Notes due 2017 (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Contractual interest coupon	$3,750	$3,750	$7,500	$7,500
Amortization of bond issuance costs	666	666	1,333	1,333
Amortization of bond discount	9,802	9,080	19,321	17,941
Total interest cost recognized	$14,218	$13,496	$28,154	$26,774

The effective interest rate on the liability component of the 1.5% Notes due 2017 was 6.85% for each of the three and six months ended June 30, 2013 and July 1, 2012. The remaining unamortized bond discount of $190.4 million as of June 30, 2013 will be amortized over the remaining life of the 1.5% Notes due 2017, which is approximately 4.1 years.

Concurrent with the issuance of the 1.5% Notes due 2017, the Company sold warrants to acquire up to approximately 19.1 million shares of its common stock at an exercise price of $73.33 per share. The warrants mature on 40 different dates from November 13, 2017 through January 10, 2018 and are exercisable at the maturity date. At each maturity date, the Company may, at its option, elect to settle the warrants on a net share basis. In addition, concurrent with the issuance of the 1.5% Notes due 2017, the Company entered into a convertible bond hedge transaction in which counterparties agreed to sell to the Company up to approximately 19.1 million shares of the Company's common stock, which is the number of shares initially issuable upon conversion of the 1.5% Notes due 2017 in full, at a price of $52.37 per share. This convertible bond hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 1.5% Notes due 2017 or the first day that none of the 1.5% Notes due 2017 remain outstanding due to conversion or otherwise. Settlement of the convertible bond hedge in net shares on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 1.5% Notes due 2017. As of June 30, 2013, the Company had not purchased any shares under this convertible bond hedge agreement.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Share Repurchase Program

The Company’s Board of Directors has authorized up to $1.25 billion for share repurchases, of which $646.1 million remained available for share repurchases as of June 30, 2013. Under this program, shares repurchased are recorded as a reduction to capital in excess of par value and retained earnings in the Company’s Condensed Consolidated Balance Sheets. From inception of this share repurchase program through June 30, 2013, the Company had repurchased 12.56 million shares for $603.9 million, of which 6.83 million shares for an aggregate purchase price of $369.9 million were repurchased during the six months ended June 30, 2013. As part of its share repurchase program, the Company may from time-to-time enter into structured share repurchase arrangements with financial institutions. During the six months ended June 30, 2013, the Company did not enter into any structured share repurchase transactions.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Share-based Compensation

Share-based Benefit Plans

Share-based Plans. The Company has a share-based compensation program that provides its Board of Directors with broad discretion in creating equity incentives for employees, officers, non-employee board members and non-employee service providers. This program includes incentive and non-statutory stock option awards, stock appreciation right awards, restricted stock awards, and performance-based cash bonus awards for Section 16 executive officers. These awards are granted under various programs, all of which are stockholder approved. Stock option awards generally vest as follows: 25% of the shares vest on the first anniversary of the vesting commencement date and the remaining 75% vest proportionately each quarter over the next 12 quarters of continued service. Restricted stock unit awards generally vest in equal annual installments over a 4-year period, subject to continued service. Under the Company’s current non-employee director compensation policy, stock option awards granted to non-employee board members are immediately exercisable upon grant but vest in one installment on the earlier of (i) the first anniversary of the grant date or (ii) the day immediately preceding the Company’s next annual meeting of stockholders following the grant date and are subject to the Company’s right of repurchase for any shares that have been exercised but have not yet vested. Restricted stock unit awards granted to non-employee board members vest in one installment on the earlier of (i) the first anniversary of the grant date or (ii) the day immediately preceding the Company’s next annual meeting of stockholders following the grant date. Additionally, the Company has an Employee Stock Purchase Plan (“ESPP”) that allows employees to purchase shares of common stock at 85% of the fair market value at the subscription date or the date of purchase, whichever is lower.

2013 Incentive Plan. On June 12, 2013, the Company’s stockholders approved the 2013 Incentive Plan (“2013 Plan”). Shares of the Company’s common stock may be issued under the 2013 Plan pursuant to two separate equity incentive programs: (i) the discretionary grant program under which stock options and stock appreciation rights may be granted to officers and other employees, non-employee board members and independent consultants, and (ii) the stock issuance and cash bonus program under which eligible persons may, at the discretion of the plan administrator, be issued shares of the Company’s common stock pursuant to restricted stock awards, restricted stock units or other share-based awards which vest upon the completion of a designated service period or the attainment of pre-established performance milestones, be awarded cash bonus opportunities which are earned through the attainment of pre-established performance milestones, or be issued shares of the Company’s common stock through direct purchase or as a bonus for services rendered to the Company. A total of 20,000,000 shares of the Company’s common stock have initially been reserved for issuance under the 2013 Plan. The 2013 Plan share reserve may be increased by up to 10,000,000 shares of common stock to the extent that outstanding share-based awards under the 1995 Stock Option Plan, the 1995 Non-Employee Directors Stock Option Plan, and the 2005 Incentive Plan expire, terminate or lapse, of which 31,626 shares of common stock as of June 30, 2013 had been added to the 2013 Plan share reserve. All options granted under the 2013 Plan are granted with an exercise price equal to the fair market value of the common stock on the date of grant and will expire seven years from the date of grant.

2005 Incentive Plan. The 2005 Incentive Plan terminated on June 12, 2013, and no further share-based awards were made under this plan after that date. However, share-based awards that were outstanding under this plan on June 12, 2013 continue to be governed by their existing terms. Options granted may be exercised for shares of the Company’s common stock at any time prior to the expiration of the seven-year option term or any earlier termination of those options in connection with the optionee’s cessation of service with the Company.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Valuation Assumptions

Option Plan Shares. The fair value of the Company's stock options granted to employees, officers and non-employee board members, excluding unvested stock options assumed through acquisitions, was estimated using the following weighted average assumptions:

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Dividend yield	None	None	None	None
Expected volatility	0.32	0.40	0.38	0.43
Risk-free interest rate	0.72%	0.53%	0.68%	0.61%
Expected term	4.3 years	3.9 years	4.4 years	4.3 years
Estimated annual forfeiture rate	8.51%	8.59%	8.51%	8.59%
Weighted average fair value at grant date	$16.22	$11.34	$16.44	$16.72

Employee Stock Purchase Plan Shares. The fair value of the Company's ESPP shares issued to employees was estimated using the following weighted average assumptions:

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Dividend yield	None	None	None	None
Expected volatility	0.33	0.38	0.33	0.38
Risk-free interest rate	0.13%	0.15%	0.13%	0.15%
Expected term	½ year	½ year	½ year	½ year
Weighted average fair value at purchase date	$12.54	$12.24	$12.54	$12.24

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Share-based Compensation Plan Activities

Stock Options and SARs. A summary of stock option and stock appreciation rights ("SARs") activity under all of the Company's share-based compensation plans as of June 30, 2013 and changes during the six months ended June 30, 2013 is presented below (in thousands, except for weighted average exercise price and remaining contractual term):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options and SARs outstanding at December 30, 2012	15,426	$40.73	3.2	$109,411
Granted	1,010	52.14		
Exercised	(4,954)	34.17		98,469
Forfeited	(300)	43.20		
Expired	(2,316)	60.78		
Options and SARs outstanding at June 30, 2013	8,866	40.38	4.2	183,720
Options and SARs vested and expected to vest after June 30, 2013, net of forfeitures	8,440	40.00	4.1	178,132
Options and SARs exercisable at June 30, 2013	4,748	35.12	3.1	123,343

At June 30, 2013, the total compensation cost related to stock options granted to employees under the Company's share-based compensation plans but not yet recognized was approximately $79.3 million, net of estimated forfeitures. This cost will be amortized on a straight-line basis over a weighted average period of approximately 2.4 years. As of June 30, 2013, the Company had fully expensed all of its SARs awards.

Restricted Stock Units. Restricted stock units ("RSUs") are settled in shares of the Company's common stock upon vesting on a one-for-one basis. Typically, vesting of RSUs is subject to the employee's continuing service to the Company. The cost of these awards is determined using the fair value of the Company's common stock on the date of grant, and compensation is recognized on a straight-line basis over the requisite vesting period.

A summary of the changes in RSUs outstanding under the Company's share-based compensation plans during the six months ended June 30, 2013 is presented below (in thousands, except for weighted average grant date fair value):

	Shares	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Non-vested share units at December 30, 2012	3,077	$43.51	$131,622
Granted	2,131	52.25	
Vested	(851)	42.18	44,068
Forfeited	(180)	45.97	
Non-vested share units at June 30, 2013	4,177	48.15	201,113

As of June 30, 2013, the Company had approximately $149.9 million of unrecognized compensation expense, net of estimated forfeitures, related to RSUs, which will be recognized over a weighted average estimated remaining life of three years.

Employee Stock Purchase Plan. At June 30, 2013, there was approximately $0.9 million of total unrecognized compensation cost related to the Company's ESPP that is expected to be recognized over a period of one month.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Share-based Compensation Expense. The following tables set forth the detailed allocation of the share-based compensation expense (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Share-based compensation expense by caption:				
Cost of revenues	$2,447	$1,923	$4,164	$3,460
Research and development	12,704	10,623	24,344	20,650
Sales and marketing	4,701	3,634	8,572	7,263
General and administrative	4,809	4,073	9,315	7,960
Total share-based compensation expense	24,661	20,253	46,395	39,333
Total tax benefit recognized	(6,222)	(4,676)	(13,138)	(9,845)
Decrease in net income	$18,439	$15,577	$33,257	$29,488
Share-based compensation expense by type of award:				
Stock options and SARs	$8,054	$9,426	$16,323	$18,642
RSUs	14,788	8,608	26,758	16,502
ESPP	1,819	2,219	3,314	4,189
Total share-based compensation expense	24,661	20,253	46,395	39,333
Total tax benefit recognized	(6,222)	(4,676)	(13,138)	(9,845)
Decrease in net income	$18,439	$15,577	$33,257	$29,488

Share-based compensation expense of $2.6 million and $1.8 million related to manufacturing personnel was capitalized into inventory as of June 30, 2013 and December 30, 2012, respectively.

The total grant date fair value of options and RSUs vested during the three and six months ended June 30, 2013 and July 1, 2012 was as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Fair value of options vested	$7,282	$8,214	$21,850	$22,974
Fair value of RSUs vested	6,082	4,283	35,903	23,584
Total fair value of options and RSUs vested	$13,364	$12,497	$57,753	$46,558

Note 9. Provision for Income Taxes

The following table presents the provision for income taxes and the effective tax rate (in thousands, except percentages):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Provision for income taxes	$121,668	$6,017	$189,333	$58,180
Effective tax rate	31.7 %	31.7 %	30.7 %	31.4 %

The provision for income taxes for the three and six months ended June 30, 2013 differs from the U.S. statutory tax rate of 35% primarily due to the tax impact of earnings from foreign operations, state taxes, non-deductibility of certain share-based compensation, federal research and development ("R&D") credit and tax-exempt interest income. Earnings and taxes resulting from foreign operations are largely attributable to the Company's Irish, Chinese, Israeli and Japanese entities. Earnings in these countries, where tax rates are lower than the U.S. notional rate, contributed to the majority of the difference between the rate of the Company's tax provision and the U.S. statutory tax rate. The lower effective tax rate for the six months ended June 30, 2013, compared to the same period in fiscal year 2012, was attributable to a retroactively extended federal R&D tax credit for fiscal year 2012, availability of a federal R&D credit for fiscal year 2013 and changes in the composition of operating income by tax jurisdiction. As of June 30, 2013, the Company believes that most of its deferred tax assets are more likely than not to be realized, except for certain loss and credit carry forwards in certain U.S. and foreign tax jurisdictions.

Unrecognized tax benefits were $171.0 million and $179.5 million as of June 30, 2013 and December 30, 2012, respectively. Unrecognized tax benefits that would impact the effective tax rate in the future were approximately $79.8 million at June 30, 2013. Income tax expense for the three and six months ended June 30, 2013 and July 1, 2012 included interest and penalties of $0.9 million, $1.6 million, $0.7 million and $1.5 million, respectively.

The Company is subject to U.S. federal income tax as well as income taxes in multiple state and foreign jurisdictions. In February 2012, the Internal Revenue Service ("IRS") completed its field audit of the Company's federal income tax returns for the years 2005 through 2008 and issued the Revenue Agent's Report. The most significant proposed adjustments are comprised of related party transactions between SanDisk Corporation and its foreign subsidiaries. The Company is contesting these adjustments through the IRS Appeals Office and cannot predict when a resolution will be reached.

The Company strongly believes the IRS's position regarding the intercompany transactions is inconsistent with applicable tax laws, judicial precedents and existing Treasury regulations, and that the Company's previously reported income tax provisions for the years in question are appropriate. The Company believes that an adequate provision has been made for the adjustments from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner that is not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

The IRS recently initiated an examination of the Company's federal income tax returns for fiscal years 2009 through 2011. The Company does not expect a resolution of this audit to be reached during the next twelve months. In addition, the Company is currently under audit by various state and international tax authorities. The Company cannot reasonably estimate the outcome of these examinations, or provide assurance that the outcome of these examinations will not materially harm the Company’s financial position, results of operations or liquidity.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10. 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):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Numerator for basic net income per share:				
Net income	$261,789	$12,969	$428,018	$127,354
Denominator for basic net income per share:				
Weighted average common shares outstanding	241,519	242,276	242,019	242,579
Basic net income per share	$1.08	$0.05	$1.77	$0.53
Numerator for diluted net income per share:				
Net income	$261,789	$12,969	$428,018	$127,354
Denominator for diluted net income per share:				
Weighted average common shares outstanding	241,519	242,276	242,019	242,579
Incremental common shares attributable to exercise of outstanding employee stock options, SARs and ESPP (assuming proceeds would be used to purchase common stock), and RSUs	2,733	2,294	3,083	3,447
Effect of dilutive 1.5% Notes due 2017	1,563	—	467	—
Shares used in computing diluted net income per share	245,815	244,570	245,569	246,026
Diluted net income per share	$1.06	$0.05	$1.74	$0.52
Anti-dilutive shares excluded from net income per share calculation	32,515	74,276	34,670	71,043

Basic earnings per share exclude any dilutive effects of stock options, SARs, RSUs, warrants and convertible debt. Diluted earnings per share include the dilutive effects of stock options, SARs, RSUs, ESPP and the 1.5% Notes due 2017. Certain common stock issuable under stock options, SARs, warrants and the 1.5% Notes due 2017 have been omitted from the current year diluted net income per share calculation because their inclusion is considered anti-dilutive. Certain common stock issuable under stock options, SARs, warrants, the 1% Notes due 2013 and the 1.5% Notes due 2017 have been omitted from the prior year diluted net income per share calculation because their inclusion is considered anti-dilutive.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11. Commitments, Contingencies and Guarantees

Flash Ventures

Flash Ventures, the Company's business ventures with Toshiba Corporation ("Toshiba"), consists of three separate legal entities: Flash Partners Ltd., Flash Alliance Ltd. and Flash Forward Ltd. The Company has a 49.9% ownership interest in each of these entities and Toshiba owns 50.1% of each of these entities. Through these ventures, the Company and Toshiba have collaborated in the development and manufacture of NAND flash memory products which are manufactured by Toshiba at its wafer fabrication facility located in Yokkaichi, Japan, using semiconductor manufacturing equipment owned or leased by Flash Ventures. The Flash Ventures purchase wafers from Toshiba at cost and then resell those wafers to the Company and Toshiba at cost plus a markup. The Company accounts for its 49.9% ownership position in each Flash Ventures entity under the equity method of accounting. The Company is committed to purchase its provided three-month forecast of Flash Ventures' NAND wafer supply, which generally equals 50% of Flash Ventures' output. The Company is not able to estimate its total wafer purchase commitment obligation beyond its rolling three-month purchase commitment because the price is determined by reference to the future cost of producing the semiconductor wafers. In addition, the Company is committed to fund 49.9% of Flash Ventures' costs to the extent that Flash Ventures' revenues from wafer sales to the Company and Toshiba are insufficient to cover these costs.

Flash Partners. Flash Partners Ltd. ("Flash Partners") was formed in fiscal year 2004. NAND flash memory products provided to the Company by this venture are manufactured by Toshiba at its 300-millimeter wafer fabrication facility ("Fab 3") located in Yokkaichi, Japan. As of June 30, 2013, the Company had notes receivable from Flash Partners of $156.5 million, denominated in Japanese yen. These notes are secured by the equipment purchased by Flash Partners with the note proceeds. The Company also has guarantee obligations to Flash Partners; see "Off-Balance Sheet Liabilities." At June 30, 2013 and December 30, 2012, the Company had an equity investment in Flash Partners of $202.8 million and $232.5 million, respectively, denominated in Japanese yen, offset by $28.7 million and $59.3 million, respectively, of cumulative translation adjustments recorded in AOCI. In the three and six months ended June 30, 2013 and July 1, 2012, the Company recorded a basis adjustment of $0.3 million, $0.6 million, $0.8 million and $2.1 million, respectively, to its equity in earnings from Flash Partners related to the difference between the basis in the Company's equity investment compared to the historical basis of the assets recorded by Flash Partners. Flash Partner's share of the Fab 3 fabrication facility is fully equipped.

Flash Alliance. Flash Alliance Ltd. ("Flash Alliance") was formed in fiscal year 2006. NAND flash memory products provided to the Company by this venture are manufactured by Toshiba at its 300-millimeter wafer fabrication facility ("Fab 4") located in Yokkaichi, Japan. As of June 30, 2013, the Company had notes receivable from Flash Alliance of $343.2 million, denominated in Japanese yen. These notes are secured by the equipment purchased by Flash Alliance with the note proceeds. The Company also has guarantee obligations to Flash Alliance; see "Off-Balance Sheet Liabilities." At June 30, 2013 and December 30, 2012, the Company had an equity investment in Flash Alliance of $302.3 million and $342.0 million, respectively, denominated in Japanese yen, offset by $8.2 million and $53.7 million, respectively, of cumulative translation adjustments recorded in AOCI. In the three and six months ended June 30, 2013 and July 1, 2012, the Company recorded a basis adjustment of $2.1 million, $5.0 million, $3.8 million and $7.8 million, respectively, to its equity earnings from Flash Alliance related to the difference between the basis in the Company's equity investment compared to the historical basis of the assets recorded by Flash Alliance. Flash Alliance's share of the Fab 4 fabrication facility is fully equipped.

Flash Forward. Flash Forward Ltd. (“Flash Forward”) was formed in fiscal year 2010. NAND flash memory products provided to the Company by this venture are manufactured by Toshiba at its 300-millimeter wafer fabrication facility (“Fab 5”) located in Yokkaichi, Japan. Fab 5 is to be built in two phases. As of June 30, 2013, over half of the Phase 1 building has been equipped with wafer capacity or equipment required to enable technology transition of the Flash Ventures’ wafer capacity. No commitment has yet been made for further Phase 1 wafer capacity expansion beyond productivity improvements; however, the Company periodically reviews the opportunity for further Phase 1 capacity expansion. The Company and Toshiba each retain some flexibility as to the extent and timing of each party’s respective fab capacity ramps, and the output allocation will be in accordance with each party’s proportionate level of equipment funding. To date, the Company has invested in 50% of the Flash Forward equipment. The Company and Toshiba have announced that the construction of the Phase 2 shell of the Fab 5 wafer fabrication facility will begin in August 2013 with expected completion in mid-2014. The Phase 2 shell is intended to be used primarily for technology transition of the existing Flash Ventures wafer capacity to 1Y and 1Z technology nodes and for a Bit-cost scaleable 3-Dimensional NAND (“BiCS”) pilot line.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of June 30, 2013, the Company had notes receivable from Flash Forward of $141.3 million, denominated in Japanese yen. These notes are secured by the equipment purchased by Flash Forward with the note proceeds. The Company also has guarantee obligations to Flash Forward; see "Off-Balance Sheet Liabilities." At June 30, 2013 and December 30, 2012, the Company had an equity investment in Flash Forward of $58.7 million and $65.7 million, respectively, denominated in Japanese yen, offset by ($12.5) million and ($3.7) million, respectively, of cumulative translation adjustments recorded in AOCI.

Toshiba Foundry. In the first quarter of fiscal year 2013, the Company concluded its foundry arrangement with Toshiba.

Inventory Purchase Commitments with Flash Ventures. Purchase orders placed under Flash Ventures for up to three months are binding and cannot be canceled. These outstanding purchase commitments are included as part of the total "Noncancelable production purchase commitments" in the "Contractual Obligations" table.

Off-Balance Sheet Liabilities

Flash Ventures. The Flash Ventures sell and lease back from a consortium of financial institutions ("lessors") a portion of their tools and have entered into equipment master lease agreements totaling 262.6 billion Japanese yen, or approximately $2.65 billion based upon the exchange rate at June 30, 2013. As of June 30, 2013, the total amount outstanding from these master leases was 121.3 billion Japanese yen, or approximately $1.22 billion based upon the exchange rate at June 30, 2013, of which the amount of the Company's guarantee obligation of the Flash Ventures' master lease agreements, which reflects future payments and any lease adjustments, was 60.7 billion Japanese yen, or approximately $612 million based upon the exchange rate at June 30, 2013.

The master lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the master lease agreements contain an acceleration clause for certain events of default related to the Company as guarantor, including, among other things, the Company's failure to maintain a minimum stockholders' equity of at least $1.51 billion, and for one master lease agreement, which matures on July 31, 2013, the Company's failure to maintain a minimum corporate rating of BB- from Standard & Poors ("S&P") or Moody's Corporation ("Moody's"), or a minimum corporate rating of BB+ from Rating & Investment Information, Inc. ("R&I"). As of June 30, 2013, Flash Ventures was in compliance with all of its master lease covenants. As of June 30, 2013, the Company's R&I credit rating was BBB, two notches above the required minimum corporate rating threshold from R&I; and the Company's S&P credit rating was BB, one notch above the required minimum corporate rating threshold from S&P. If both S&P and R&I were to downgrade the Company's credit rating below the minimum corporate rating threshold, the Company's stockholders' equity falls below $1.51 billion, or other events of default occur, Flash Ventures would become non-compliant under its master equipment lease agreements and would be required to negotiate a resolution to the non-compliance to avoid acceleration of the obligations under such agreements. Such resolution could include, among other things, supplementary security to be supplied by the Company, as guarantor, or increased interest rates or waiver fees, should the lessors decide they need additional collateral or financial consideration under the circumstances. If a non-compliance event were to occur and if the Company failed to reach a resolution, the Company could be required to pay a portion or the entire outstanding lease obligations covered by its guarantees under such Flash Ventures master lease agreements.

27

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table details the Company’s portion of the remaining guarantee obligations under each of Flash Ventures’ master lease facilities (both original and refinanced leases) in both Japanese yen and U.S. dollar equivalent based upon the exchange rate at June 30, 2013.

Master Lease Agreements by Execution Date	Lease Type	Lease Amounts		Expiration
		(Yen in billions)	(Dollars in thousands)	
Flash Partners				
April 2010	Refinanced	¥1.2	$12,174	2014
January 2011	Refinanced	1.9	18,822	2014
November 2011	Refinanced	5.6	56,209	2014
March 2012	Refinanced	3.5	35,885	2015
		12.2	123,090	
Flash Alliance				
June 2008	Original	4.0	40,659	2013
March 2012	Original	7.6	76,367	2017
July 2012	Refinanced	14.3	144,107	2017
		25.9	261,133	
Flash Forward				
November 2011	Original	12.3	124,205	2016
March 2012	Original	7.5	75,680	2017
July 2012	Original	2.8	28,262	2017
		22.6	228,147	
Total guarantee obligations		¥60.7	$612,370	

The following table details the breakdown of the Company’s remaining guarantee obligations between the principal amortization and the purchase option exercise price at the end of the term of the master lease agreements, in annual installments as of June 30, 2013 in U.S. dollars based upon the yen/dollar exchange rate at June 30, 2013 (in thousands).

Annual Installments	Payment of Principal Amortization	Purchase Option Exercise Price at Final Lease Terms	Guarantee Amount
Year 1	$134,938	$51,826	$186,764
Year 2	137,240	35,962	173,202
Year 3	90,591	11,544	102,135
Year 4	58,465	63,714	122,179
Year 5	8,691	19,399	28,090
Total guarantee obligations	$429,925	$182,445	$612,370

Guarantees

Indemnification Agreements. The Company has agreed to indemnify 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 periodically engage in litigation as a result of these indemnification obligations. The Company's insurance policies exclude coverage for third-party claims for patent infringement. Although the liability is not remote, the nature of the patent infringement indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to its suppliers and customers. Historically, the Company has not made any significant indemnification payments under any such agreements. As of June 30, 2013, no amounts had been accrued in the accompanying Condensed Consolidated Financial Statements with respect to these indemnification guarantees.

As permitted under Delaware law and the Company's certificate of incorporation and bylaws, the Company has agreements, or has assumed agreements in connection with its acquisitions, whereby it indemnifies certain of its officers and employees, and each of its directors for certain events or occurrences while the officer, employee or director is, or was, serving at the Company's or the acquired company's request in such capacity. The term of the indemnification period is for the officer's, employee's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is generally unlimited; however, the Company has a Director and Officer insurance policy that may reduce its exposure and enable it to recover all or a portion of any future amounts paid. As a result of its insurance coverage, the Company believes the estimated fair value of these indemnification agreements is minimal. The Company has no liabilities recorded for these agreements as of June 30, 2013 or December 30, 2012, as these liabilities are not reasonably estimable even though liabilities under these agreements are not remote.

The Company and Toshiba have agreed to mutually contribute to, and indemnify each other and Flash Ventures for, environmental remediation costs or liability resulting from Flash Ventures' manufacturing operations in certain circumstances. The Company and Toshiba have also entered into a Patent Indemnification Agreement under which, in many cases, the Company will share in the expenses associated with the defense and cost of settlement associated with such claims. This agreement provides limited protection for the Company against third-party claims that NAND flash memory products manufactured and sold by Flash Ventures infringe third-party patents. The Company has not made any indemnification payments under any such agreements. As of June 30, 2013, no amounts have been accrued in the accompanying Condensed Consolidated Financial Statements with respect to these indemnification guarantees.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Contractual Obligations and Off-Balance Sheet Arrangements

The following tables summarize the Company's contractual cash obligations, commitments and off-balance sheet arrangements at June 30, 2013, and the effect such obligations are expected to have on its liquidity and cash flows in future periods.

Contractual Obligations. Contractual cash obligations and commitments as of June 30, 2013 are as follows (in thousands):

	Total		1 Year or Less (Remaining 6 months in Fiscal 2013)	2 – 3 Years (Fiscal 2014 and 2015)	4 – 5 Years (Fiscal 2016 and 2017)	More than 5 Years (Beyond Fiscal 2017)
Facility and other operating leases	$15,744	(4)	$3,379	$9,712	$2,371	$282
Flash Partners (1)	459,073	(4)(5)	92,683	247,061	108,555	10,774
Flash Alliance (1)	1,469,113	(4)(5)	175,833	885,333	317,414	90,533
Flash Forward (1)	587,723	(4)(5)	151,266	262,247	142,993	31,217
Toshiba research and development	57,405	(4)	27,405	30,000	—	—
Capital equipment purchase commitments	47,345		46,167	1,070	108	—
1.5% Convertible senior notes principal and interest (2)	1,067,500		7,500	30,000	1,030,000	—
Operating expense commitments	51,601		44,587	7,014	—	—
Noncancelable production purchase commitments (3)	255,705	(4)	255,705	—	—	—
Total contractual cash obligations	$4,011,209		$804,525	$1,472,437	$1,601,441	$132,806

(1) Includes reimbursement for depreciation and lease payments on owned and committed equipment, funding commitments for loans and equity investments and reimbursement for other committed expenses. Funding commitments assume no additional operating lease guarantees; new operating lease guarantees can reduce funding commitments.

(2) In August 2010, the Company issued and sold $1.0 billion in aggregate principal amount of 1.5% Notes due 2017. The Company will pay cash interest on the outstanding notes at an annual rate of 1.5%, payable semi-annually on August 15 and February 15 of each year until August 15, 2017.

(3) Includes Flash Ventures, related party vendors and other silicon source vendor purchase commitments.

(4) Includes amounts denominated in a currency other than the U.S. dollar, which are subject to fluctuation in exchange rates prior to payment and have been translated using the exchange rate at June 30, 2013.

(5) Excludes amounts related to the master lease agreements' purchase option exercise price at final lease term.

The Company has excluded $197.2 million of unrecognized tax benefits (which includes penalties and interest) from the contractual obligation table above due to the uncertainty with respect to the timing of associated future cash flows at June 30, 2013. The Company is unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authorities.

Off-Balance Sheet Arrangements. Off-balance sheet arrangements are as follows (in thousands):

	June 30, 2013
Guarantee of Flash Ventures equipment leases [1]	$612,370

(1) The Company's guarantee obligation, net of cumulative lease payments, was 60.7 billion Japanese yen, or approximately $612 million based upon the exchange rate at June 30, 2013.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company leases many of its office facilities and operating equipment for various terms under long-term, noncancelable operating lease agreements. The leases expire at various dates from fiscal year 2014 through fiscal year 2018. Future minimum lease payments are presented below (in thousands):

	June 30, 2013
Fiscal year:	
2013 (remaining six months)	$3,640
2014	5,960
2015	4,857
2016	1,837
2017	680
2018	282
	17,256
Sublease income to be received in the future under noncancelable subleases	(1,512)
Net operating leases	$15,744

Net rent expense was as follows (in thousands):

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
Rent expense, net	$1,330	$1,685	$3,173	$2,798

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12. Related Parties and Strategic Investments

Flash Ventures with Toshiba. The Company owns 49.9% of each entity within Flash Ventures and accounts for its ownership position under the equity method of accounting. The Company’s obligations with respect to the Flash Ventures master lease agreements, take-or-pay supply arrangements and research and development cost sharing are described in Note 11, “Commitments, Contingencies and Guarantees.” The financial and other support provided by the Company in all periods presented was either contractually required or the result of a joint decision to expand wafer capacity, transition to new technologies or refinance existing equipment lease commitments. Flash Ventures are variable interest entities. The Company evaluated whether it is the primary beneficiary of any of the entities within Flash Ventures for all periods presented and determined that it is not the primary beneficiary of any of the entities within Flash Ventures because it does not have a controlling financial interest in any of those entities. In determining whether the Company is the primary beneficiary, the Company analyzed the primary purpose and design of Flash Ventures, the activities that most significantly impact Flash Ventures’ economic performance, and whether the Company had the power to direct those activities. The Company concluded based upon its 49.9% ownership in Flash Ventures, the voting structure of Flash Ventures and the manner in which the day-to-day operations of Flash Ventures are conducted that the Company lacked the power to direct most of the activities that most significantly impact Flash Ventures’ economic performance.

The Company purchased NAND flash memory wafers from Flash Ventures and made prepayments, investments and loans to Flash Ventures totaling $455.4 million, $934.3 million, $746.1 million and $1.43 billion in the three and six months ended June 30, 2013 and July 1, 2012, respectively. The Company received loan repayments from Flash Ventures of $19.8 million, $73.4 million, $148.0 million and $211.8 million in the three and six months ended June 30, 2013 and July 1, 2012, respectively. At June 30, 2013 and December 30, 2012, the Company had accounts payable balances due to Flash Ventures of $167.0 million and $214.5 million, respectively.

The Company’s maximum reasonably estimable loss exposure (excluding lost profits), based upon the exchange rate at each respective balance sheet date, as a result of its involvement with Flash Ventures is presented below (in millions).

	June 30, 2013	December 30, 2012
Notes receivable	$641	$820
Equity investments	564	640
Operating lease guarantees	612	926
Prepayments	15	26
Maximum loss exposure	$1,832	$2,412

Solid State Storage Solutions, Inc. During the second quarter of fiscal year 2007, the Company formed Solid State Storage Solutions, Inc. (“S4”), a venture with third parties to license intellectual property. S4 qualifies as a variable interest entity. The Company is considered the primary beneficiary of S4 and the Company consolidates S4 in its Condensed Consolidated Financial Statements for all periods presented. The Company considered multiple factors in determining it was the primary beneficiary, including its overall involvement with the venture, contributions and participation in operating activities. S4’s assets and liabilities were not material to the Company’s Condensed Consolidated Balance Sheets as of June 30, 2013 and December 30, 2012.

Note 13. Litigation

From time to time, we are involved in various litigation, including those described below, among others. The litigation proceedings in which we are involved from time to time may include matters such as intellectual property, antitrust, commercial, labor, class action, and insurance disputes. The semiconductor industry is characterized by significant litigation seeking to enforce patent and other intellectual property rights. The Company has enforced and likely will continue to enforce its own intellectual property rights through litigation and related proceedings.

In each case listed below where the Company is the defendant, the Company intends to vigorously defend the action. At this time, the Company does not believe it is reasonably possible that losses related to the litigation described below have occurred beyond the amounts, if any, which have been accrued. However, legal discovery and litigation is highly unpredictable and future legal developments may cause current estimates to change in future periods.

Patent Infringement Litigation With Round Rock Research LLC. On October 27, 2011, in response to infringement allegations by Round Rock Research LLC (“Round Rock”), the Company filed a lawsuit against Round Rock in the U.S. District Court for the Northern District of California. The lawsuit seeks a declaratory judgment that twelve Round Rock patents are invalid and/or not infringed by flash memory products sold by the Company. Round Rock has since withdrawn its allegations of infringement as to three of the patents. SanDisk has filed motions for summary judgment of invalidity directed at two additional Round Rock patents, and Round Rock has filed a motion for summary judgment as to certain affirmative defenses asserted by SanDisk to the counterclaims in this action. These motions are currently pending. Discovery is underway and expert discovery has not yet commenced in the case. Trial is currently scheduled to begin on August 11, 2014.

On May 3, 2012, Round Rock filed an action in the U.S. District Court for the District of Delaware alleging that the Company infringed eleven patents, and subsequently filed an amended complaint alleging that SanDisk’s infringement was willful. The parties agreed to dismiss one patent from this Delaware lawsuit that was also being litigated in the California case described above. Discovery is underway. Trial is currently scheduled to begin on September 29, 2014.

Ritz Camera Federal Antitrust Class Action. On June 25, 2010, Ritz Camera & Image, LLC (“Ritz”) filed a complaint in the U.S. District Court for the Northern District of California (the “District Court”), alleging that the Company violated federal antitrust law by conspiring to monopolize and monopolizing the market for flash memory products. The lawsuit captioned Ritz Camera & Image, LLC v. SanDisk Corporation, Inc. and Eliyahou Harari, purports to be on behalf of direct purchasers of flash memory products sold by the Company and joint ventures controlled by the Company from June 25, 2006 through the present. The complaint alleges that the Company created and maintained a monopoly by fraudulently obtaining patents and using them to restrain competition and by allegedly converting other patents for its competitive use. On February 24, 2011, the District Court issued an Order granting in part and denying in part the Company’s motion to dismiss which resulted in Dr. Harari being dismissed as a defendant. On September 19, 2011, the Company filed a petition for permission to file an interlocutory appeal in the U.S. Court of Appeals for the Federal Circuit (the “Federal Circuit”) for the portion of the District Court’s Order denying the Company’s motion to dismiss based on Ritz’s lack of standing to pursue Walker Process antitrust claims. On October 27, 2011, the District Court administratively closed the case pending the Federal Circuit’s ruling on the Company’s petition. On November 20, 2012, the Federal Circuit affirmed the District Court’s order denying SanDisk’s motion to dismiss. On December 2, 2012, the Federal Circuit issued its mandate returning the case to the District Court. Discovery is now open in the District Court. On February 20, 2013, Ritz filed a motion requesting that Albert Giuliano, the Chapter 7 Trustee of the Ritz bankruptcy estate, be substituted as the plaintiff in this case, which the District Court granted on July 5, 2013.

Samsung Federal Antitrust Action Against Panasonic and SD-3C. On July 15, 2010, Samsung Electronics Co., Ltd. ("Samsung") filed an action in the U.S. District Court for the Northern District of California (the "District Court") alleging various claims against Panasonic Corporation and Panasonic Corporation of North America (collectively, "Panasonic") and SD-3C, LLC ("SD-3C") under federal antitrust law pursuant to Sections 1 and 2 of the Sherman Act, and under California antitrust and unfair competition laws relating to the licensing practices and operations of SD-3C. The complaint seeks an injunction against collection of Secure Digital ("SD") card royalties, treble damages, restitution, pre- and post-judgment interest, costs, and attorneys' fees, as well as a declaration that Panasonic and SD-3C engaged in patent misuse and that the patents subject to such alleged misuse should be held unenforceable. The Company is not named as a defendant in this case, but it established SD-3C along with Panasonic and Toshiba, and the complaint includes various factual allegations concerning the Company. As a member of SD-3C, the Company may be responsible for a portion of any monetary award. Other requested relief, including an injunction or declaration of patent misuse, could result in a loss of revenue to the Company. Defendants

Table of Contents

filed a motion to dismiss on September 24, 2010, and Samsung filed a First Amended Complaint ("FAC") on October 14, 2010. On August 25, 2011, the District Court dismissed the patent misuse claim with prejudice, but gave Samsung leave to amend its other claims. On January 3, 2012, the District Court granted defendants' motion to dismiss Samsung's complaint without leave to amend. Samsung has appealed, dated January 25, 2012. The briefing on appeal is complete but a hearing date has not yet been set.

Federal Antitrust Class Action Against SanDisk, et al. On March 15, 2011, a putative class action captioned Oliver v. SD-3C LLC, et al was filed in the U.S. District Court for the Northern District of California (the "District Court") on behalf of a nationwide class of indirect purchasers of SD cards alleging various claims against the Company, SD-3C, Panasonic, Toshiba, and Toshiba America Electronic Components, Inc. under federal antitrust law pursuant to Section 1 of the Sherman Act, California antirust and unfair competition laws, and common law. The complaint seeks an injunction of the challenged conduct, dissolution of "the cooperation agreements, joint ventures and/or cross-licenses alleged herein," treble damages, restitution, disgorgement, pre- and post-judgment interest, costs, and attorneys' fees. Plaintiffs allege that the Company (along with the other members of SD-3C) conspired to artificially inflate the royalty costs associated with manufacturing SD cards in violation of federal and California antitrust and unfair competition laws, which in turn allegedly caused plaintiffs to pay higher prices for SD cards. The allegations are similar to, and incorporate by reference the complaint in the Samsung Electronics Co., Ltd. v. Panasonic Corporation; Panasonic Corporation of North America; and SD-3C LLC described above. On May 21, 2012, the District Court granted Defendants' motion to dismiss the complaint with prejudice. Plaintiffs have appealed. Briefing on the appeal was completed on June 21, 2013. No date for oral argument has been set.

Insurance Litigation. On November 30, 2012, the Company filed a complaint in the U.S. District Court for the Northern District of California against Zurich American Insurance Company ("Zurich") for breach of an insurance contract issued by Zurich to the Company (the "Policy"). The action relates to Zurich's denial of the Company's claim under the Policy for coverage of losses suffered in connection with a power outage that occurred in December 2010 at the Fab 3 and Fab 4 facilities in Yokkaichi, Japan. The Company is seeking damages in an amount to be proven at trial, but in excess of approximately $60 million, less any applicable deductible, as well as costs and other associated remedies. Zurich filed its answer to the Company's complaint on December 21, 2012. Trial is currently scheduled to begin on July 14, 2014.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Statements in this report, which are not historical facts, are forward-looking statements within the meaning of the federal securities laws. These statements may contain words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" or other wording indicating future results or expectations. Forward-looking statements are subject to significant risks and uncertainties. Our actual results may differ materially from the results discussed in these forward-looking statements. Factors that could cause our actual results to differ materially include, but are not limited to, those discussed under "Risk Factors" in Part II, Item 1A, and elsewhere in this report. Our business, financial condition or results of operations could be materially harmed by any of these or other factors. We undertake no obligation to revise or update any forward-looking statements to reflect any event or circumstance that arises after the date of this report. References in this report to "SanDisk®," "we," "our," and "us" refer collectively to SanDisk Corporation, a Delaware corporation, and its subsidiaries.

Overview

We are a global leader in flash memory storage solutions. Our goal is to provide simple, reliable and affordable storage solutions for consumer and enterprise use in a wide variety of formats and devices. We sell our products globally to commercial and retail customers.

We design, develop, market and manufacture data storage solutions in a variety of form factors using our flash memory, controller and firmware technologies. Our flash-based products enable businesses and consumers to efficiently and effectively capture, share, use and preserve digital content. Our solutions include solid state drives, or SSDs, removable cards, embedded products, universal serial bus, or USB, drives, digital media players, wafers and components. Our SSD products are used in client computing platforms and enterprise data centers to provide high-speed, high-capacity storage solutions that can be used in lieu of, or in conjunction with, hard disk drives. Our removable cards are used in a wide range of consumer electronics devices such as mobile phones, tablets, digital cameras, gaming devices and PCs. Our embedded flash products are used in mobile phones, tablets, thin-and-light laptops, eReaders, global positioning system, or GPS, devices, gaming systems, imaging devices and computing platforms.

We strive to continuously reduce the cost of NAND flash memory in order to enable us to profitably grow our business, supply a diverse set of customers and channels, and continue to grow our markets. A key component of our ability to reduce the cost of NAND flash memory is our ability to continue to transition our NAND flash memory process technology to smaller nodes. We currently expect to be able to continue to scale our current NAND flash memory architecture, also known as planar NAND, through a few additional generations, but beyond that there is no certainty that further technology scaling can be achieved cost-effectively with the planar NAND flash memory architecture. We continue to invest in future generations of NAND flash memory, and we are also pursuing alternative technologies, such as Bit-cost scaleable 3-Dimensional NAND, or BiCS, and 3-Dimensional resistive RAM, or 3D ReRAM, technologies, both of which we believe may be viable alternatives to NAND flash memory when NAND flash memory can no longer cost-effectively scale at a sufficient rate, or at all. However, even when NAND flash memory can no longer scale further, we expect NAND flash memory and potential alternative technologies to coexist for an extended period of time. Currently, we are focused on transitioning our products to 19 nanometer and 1Y nanometer technologies and improving manufacturing efficiencies. 1Y nanometer and subsequent technology nodes will have increased manufacturing equipment requirements, which will impact the cost reduction benefits obtainable through these technologies.

Through our investments in our ventures with Toshiba Corporation, or Toshiba, and our in-house assembly and test facility, we have invested heavily in a vertically integrated business model. We purchase the vast majority of our NAND flash memory supply requirements through Flash Partners Ltd., Flash Alliance Ltd. and Flash Forward Ltd., collectively referred to as Flash Ventures, our significant flash venture relationships with Toshiba, which produce and provide us with leading-edge, low-cost memory wafers. Our manufacturing operations are concentrated in two locations, with Flash Ventures located in Yokkaichi, Japan, and our in-house assembly and test operations located in Shanghai, China. While we do not unilaterally control the operations of Flash Ventures, we believe that our vertically integrated business model helps us to reduce the costs of producing our products, increases our ability to control the quality of our products and speeds delivery to our customers.

Beginning in the first quarter of fiscal year 2013, we report only total revenues, which include product revenues and license and royalty revenues. In addition, during the first quarter of fiscal year 2013, we have recast our sales channels to be Retail and Commercial. Retail channel sales are made directly to retail customers and indirectly through distributors to retail customers. The Commercial channel includes original equipment manufacturer, or OEM, business-to-business, and direct enterprise customers as well as licensees. We have adjusted all prior year comparative amounts and explanations within

Management's Discussion and Analysis of Financial Condition and Results of Operations to reflect these changes in classification to be consistent for all periods presented.

Industry and Company Trends

We operate in an industry characterized by rapid technology transitions, price declines and evolving end-user markets for NAND flash memory. Historically, removable flash memory cards for imaging devices and USB drives provided the majority of our revenues. With the emergence of the smartphone and tablet markets, our sales of embedded NAND flash memory and cards for mobile phones, tablets, and other mobile devices have increased and now represent the largest percentage of our revenues, and we continue to see growth in smartphone and tablet adoption as well as the average capacity of our embedded and removable products used in these mobile devices. In addition, we continue to see new smartphones featuring card slots to expand device storage beyond the embedded capacity. We believe these trends will lead to continued revenue growth for our mobile products; however, we believe that demand for NAND flash memory in the mobile market will grow at a slower rate than in the past. Over the next several years, we believe the largest growth areas for NAND flash memory will be SSD solutions in the client computing and enterprise data center markets. We expect the retail market for NAND flash memory in imaging products and USB drives to be approximately constant or declining over the next several years. We continue to focus on adapting our business to the changing end-markets for NAND flash memory and aligning our resources accordingly.

We expect that industry bit supply growth for fiscal year 2013 will be significantly lower than in fiscal year 2012, and that our bit supply growth for fiscal year 2013 will be less than the industry's growth rate. We believe the reduced rate of industry bit supply growth is contributing to a healthy supply/demand balance and therefore a shallower rate of price decline, and will continue to do so for the remainder of fiscal year 2013 and into fiscal year 2014. Our revenue for fiscal year 2013 will be influenced primarily by our bit supply growth, industry pricing trends and the mix of our product sales.

Convertible Notes

In the second quarter of fiscal year 2013, we settled our 1% Notes due 2013 in cash for $928.1 million principal plus $4.6 million of accrued interest. In addition, the associated convertible bond hedge transaction was terminated, with no shares purchased. The associated warrants will either be settled on a net share basis or expire unexercised based upon the closing stock price on their respective expiration dates.

Other Transactions

On July 2, 2013, we entered into a definitive agreement to acquire SMART Storage Systems, a developer of enterprise SSDs. Under the terms of the agreement, we will pay approximately $307 million in cash and certain equity-based incentive awards to acquire SMART Storage Systems. The transaction, which has been approved by the boards of directors of both companies, is subject to customary closing conditions, including regulatory review and approval, and is expected to close in August 2013.

Results of Operations

	Three months ended				Six months ended			
	June 30, 2013	% of Revenues	July 1, 2012	% of Revenues	June 30, 2013	% of Revenues	July 1, 2012	% of Revenues
	(In millions, except percentages)							
Revenues	$1,476.3	100.0 %	$1,032.3	100.0 %	$2,817.0	100.0 %	$2,237.8	100.0 %
Cost of revenues	789.6	53.5 %	742.3	71.9 %	1,589.0	56.4 %	1,517.6	67.8 %
Amortization of acquisition-related intangible assets	9.9	0.7 %	9.2	0.9 %	19.7	0.7 %	22.9	1.0 %
Total cost of revenues	799.5	54.2 %	751.5	72.8 %	1,608.7	57.1 %	1,540.5	68.8 %
Gross profit	676.8	45.8 %	280.8	27.2 %	1,208.3	42.9 %	697.3	31.2 %
Operating expenses								
Research and development	172.1	11.7 %	152.4	14.8 %	343.2	12.2 %	293.4	13.1 %
Sales and marketing	63.6	4.2 %	52.3	5.1 %	122.7	4.4 %	101.3	4.5 %
General and administrative	46.9	3.2 %	37.7	3.6 %	92.0	3.3 %	70.3	3.2 %
Amortization and write-off of acquisition-related intangible assets	1.7	0.1 %	2.2	0.2 %	4.1	0.1 %	4.3	0.2 %
Total operating expenses	284.3	19.2 %	244.6	23.7 %	562.0	20.0 %	469.3	21.0 %
Operating income	392.5	26.6 %	36.2	3.5 %	646.3	22.9 %	228.0	10.2 %
Other income (expense), net	(9.1)	(0.6 %)	(17.2)	(1.7 %)	(29.0)	(1.0 %)	(42.5)	(1.9 %)
Income before income taxes	383.4	26.0 %	19.0	1.8 %	617.3	21.9 %	185.5	8.3 %
Provision for income taxes	121.6	8.3 %	6.0	0.5 %	189.3	6.7 %	58.1	2.6 %
Net income	$261.8	17.7 %	$13.0	1.3 %	$428.0	15.2 %	$127.4	5.7 %

Revenues by Channel

	Three months ended					Six months ended				
	June 30, 2013	% of Revenues	July 1, 2012	% of Revenues	Percent Change	June 30, 2013	% of Revenues	July 1, 2012	% of Revenues	Percent Change
	(In millions, except percentages)									
Commercial	$960.6	65.1 %	$611.4	59.2 %	57.1 %	$1,789.3	63.5 %	$1,434.8	64.1 %	24.7 %
Retail	515.7	34.9 %	420.9	40.8 %	22.5 %	1,027.7	36.5 %	803.0	35.9 %	28.0 %
Total revenues	$1,476.3	100.0 %	$1,032.3	100.0 %	43.0 %	$2,817.0	100.0 %	$2,237.8	100.0 %	25.9 %

The increase in our revenues for the three months ended June 30, 2013, compared to the three months ended July 1, 2012, was due primarily to an increase in gigabytes sold of 35% and an increase in average selling price per gigabyte of 6%. The increase in our average selling price per gigabyte in the second quarter of fiscal year 2013, compared to the second quarter of fiscal year 2012, was largely influenced by product price increases due to a healthy supply/demand balance in the NAND industry and an increased mix of SSDs and embedded products. Commercial revenues in the three months ended June 30, 2013, compared to the three months ended July 1, 2012, reflect significantly increased sales of embedded products for mobile devices and SSDs, partially offset by a decrease in revenue from cards for the mobile market. Retail product revenues in the three months ended June 30, 2013, compared to the three months ended July 1, 2012, increased due primarily to higher sales of cards for mobile devices, USB drives and SSDs.

The increase in our revenues for the six months ended June 30, 2013, compared to the six months ended July 1, 2012, was due primarily to an increase in gigabytes sold of 35%, partially offset by a decline in average selling price per gigabyte of 6%. Commercial revenues in the six months ended June 30, 2013, compared to the six months ended July 1, 2012, reflect significantly increased sales of SSDs and embedded products for mobile devices, partially offset by a decrease in revenue from cards for the mobile market, wafers and components and gaming cards. Retail product revenues in the six months ended June 30, 2013, compared to the six months ended July 1, 2012, increased due primarily to higher sales of cards for mobile devices, USB drives and SSDs.

Our ten largest customers represented approximately 49% and 48% of our total revenues in the three and six months ended June 30, 2013, respectively, compared to 37% and 38% in the three and six months ended July 1, 2012, respectively. One customer represented 16% of our total revenues in the three months ended June 30, 2013. Two customers represented 18% and 11% of our total revenues in the six months ended June 30, 2013. One customer represented 10% of our total revenues in each of the three and six months ended July 1, 2012.

Geographical Revenues

	Three months ended										Six months ended									
	June 30, 2013	% of Revenues		July 1, 2012	% of Revenues		Percent Change			June 30, 2013	% of Revenues		July 1, 2012	% of Revenues		Percent Change	
	(In millions, except percentages)																
United States	$190.0	12.9	%	$159.0	15.4	%	19.5	%		$403.5	14.3	%	$329.6	14.7	%	22.4	%
Asia-Pacific	1,038.5	70.3	%	659.8	64.0	%	57.4	%		1,948.4	69.2	%	1,491.3	66.6	%	30.7	%
Europe, Middle East and Africa	176.6	12.0	%	161.4	15.6	%	9.4	%		350.2	12.4	%	308.2	13.8	%	13.6	%
Other foreign countries	71.2	4.8	%	52.1	5.0	%	36.7	%		114.9	4.1	%	108.7	4.9	%	5.7	%
Total revenues	$1,476.3	100.0	%	$1,032.3	100.0	%	43.0	%		$2,817.0	100.0	%	$2,237.8	100.0	%	25.9	%

For the three months ended June 30, 2013, compared to the three months ended July 1, 2012, our U.S. revenues increased primarily as a result of increased retail sales of mobile cards, SSDs and USB drives. The increase in Asia-Pacific revenues was due primarily to increased commercial sales of SSDs and mobile embedded products and increased retail sales of cards and USB drives, partially offset by a decrease in sales of OEM mobile cards. The increase in revenues in Europe, Middle East and Africa was due primarily to increased retail sales of mobile cards, USB drives and SSDs, partially offset by a decline in commercial sales of embedded products. The increase in revenues in Other foreign countries was due primarily to increased retail sales of USB drives and mobile cards. Our revenues are designated based on the geographic location where the product is delivered, or in the case of license and royalty revenue, the location of the headquarters of the licensee, and therefore may not be indicative of the actual demand in those regions.

For the six months ended June 30, 2013, compared to the six months ended July 1, 2012, our U.S. revenues increased primarily as a result of increased retail sales of mobile cards and SSDs. The increase in Asia-Pacific revenues was due primarily to increased commercial sales of mobile embedded products and retail sales of cards and USB drives, partially offset by a decrease in sales of OEM mobile cards and wafers and components. The increase in revenues in Europe, Middle East and Africa was due primarily to increased retail sales of mobile cards, USB drives and SSDs, partially offset by a decline in commercial sales of embedded products.

Gross Profit and Margin

	Three months ended						Six months ended					
	June 30, 2013		July 1, 2012		Percent Change		June 30, 2013		July 1, 2012		Percent Change	
	(In millions, except percentages)											
Gross profit	$676.8		$280.8		141.0	%	$1,208.3		$697.3		73.3	%
Gross margin	45.8	%	27.2	%			42.9	%	31.2	%		

The increase in gross margin for the three months ended June 30, 2013, compared to the three months ended July 1, 2012, was due primarily to an increase in average selling price per gigabyte of 6% and a reduction in cost per gigabyte of (21%). Costs per gigabyte improved over the prior year primarily due to wafer production transitioning from 24 nanometer to 19 nanometer products and the weakening of the Japanese yen to the U.S. dollar for wafer purchases denominated in Japanese yen, partially offset by an increase in non-flash memory costs. Non-flash memory costs increased as a result of an increased sales mix of SSDs and multi-chip package products, which have higher non-flash memory costs than most of our other products.

The increase in gross margin for the six months ended June 30, 2013, compared to the six months ended July 1, 2012, was due primarily to reductions in cost per gigabyte of (23%) exceeding average selling price reductions of (6%). Costs per gigabyte improved over the prior year primarily due to wafer production transitioning from 24 nanometer to 19 nanometer and the weakening of the Japanese yen to the U.S. dollar for wafer purchases denominated in Japanese yen, partially offset by an increase in non-flash memory costs. Non-flash memory costs increased as a result of an increased sales mix of SSDs and multi-chip package products, which have higher non-flash memory costs than most of our other products.

Research and Development

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
Research and development	$172.1	$152.4	12.9 %	$343.2	$293.4	17.0 %
Percent of revenues	11.7 %	14.8 %		12.2 %	13.1 %	

The increase in our research and development expense for the three months ended June 30, 2013, compared to the three months ended July 1, 2012, was due primarily to higher employee-related costs of $26 million related to increased headcount and incentive compensation expense, partially offset by lower third-party engineering costs of ($7) million.

The increase in our research and development expense for the six months ended June 30, 2013, compared to the six months ended July 1, 2012, was due primarily to higher employee-related costs of $48 million related to increased headcount and incentive compensation expense.

Incentive compensation expense was higher in the three and six months ended June 30, 2013, compared to the three and six months ended July 1, 2012, due to improved financial performance.

Sales and Marketing

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
Sales and marketing	$63.6	$52.3	21.6 %	$122.7	$101.3	21.1 %
Percent of revenues	4.2 %	5.1 %		4.4 %	4.5 %	

The increase in our sales and marketing expense for the three months ended June 30, 2013, compared to the three months ended July 1, 2012, was due primarily to higher employee-related costs of $11 million related to increased incentive compensation expense.

The increase in our sales and marketing expense for the six months ended June 30, 2013, compared to the six months ended July 1, 2012, was due primarily to higher employee-related costs of $20 million related to increased incentive compensation expense.

Incentive compensation expense was higher in the three and six months ended June 30, 2013, compared to the three and six months ended July 1, 2012, due to improved financial performance.

General and Administrative

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
General and administrative	$46.9	$37.7	24.4 %	$92.0	$70.3	30.9 %
Percent of revenues	3.2 %	3.6 %		3.3 %	3.2 %	

The increase in our general and administrative expense for the three months ended June 30, 2013, compared to the three months ended July 1, 2012, was due primarily to higher employee-related costs of $5 million related to increased incentive compensation expense and an increase in bad debt expense of $2 million due to an overall revenue increase.

The increase in our general and administrative expense for the six months ended June 30, 2013, compared to the six months ended July 1, 2012, was due primarily to higher employee-related costs of $7 million related to increased incentive compensation expense, one-time insurance recoveries of legal fees of ($5) million in the first quarter of fiscal year 2012, higher facility and IT costs of $4 million and an increase in bad debt expense of $3 million.

Incentive compensation expense was higher in the three and six months ended June 30, 2013, compared to the three and six months ended July 1, 2012, due to improved financial performance.

Amortization and Write-off of Acquisition-Related Intangible Assets

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
Amortization and write-off of acquisition-related intangible assets	$1.7	$2.2	(22.7 %)	$4.1	$4.3	(4.7 %)
Percent of revenues	0.1 %	0.2 %		0.1 %	0.2 %	

Amortization of acquisition-related intangible assets in the three and six months ended June 30, 2013, compared to the three and six months ended July 1, 2012, reflected lower amortization of intangible assets from our Pliant Technology, Inc. acquisition, as two intangibles became fully amortized during the second quarter of fiscal year 2013, and from our Matrix Semiconductor, Inc. acquisition, which became fully amortized during the first quarter of fiscal year 2012.

Other Income (Expense), net

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
Interest income	$12.8	$15.0	(14.7 %)	$25.7	$30.0	(14.3 %)
Interest expense	(22.7)	(29.8)	(23.8 %)	(53.7)	(59.1)	(9.1 %)
Other income (expense), net	0.8	(2.4)	(133.3 %)	(1.0)	(13.4)	(92.5 %)
Total other income (expense), net	$(9.1)	$(17.2)	(47.1 %)	$(29.0)	$(42.5)	(31.8 %)

“Total other income (expense), net” for the three months ended June 30, 2013 reflected a lower net expense, compared to the three months ended July 1, 2012, due primarily to lower interest expense as a result of the maturation of our 1% Notes due 2013 in the second quarter of fiscal year 2013.

“Total other income (expense), net” for the six months ended June 30, 2013 reflected a lower net expense, compared to the six months ended July 1, 2012, due primarily to a charge incurred by Flash Ventures and losses on non-designated foreign exchange contracts included in "Other income (expense)" in the first quarter of fiscal year 2012 that did not recur in fiscal year 2013, and lower interest expense as a result of the maturation of our 1% Notes due 2013 in the second quarter of fiscal year 2013.

Provision for Income Taxes

	Three months ended			Six months ended		
	June 30, 2013	July 1, 2012	Percent Change	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)					
Provision for income taxes	$121.6	$6.0	1,926.7 %	$189.3	$58.1	225.8 %
Effective tax rate	31.7 %	31.7 %		30.7 %	31.4 %	

The provision for income taxes for the three and six months ended June 30, 2013 differs from the U.S. statutory tax rate of 35% primarily due to the tax impact of earnings from foreign operations, state taxes, non-deductibility of certain share-based compensation, federal research and development, or R&D, credit and tax-exempt interest income. Earnings and taxes resulting from foreign operations are largely attributable to our Irish, Chinese, Israeli and Japanese entities. Earnings in these countries, where tax rates are lower than the U.S. notional rate, contributed to the majority of the difference between the rate of our tax provision and the U.S. statutory tax rate. The lower effective tax rate for the six months ended June 30, 2013, compared to the same period in fiscal year 2012, was attributable to a retroactively extended federal R&D tax credit for fiscal year 2012, availability of a federal R&D credit for fiscal year 2013 and changes in the composition of operating income by tax jurisdiction. As of June 30, 2013, we believe that most of our deferred tax assets are more likely than not to be realized, except for certain loss and credit carry forwards in certain U.S. and foreign tax jurisdictions.

Unrecognized tax benefits were $171.0 million and $179.5 million as of June 30, 2013 and December 30, 2012, respectively. Unrecognized tax benefits that would impact our effective tax rate in the future were approximately $79.8 million at June 30, 2013. Income tax expense for the three and six months ended June 30, 2013 and July 1, 2012 included interest and penalties of $0.9 million, $1.6 million, $0.7 million and $1.5 million, respectively.

We are subject to U.S. federal income tax as well as income taxes in multiple state and foreign jurisdictions. In February 2012, the Internal Revenue Service, or IRS, completed its field audit of our federal income tax returns for the years 2005 through 2008 and issued the Revenue Agent’s Report. The most significant proposed adjustments are comprised of related party transactions between our U.S. parent company and our foreign subsidiaries. We are contesting these adjustments through the IRS Appeals Office and cannot predict when a resolution will be reached.

We strongly believe the IRS’s position regarding the intercompany transactions is inconsistent with applicable tax laws, judicial precedents and existing Treasury regulations, and that our previously reported income tax provisions for the years in question are appropriate. We believe that an adequate provision has been made for the adjustments from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in our tax audits are resolved in a manner that is not consistent with management’s expectations, we could be required to adjust our provision for income tax in the period such resolution occurs.

The IRS recently initiated an examination of our federal income tax returns for fiscal years 2009 through 2011. We do not expect a resolution of this audit to be reached during the next twelve months. In addition, we are currently under audit by various state and international tax authorities. We cannot reasonably estimate the outcome of these examinations, or provide assurance that the outcome of these examinations will not materially harm our financial position, results of operations or liquidity.

Non-GAAP Financial Measures

Reconciliation of Net Income.

	Three months ended		Six months ended	
	June 30, 2013	July 1, 2012	June 30, 2013	July 1, 2012
	(In millions except per share and share amounts)			
Net income	$261.8	$13.0	$428.0	$127.4
Share-based compensation	24.7	20.2	46.4	39.3
Amortization and write-off of acquisition-related intangible assets	11.6	11.4	23.8	27.2
Convertible debt interest	16.7	22.4	40.3	44.2
Income tax adjustments	(15.8)	(15.9)	(32.6)	(30.7)
Non-GAAP net income	$299.0	$51.1	$505.9	$207.4
Diluted net income per share	$1.06	$0.05	$1.74	$0.52
Share-based compensation	0.10	0.08	0.19	0.16
Amortization and write-off of acquisition-related intangible assets	0.05	0.05	0.10	0.11
Convertible debt interest	0.06	0.09	0.16	0.18
Income tax adjustments	(0.06)	(0.06)	(0.13)	(0.13)
Non-GAAP diluted net income per share	$1.21	$0.21	$2.06	$0.84

We believe these non-GAAP measures provide investors the ability to better assess and understand operating performance, especially when comparing results with previous periods or forecasting performance for future periods, primarily because management typically monitors the business excluding these items. We also use these non-GAAP measures to establish operational goals and for measuring performance for compensation purposes. However, analysis of results on a non-GAAP basis should be used as a complement to, and in conjunction with, and not as a replacement for, data presented in accordance with GAAP.

We believe that the presentation of non-GAAP measures, including non-GAAP net income and non-GAAP diluted net income per share, provides important supplemental information to management and investors about financial and business trends relating to our operating results. We believe that the use of these non-GAAP financial measures also provides consistency and comparability with our past financial reports.

We have historically used these non-GAAP measures when evaluating operating performance because we believe that the inclusion or exclusion of the items described below provides an additional measure of our core operating results and facilitates comparisons of our core operating performance against prior periods and our business model objectives. We have chosen to provide this information to investors to enable them to perform additional analyses of past, present and future operating performance and as a supplemental means to evaluate our ongoing core operations. Externally, we believe that these non-GAAP measures continue to be useful to investors in their assessment of our operating performance and their valuation of our company.

Internally, these non-GAAP measures are significant measures used by us for purposes of:
•evaluating our core operating performance;
•establishing internal budgets;
•setting and determining variable compensation levels;
•calculating return on investment for development programs and growth initiatives;
•comparing performance with internal forecasts and targeted business models;
•strategic planning; and

•benchmarking performance externally against our competitors.

We exclude the following items from our non-GAAP measures:

Share-based Compensation Expense. These expenses consist primarily of expenses for share-based compensation, such as stock options, restricted stock units and our employee stock purchase plan. Although share-based compensation is an important aspect of the compensation of our employees and executives, we exclude share-based compensation expenses from our non-GAAP measures primarily because they are non-cash expenses. Further, share-based compensation expenses are based on valuations with many underlying assumptions not in our control that vary over time and may include modifications that may not occur on a predictable cycle, neither of which are necessarily indicative of our ongoing business performance. In addition, the share-based compensation expenses recorded are often unrelated to the actual compensation an employee realizes. We believe that it is useful to exclude share-based compensation expense for investors to better understand the long-term performance of our core operations and to facilitate comparison of our results to our prior periods and to our peer companies.

Amortization and Write-off of Acquisition-related Intangible Assets. We incur amortization, and, occasionally, write-offs of intangible assets in connection with acquisitions. Since we do not acquire businesses on a predictable cycle, we exclude these items in order to provide investors and others with a consistent basis for comparison across accounting periods.

Convertible Debt Interest. We incur non-cash economic interest expense relating to the implied value of the equity conversion component of the convertible debt. The value of the equity conversion component is treated as a debt discount and amortized to interest expense over the life of the notes using the effective interest rate method. We also incur interest expense equal to the change in fair value of the liability component of the convertible debt when we repurchase a portion of the convertible debt. We exclude these non-cash interest expenses that do not represent cash interest payments made to our note holders.

Income Tax Adjustments. This amount is used to present each of the amounts described above on an after-tax basis, considering jurisdictional tax rates, consistent with the presentation of non-GAAP net income.

From time-to-time in the future, there may be other items that we may exclude if we believe that doing so is consistent with the goal of providing useful information to investors and management.

Limitations of Relying on Non-GAAP Financial Measures. We have incurred and will incur in the future, many of the costs that we exclude from the non-GAAP measures, including share-based compensation expense, impairment of goodwill and acquisition-related intangible assets, amortization and write-off of acquisition-related intangible assets and other acquisition-related costs, non-cash economic interest expense associated with our convertible debt and income tax adjustments. These measures should be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for, or superior to, GAAP results. These non-GAAP measures may be different than the non-GAAP measures used by other companies.

Liquidity and Capital Resources

Cash Flows. Our cash flows were as follows:

	Six months ended		
	June 30, 2013	July 1, 2012	Percent Change
	(In millions, except percentages)		
Net cash provided by operating activities	$864.5	$86.3	901.7 %
Net cash provided by (used in) investing activities	307.0	(72.1)	525.8 %
Net cash used in financing activities	(1,119.5)	(111.2)	(906.7 %)
Effect of changes in foreign currency exchange rates on cash	6.7	—	**
Net increase (decrease) in cash and cash equivalents	$58.7	$(97.0)	160.5 %

** Amount not meaningful

Operating Activities. Cash provided by operating activities is generated by net income adjusted for certain non-cash items and changes in assets and liabilities. The increase in cash provided by operations in the first half of fiscal year 2013, compared to the first half of fiscal year 2012, resulted primarily from an increase in net income and a decrease in cash usage from other liabilities. Cash flow from other liabilities was a source of cash in the first half of fiscal year 2013, compared to a cash usage in the first half of fiscal year 2012, primarily due to significantly lower tax and incentive compensation payments in the first half of fiscal year 2013 compared to the first half of fiscal year 2012 and higher accruals for incentive compensation and taxes in the first half of fiscal year 2013 compared to the first half of fiscal year 2012. Cash flow from accounts receivable decreased primarily due to higher sales in the first half of fiscal year 2013 compared to the first half of fiscal year 2012. Cash flow from inventory resulted in an inflow of cash compared to the prior year due to a decrease in inventory balances resulting from higher sales and reduced growth in memory supply. Cash flow from other assets decreased compared to the prior year primarily due to higher non-trade receivable balances from Toshiba associated with Flash Venture activity. Cash flow from accounts payable increased due to the timing of payments as compared to the prior year.

Investing Activities. Net cash provided by investing activities in the first half of fiscal year 2013 was primarily related to the net proceeds of short and long-term marketable securities of $357 million and repayments of notes receivables from Flash Ventures of $73 million, offset by acquisition of property and equipment of ($120) million. In the first half of fiscal year 2012, net cash used in investing activities was primarily related to acquisition of property and equipment of ($240) million and net cash used for acquisitions of other companies of ($69) million, offset by net proceeds from short and long-term marketable securities of $219 million.

Financing Activities. Net cash used by financing activities for the first half of fiscal year 2013 was primarily related to the repayment of our 1% Notes due 2013 of ($928) million and our share repurchase program of ($370) million, partially offset by cash received from employee stock programs of $163 million. Net cash used by financing activities for the first half of fiscal year 2012 was primarily related to our share repurchase program of ($154) million, partially offset by cash received from employee stock programs of $51 million.

Liquid Assets. At June 30, 2013, we had cash, cash equivalents and short-term marketable securities of $2.59 billion. We had $2.77 billion of long-term marketable securities, which we believe are also liquid assets, but are classified as long-term marketable securities due to the remaining effective maturity of the investment being greater than one year.

Short-Term Liquidity. As of June 30, 2013, our working capital balance was $3.19 billion. During fiscal year 2013, we expect our total capital investment to be approximately $1.1 billion, inclusive of our portion of capital investments in Flash Ventures. We expect our net cash usage for capital investments in Flash Ventures and non-fab property and equipment to be approximately ($350) million. Our current estimate of capital investments for the Flash Ventures is primarily comprised of investments for technology transition and productivity improvements. In the first half of fiscal year 2013, we received cash from notes receivable repayments from Flash Ventures of $73 million and our cash usage for non-fab property and equipment investments was ($120) million.

Depending on the forecasted demand for our products, we may decide to make additional investments, which could be substantial, in wafer fabrication capacity and assembly and test manufacturing equipment. We may also engage in merger or acquisition transactions, make equity investments in other companies or purchase or license technologies. These activities may require us to raise additional financing, which could be difficult to obtain, and which if not obtained in satisfactory amounts, could prevent us from funding Flash Ventures, increasing our wafer supply, developing or enhancing our products, taking advantage of future opportunities, engaging in acquisitions of or investments in companies, growing our business, or responding to competitive pressures or unanticipated industry changes, any of which could harm our business.

Our short-term liquidity is impacted in part by our ability to maintain compliance with covenants in the outstanding Flash Ventures master lease agreements. The Flash Ventures master lease agreements contain customary covenants for Japanese lease facilities as well as an acceleration clause for certain events of default related to us as guarantor, including, among other things, our failure to maintain a minimum shareholder equity of at least $1.51 billion, and for one master lease agreement, which matures on July 31, 2013, our failure to maintain a minimum corporate rating of BB- from Standard & Poors, or S&P, or Moody's Corporation, or Moody's, or a minimum corporate rating of BB+ from Rating & Investment Information, Inc., or R&I. As of June 30, 2013, Flash Ventures was in compliance with all of its master lease covenants. As of June 30, 2013, our R&I credit rating was BBB, two notches above the required minimum corporate rating threshold for R&I; and our S&P credit rating was BB, one notch above the required minimum corporate rating threshold for S&P.

If our shareholders' equity falls below $1.51 billion, or both S&P and R&I were to downgrade our credit rating below the minimum corporate rating threshold, or other events of default occur, Flash Ventures would become non-compliant with certain covenants under certain master equipment lease agreements and would be required to negotiate a resolution to the non-compliance to avoid acceleration of the obligations under such agreements. Such resolution could include, among other things, supplementary security to be supplied by us, as guarantor, or increased interest rates or waiver fees, should the lessors decide they need additional collateral or financial consideration under the circumstances. If a resolution was unsuccessful, we could be required to pay a portion or up to the entire $612 million outstanding lease obligations covered by our guarantees under such Flash Ventures master lease agreements, based upon the exchange rate at June 30, 2013, which would negatively impact our short-term liquidity.

As of June 30, 2013, the amount of cash and cash equivalents and short and long-term marketable securities held by foreign subsidiaries was $795 million. We provide for U.S. income taxes on the earnings of foreign subsidiaries unless the earnings are considered indefinitely invested outside of the U.S. As of December 30, 2012, no provision had been made for U.S. income taxes or foreign withholding taxes on $583 million of undistributed earnings of foreign subsidiaries since we intend to indefinitely reinvest these earnings outside the U.S. We determined that the calculation of the amount of unrecognized deferred tax liability related to these cumulative unremitted earnings was not practicable. If these earnings were distributed to the U.S., we would be subject to additional U.S. income taxes and foreign withholding taxes reduced by available foreign tax credits.

Our Board of Directors has authorized up to $1.25 billion for stock repurchases, of which $646 million remained available for stock repurchases as of June 30, 2013. As of June 30, 2013, we had cumulatively repurchased 12.6 million shares for $604 million, of which 6.8 million shares for $370 million were repurchased in the first half of fiscal year 2013 at an average price of $54.16. Under this program, share purchases may be made, from time-to-time, in both the open market and privately negotiated transactions, and may include the use of derivative contracts, structured stock repurchase agreements and Rule 10b5-1 trading plans. The stock repurchase program does not obligate us to purchase any particular amount of shares.

On July 2, 2013, we entered into a definitive agreement to acquire SMART Storage Systems, a developer of enterprise SSDs. Under the terms of the agreement, we will pay approximately $307 million in cash and certain equity-based incentive awards to acquire SMART Storage Systems. The transaction, which has been approved by the boards of directors of both companies, is subject to customary closing conditions, including regulatory review and approval, and is expected to close in August 2013.

Long-Term Requirements. Depending on the forecasted demand for our products, we may decide to make additional investments, which could be substantial, in wafer fabrication capacity and assembly and test manufacturing equipment. We may also engage in merger or acquisition transactions, make equity investments in other companies or purchase or license technologies. These activities may require us to raise additional financing, which could be difficult to obtain, and which if not obtained in satisfactory amounts, could prevent us from funding Flash Ventures, increasing our wafer supply, developing or enhancing our products, taking advantage of future opportunities, engaging in investments in or acquisitions of companies, growing our business, responding to competitive pressures or unanticipated industry changes, any of which could harm our business.

Financing Arrangements. At June 30, 2013, we had $1.0 billion aggregate principal amount of 1.5% Notes due 2017 outstanding. See Note 6, “Financing Arrangements,” in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q for more detail.

Concurrent with the issuance of the 1% Notes due 2013, we sold warrants to acquire shares of our common stock at an exercise price of $95.03 per share. The warrants expire on 20 different dates from August 23, 2013 through September 20, 2013. At expiration, we may, at our option, elect to settle the warrants on a net share basis. As of June 30, 2013, no warrants had been exercised.

Concurrent with the issuance of the 1.5% Notes due 2017, we sold warrants to acquire up to approximately 19.1 million shares of our common stock at an exercise price of $73.33 per share. The warrants mature on 40 different dates from November 13, 2017 through January 10, 2018 and are exercisable at the maturity date. At each maturity date, we may, at our option, elect to settle the warrants on a net share basis. As of June 30, 2013, the warrants had not been exercised and remain outstanding. In addition, concurrent with the issuance of the 1.5% Notes due 2017, we entered into a convertible bond hedge transaction in which counterparties agreed to sell to us up to approximately 19.1 million shares of our common stock, which is the number of shares initially issuable upon conversion of the 1.5% Notes due 2017 in full, at a conversion price of $52.37 per share. The convertible bond hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 1.5% Notes due 2017 or the first day none of the 1.5% Notes due 2017 remain outstanding due to conversion or otherwise. Settlement of the convertible bond hedge in net shares, based on the number of shares issuable upon conversion of the 1.5% Notes due 2017, on the expiration date would result in us receiving net shares equivalent to the number of shares issuable by us upon conversion of the 1.5% Notes due 2017. As of June 30, 2013, we had not purchased any shares under this convertible bond hedge agreement.

Ventures with Toshiba. We are a 49.9% owner in each of the Flash Ventures, our business ventures with Toshiba to develop and manufacture NAND flash memory products. These NAND flash memory products are manufactured by Toshiba at Toshiba’s Yokkaichi, Japan operations using the semiconductor manufacturing equipment owned or leased by the Flash Ventures. This equipment is funded or will be funded by investments in or loans to the Flash Ventures from us and Toshiba as well as through operating leases received by Flash Ventures from third-party banks and guaranteed by us and Toshiba. The Flash Ventures purchase wafers from Toshiba at cost and then resell those wafers to us and Toshiba at cost plus a markup. We are contractually obligated to purchase half of the Flash Ventures’ NAND wafer supply or pay for 50% of the fixed costs of the Flash Ventures. We are not able to estimate our total wafer purchase obligations beyond our rolling three month purchase commitment because the price is determined by reference to the future cost to produce the semiconductor wafers. See Note 12, “Related Parties and Strategic Investments,” in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

From time-to-time, we and Toshiba mutually approve the purchase of equipment for the Flash Ventures in order to convert to new process technologies or add wafer capacity. Flash Partners Ltd., or Flash Partners, and Flash Alliance Ltd., or Flash Alliance, have been previously equipped to full wafer capacity. Flash Forward Ltd, or Flash Forward, occupies Fab 5 which is being built in two phases. As of June 30, 2013, over half of the Phase 1 building has been equipped with wafer capacity or equipment required to enable technology transition of the Flash Ventures’ wafer capacity. The last new Flash Ventures wafer capacity was added in January 2012 in Phase 1 of Fab 5. As of June 30, 2013, SanDisk has made no commitment to invest in further Phase 1 wafer capacity expansion beyond productivity improvements; however, we periodically review the opportunity for further capacity expansion. We and Toshiba each retain some flexibility as to the extent and timing of each party’s respective fab capacity ramps, and the output allocation will be in accordance with each party’s proportionate level of equipment funding. To date, we have invested in 50% of the Flash Forward equipment. We and Toshiba have announced that the construction of the Phase 2 shell of the Fab 5 wafer fabrication facility will begin in August 2013 with expected completion in mid-2014. The Phase 2 shell is intended to be used primarily for technology transition of the existing Flash Ventures wafer capacity to 1Y and 1Z technology nodes and for a BiCS pilot line.

The cost of the wafers we purchase from Flash Ventures is recorded in inventory and ultimately cost of revenues. Flash Ventures are variable interest entities; however, we are not the primary beneficiary of these ventures because we do not have a controlling financial interest in each venture. Accordingly, we account for our investments under the equity method and do not consolidate.

For semiconductor manufacturing equipment that is leased by Flash Ventures, we and Toshiba jointly guarantee, on an unsecured and several basis, 50% of the outstanding Flash Ventures' lease obligations under original master lease agreements entered into by Flash Ventures. These master lease obligations are denominated in Japanese yen and are noncancelable. Our total master lease obligation guarantees as of June 30, 2013 were 60.7 billion Japanese yen, or approximately $612 million based upon the exchange rate at June 30, 2013.

In the first quarter of fiscal year 2011, we made a $62 million prepayment for Flash Forward Ltd., or Flash Forward, building-related costs. As of June 30, 2013, approximately $15 million of this remained, which was classified as Other current assets.

Contractual Obligations and Off-Balance Sheet Arrangements

Our contractual obligations and off-balance sheet arrangements at June 30, 2013, and the effect those contractual obligations are expected to have on our liquidity and cash flow over the next five years are presented in textual and tabular format in Note 11, "Commitments, Contingencies and Guarantees," of the Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Impact of Currency Exchange Rates

Exchange rate fluctuations could have a material adverse effect on our business, financial condition and results of operations. Our most significant foreign currency exposure is to the Japanese yen in which we purchase the vast majority of our NAND flash wafers. In addition, we also have significant costs denominated in the Chinese renminbi and the Israeli new shekel, and we have revenue denominated in the European euro, the British pound, the Japanese yen, the Chinese renminbi and the Canadian dollar. We do not enter into derivatives for speculative or trading purposes. We use foreign currency forward and cross currency swap contracts to mitigate transaction gains and losses generated by certain monetary assets and liabilities denominated in currencies other than the U.S. dollar. From time-to-time, we use foreign currency forward contracts and options to partially hedge our future Japanese yen costs for NAND flash wafers. Our derivative instruments are recorded at fair value in assets or liabilities with final gains or losses recorded in other income (expense) or as a component of accumulated other comprehensive income, or AOCI, and subsequently reclassified into cost of revenues in the same period or periods in which the cost of revenues is recognized. These foreign currency exchange exposures may change over time as our business and business practices evolve, and they could harm our financial results and cash flows. See Note 3, "Derivatives and Hedging Activities," in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Because we purchase the vast majority of our flash memory wafers from Flash Ventures, our flash memory costs, which represent the largest portion of our cost of revenues, are based upon wafer purchases denominated in Japanese yen. However, our cost of revenues in any given quarter generally reflect wafer purchases that were made in the previous quarter, and are impacted by hedging decisions we may make from time to time, including entering into forward contracts or other instruments to hedge our future Japanese yen purchase rate. Based on wafer purchases made in the first half of 2013 and forward contracts entered into throughout 2013, changes in the Japanese yen to U.S. dollar exchange rate after June 2013 are not expected to have a material impact on our cost of revenues in the third quarter of 2013. We expect the average rate of the Japanese yen to the U.S. dollar for the wafer portion of our cost of revenues to be approximately 94 for the third quarter of fiscal 2013, in comparison to a rate of approximately 85 in our second quarter of fiscal 2013 cost of sales. In addition, we have locked in approximately 70% of the yen purchases that we expect will impact our fourth quarter cost of sales at a yen rate of approximately 97. Wafer purchases generally comprise 50 percent or more of our cost of sales. See Item 3, "Quantitative and Qualitative Disclosure About Market Risk - Foreign Currency Risk" for more information about our foreign currency forward and cross currency swap contracts.

For a discussion of foreign operating risks and foreign currency risks, see Part II, Item 1A, "Risk Factors."

Critical Accounting Policies

Our discussion and analysis of our financial condition and operating results is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. The estimates and judgments affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent liabilities. On an ongoing basis, we evaluate estimates, including those related to customer programs and incentives, intellectual property claims, product returns, allowance for doubtful accounts, inventories and inventory reserves, valuation and impairments of marketable securities and investments, impairments of goodwill and long-lived assets, income taxes, warranty obligations, restructurings, contingencies, share-based compensation and litigation. We base our estimates on historical experience and on other assumptions that we believe are reasonable under the circumstances. These estimates form the basis for making judgments about the carrying value of assets and liabilities when those values are not readily apparent from other sources. Actual results could materially differ from these estimates.

There were no significant changes to our critical accounting policies during the three and six months ended June 30, 2013. For information about critical accounting policies, see the discussion of critical accounting policies in our most recent Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on February 19, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates.

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. As of June 30, 2013, a hypothetical 50 basis point increase in interest rates would result in an approximate $30.2 million decline (less than 0.67%) of the fair value of our available-for-sale debt securities.

Foreign Currency Risk. The majority of our revenues are transacted in the U.S. dollar, with some revenues transacted in the European euro, the British pound, the Japanese yen, the Chinese renminbi and the Canadian dollar. Our flash memory costs, which represent the largest portion of our cost of revenues, are denominated in Japanese yen. We also have some cost of revenues denominated in the Chinese renminbi. The majority of our operating expenses are denominated in the U.S. dollar; however, we have expenses denominated in Japanese yen, the Chinese renminbi, the Israeli new shekel and numerous other currencies. On the balance sheet, we have numerous foreign currency denominated monetary assets and liabilities, with the largest monetary exposure being our balances with Flash Ventures, which are denominated in Japanese yen.

We enter into foreign currency forward and cross currency swap contracts to hedge the gains or losses generated by the remeasurement of our significant foreign currency denominated monetary assets and liabilities. The fair value of these contracts is reflected as other assets or other liabilities and the change in fair value of these balance sheet hedge contracts is recorded into earnings as a component of other income (expense) to largely offset the change in fair value of the foreign currency denominated monetary assets and liabilities which is also recorded in other income (expense).

We use foreign currency forward contracts to partially hedge future Japanese yen flash memory costs. These contracts are designated as cash flow hedges and are carried on our balance sheet at fair value with the effective portion of the contracts' gains or losses included in accumulated other comprehensive income and subsequently recognized in cost of revenues in the same period the hedged cost of revenues is recognized.

At June 30, 2013, we had both foreign currency forward contracts and cross currency swap contracts in place that amounted to a net purchase in U.S. dollar equivalents of $6.1 million in foreign currencies to hedge our foreign currency denominated monetary net liability position over the next twelve months. The notional amount and unrealized gain or loss of our outstanding cross currency swap and foreign currency forward contracts that are non-designated (balance sheet hedges) as of June 30, 2013 are shown in the table below. In addition, this table shows the change in fair value of these balance sheet hedges assuming a hypothetical adverse foreign currency exchange rate movement of 10 percent. These changes in fair values would be largely offset in other income (expense) by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities.

	Notional Amount	Unrealized Gain (Loss) as of June 30, 2013	Change in Fair Value Due to 10% Adverse Rate Movement
	(In millions)		
Balance sheet hedges			
Cross currency swap contracts sold	$(29.3)	$5.5	$2.7
Forward contracts sold	(72.5)	(0.3)	(5.1)
Forward contracts purchased	107.9	(0.4)	(9.6)
Total net outstanding contracts	$6.1	$4.8	$(12.0)

48

At June 30, 2013, we had foreign currency forward contracts in place that amounted to a net purchase in U.S. dollar equivalent of approximately $247 million to partially hedge our expected future wafer purchases in Japanese yen. The maturities of these contracts were 12 months or less. The notional amount and fair value of our outstanding forward contracts that are designated as cash flow hedges as of June 30, 2013 is shown in the table below. In addition, this table shows the change in fair value of these cash flow hedges assuming a hypothetical adverse foreign currency exchange rate movement of 10 percent.

	Notional Amount	Fair Value as of June 30, 2013	Change in Fair Value Due to 10% Adverse Rate Movement
	(In millions)		
Cash flow hedges			
Forward contracts purchased	$247.2	$(7.4)	$(22.4)

Notwithstanding our efforts to mitigate some foreign exchange risks, we do not hedge all of our foreign currency exposures, and there can be no assurances that our mitigating activities related to the exposures that we hedge will adequately protect us against risks associated with foreign currency fluctuations.

Market Risk. With the U.S. long-term sovereign credit rating below the highest available rating and the risk of additional future downgrades or related downgrades by recognized credit rating agencies, the investment choices for our cash and marketable securities portfolio could be reduced, which could negatively impact our non-operating results. We do not have direct ownership of European sovereign debt in our investment portfolio. Sales to Europe accounted for approximately 12% of our total revenues in the three and six months ended June 30, 2013, respectively, and any significant uncertainties in the European financial markets could impact our revenues and financial condition in Europe or elsewhere.

All of the potential changes noted above are based on sensitivity analysis performed on our financial position at June 30, 2013. Actual results may differ materially.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of June 30, 2013. Based on their evaluation as of June 30, 2013, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Quarterly Report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings, see Note 13, “Litigation,” in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Item 1A. Risk Factors

The following description of the risk factors associated with our business includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part II, Item 1A of our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2013.

Our operating results may fluctuate significantly, which may harm our financial condition and 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. Our results of operations are subject to fluctuations and other risks, including, among others:

- competitive pricing pressures, resulting in lower average selling prices and lower revenues;
- inability to reduce manufacturing costs to keep pace with reductions in average selling prices, resulting in lower or negative product gross margins;
- excess, insufficient or mismatched captive memory output or capacity, resulting in lower average selling prices, financial charges and impairments, lost revenue and growth opportunities, lower gross margins or other consequences;
- timing, volume and cost of wafer production from Flash Ventures as impacted by fab start-up delays and costs, technology transitions, lower than expected yields or production interruptions;
- inability to penetrate new or growing markets for flash memory, including the SSD markets, failure of existing or new markets for flash memory to grow or develop, or failure to maintain or improve our position in any of these markets;
- potential delays in product development or lack of customer acceptance of our solutions, particularly OEM products such as our embedded flash storage solutions and SSD solutions;
- fluctuations in customer concentration and the loss of, or reduction in orders from, one or more of our major customers that account for a significant portion of our revenues;
- inability to develop, or unexpected difficulties or delays in developing or ramping with acceptable yields, new technologies such as 1Y nanometer or subsequent process technologies, X3 NAND memory architecture, BiCS technology, 3D ReRAM, or other advanced alternative technologies;
- fluctuations or declines in our license and royalty revenues due to license agreement renewals on less favorable terms, non-renewals, declines in sales of the products or use of technology underlying the license and royalty revenues by our licensees, or if licensees or we fail to perform on contractual obligations;
- lengthy, costly and unpredictable design, qualification and sales processes for a limited number of customers in the enterprise SSD market;
- increased costs and lower gross margins due to potentially higher warranty claims from our more complex SSD solutions and firmware;
- excess inventory or lost sales resulting from unpredictable or changing demand for our products;
- failure to manage the risks associated with our ventures and strategic partnerships with Toshiba;
- insufficient non-flash memory materials or capacity from our suppliers and contract manufacturers to meet demand or increases in the cost of non-flash memory materials or capacity;
- fluctuations in our product gross margins due to changes in product mix or customer mix, as well as variations in the technologies or form factors of our products;
- disruptions in our supply chain, whether due to natural disasters, emergencies such as power outages, fires or chemical spills, or employee strikes or other job actions;
-

inability to enhance current products, develop new products or transition products to new technologies on a timely basis or in advance of our competitors;

- increased memory component and other costs as a result of currency exchange rate fluctuations for the U.S. dollar, particularly with respect to the Japanese yen;

- inability to obtain non-captive memory supply of the right product mix and quality in the time frame necessary to meet demand, or inability to realize an adequate margin on non-captive purchases;
- insufficient assembly and test or retail packaging and shipping capacity from our Shanghai, China facility or our contract manufacturers, or labor unrest, employee strikes or other disruptions at any of these facilities;
- errors or defects in our products caused by, among other things, errors or defects in the memory or controller components, including memory and non-memory components we procure from third-party suppliers;
- inability to realize the potential financial or strategic benefits of business acquisitions or strategic investments;
- the financial strength and market position of our customers; and
- the other factors described in this “Risk Factors” section and elsewhere in this report.

Competitive pricing pressures may result in lower average selling prices for our products, and if such price declines are not offset by a corresponding increase in demand for our products, our revenues may decline. The price of NAND flash memory is influenced by, among other factors, the balance between supply and demand, including the effects of new fab capacity, macroeconomic factors and business conditions, technology transitions, conversion of industry DRAM capacity to NAND, development of new technologies or other actions taken by us or our competitors to gain market share. In particular, the NAND flash memory industry has, from time-to-time, experienced periods of excess supply, resulting in price declines. Industry capacity is expected to continue to grow, and if capacity grows at a faster rate than market demand, the industry could again experience price declines. If we are not able to offset price declines with sufficient increases in unit sales or average memory capacity per unit or a shift in product mix towards products with higher average selling prices, our revenues and operating results may be harmed.

If we are unable to reduce our manufacturing costs to keep pace with reductions in average selling prices, our gross margins may be harmed. Because of the historical and expected future declines in the price of NAND flash memory, we need to reduce our manufacturing costs in order to maintain adequate gross margins. Our ability to reduce our cost per gigabyte of memory produced depends on technology transitions and the improvement of manufacturing efficiency, including manufacturing yields. If our technology transitions (for example, the production ramp of NAND technology on the 1Y nanometer process node) take longer or are more costly to complete than anticipated, our manufacturing costs may not remain competitive with other NAND flash memory producers, which would harm our gross margins and financial results. Furthermore, the inherent physical technology limitations of NAND flash technology may result in more costly technology transitions than we have experienced in the past, particularly with respect to required capital expenditures, which could further limit our ability to keep pace with reductions in average selling prices. Manufacturing yields are a function of both design and manufacturing process technology, and yields may also be impacted by equipment malfunctions, fabrication facility accidents or human error. Yield problems may not be identified during the production process or solved until an actual product is manufactured and tested, further increasing our costs. If we are unable to improve manufacturing yields or other manufacturing efficiencies, our gross margins and results of operations would be harmed.

Our reliance on and investments in captive manufacturing capacity limit our ability to respond to industry fluctuations in supply and demand. The semiconductor industry, and the NAND flash memory industry in particular, is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence, price declines, evolving standards, short product life cycles and wide fluctuations in product supply and demand. We are limited in our ability to react or adjust our cost structure in response to these cyclical fluctuations. We rely on our significant investments in Flash Ventures as a captive source of the vast majority of our NAND flash memory supply. Growth in our captive memory supply comes from investments in technology transitions and new capacity at Flash Ventures. These investment decisions require significant planning and lead-time before an increase in supply can be realized, and are further determined by factors such as the timing, rate and type of investment by us and Toshiba, our partner in Flash Ventures, agreement between us and Toshiba as to these matters, our evaluation of the potential return on investment of the addition of new capacity, particularly in light of the timing, cost and availability of next generation technology, our profitability, our estimation of market demand and our liquidity position. A failure to accurately forecast demand for our products or industry capacity could cause us to over-invest or under-invest in the expansion of captive memory capacity in Flash Ventures. Over-investment could result in excess supply, which could cause significant decreases in our product prices, significant excess, obsolete or lower of cost or market inventory write-downs or under-utilization charges, and the potential impairment of our investments in Flash Ventures. For example, in fiscal year 2008 and the first quarter of fiscal year 2009, we recorded charges for adverse purchase commitments associated with under-utilization of Flash Ventures' capacity. On the other hand, if we or Toshiba under-invest in captive memory capacity or technology transitions, if we grow capacity more slowly than the rest of the industry, if our technology transitions do not occur on the timeline that we expect or we encounter unanticipated difficulties in implementing these transitions, or if we implement technology transitions more slowly than our competitors, we may not have enough captive supply to meet demand on a timely and cost effective basis and we may lose opportunities for revenue growth and market share as a result, which would harm our ability to grow revenues. In such cases, we may have only a limited ability to satisfy our supply needs from non-captive supply sources and may not be able to obtain the right mix of non-captive product that meets our requirements within an adequate lead time or at a cost that allows us to generate an adequate gross margin. Furthermore, if our memory supply is limited, we may make strategic decisions with respect to the allocation of our supply among our products and customers that may preserve our long-term goals and customer relationships but result in short-term declines in our gross margin or less favorable gross margins. Our customers also may not allow us to change the memory in the products that they have already qualified, which can further limit our ability to satisfy our supply needs from other sources for products that require long and extensive qualification cycles, such as enterprise SSDs. Our inability to obtain sufficient cost-effective non-captive memory that meets our requirements may cause us to lose sales, market share and profits, which would harm our operating results. In addition, we are contractually obligated to pay for 50% of the fixed costs of Flash Ventures regardless of whether we purchase any wafers from Flash Ventures. Furthermore, purchase orders placed under Flash Ventures and the foundry arrangement with Toshiba for up to three months are binding and cannot be canceled. Therefore, once our purchase decisions have been made, our production costs are fixed, and we may be unable to reduce costs to match any subsequent declines in pricing or demand, which would harm our gross margins. Our limited ability to react to fluctuations in supply and demand makes us particularly susceptible to variations from our forecasts and expectations, and even in times of excess demand, our operating results may be harmed.

The future growth of our business depends on the development and performance of new and growing, as well as existing, markets and products for flash memory, including the SSD markets, and on our ability to maintain or improve our position in these markets. Historically, removable flash memory cards and USB drives, both sold primarily through the retail channel, provided the majority of our revenues. As growth in these retail products slowed, we increased sales of embedded NAND flash memory for devices such as mobile phones, tablets, and other mobile devices, which now represent the largest percentage of our revenues. Our future growth is dependent on the development of new markets, new applications and new products for NAND flash memory, and on the continued use of NAND flash memory in existing markets and on our ability to maintain or improve our position in such markets. There can be no assurance that the use of NAND flash memory in existing markets and products will continue or grow fast enough, or at all, that we will be able to maintain or improve our position in existing markets, or that new markets will adopt NAND flash technologies in general or our products in particular, to enable us to grow.

Over the next several years, we believe that the largest growth areas for NAND flash will be SSD solutions in client computing and enterprise data center applications, whereas the mobile market for NAND flash is expected to grow at a slower rate than in the past, and the retail market for NAND flash is expected to be approximately constant or declining. We will continue to make significant investments in the development of hardware and software solutions for SSD markets in order to successfully penetrate and gain market share in SSD solutions. Our ability to succeed in the SSD solutions market is subject to various risks and uncertainties, including, among other things:

- we may be unable to successfully develop or qualify SSD solutions that meet our customers’ requirements, and even if we do, we cannot guarantee that customers will adopt our SSD solutions;
- designing and qualifying products in the SSD solutions market will require greater investments and customization than our traditional products, which may result in higher costs;
- due to longer customer product cycles and end-of-life product support requirements in SSD solutions, we may be unable to transition customers to our leading edge products, which would prevent us from achieving the full cost advantage of new technology transitions;
- we may be unable to reap the expected benefits of our recently completed and pending acquisitions, many of which relate to the SSD solutions space;
- SSD solutions require more software than our traditional products, therefore we must continue to develop software expertise;
- SSD solutions require more complex controllers than our traditional products, and we may be unable to develop or source controllers that meet the performance requirements of SSDs;
- SSD solutions incorporate unique non-flash memory parts, and if there is lower than expected demand, we may be unable to incorporate these unique parts in other non-SSD products;
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SSD solutions require longer production cycle times due to, among other things, more complex assembly and testing to produce a finished product, as well as customer requirements for consigned inventory and increased use of hubs for order fulfillment, which could lead to higher levels and cost of inventory;

- SSD solutions require different go-to-market strategies compared to our historical consumer and mobile products, which could increase our operating expenses, and we may be unable to build an effective sales and marketing operation to sell our SSD solutions.

If we are unable to successfully develop, qualify and sell SSD solutions, we could lose sales and corresponding profit opportunities, which would harm our operating results.

Our revenues depend in large part on our ability to achieve design wins with OEM customers and the success of products sold by our OEM customers. Our primary OEM products include cards for mobile devices, embedded memory products, and SSDs for the notebook and server markets. Our OEM revenue is primarily dependent upon our products meeting OEM specifications and the achievement of design wins in an OEM's products such as mobile phones, tablets, computers and enterprise servers. Even if our products meet OEM specifications, our sales to these customers are dependent upon the OEMs choosing our products over those of our competitors, on the OEMs' ability to create, market and sell their products successfully, and our ability to supply our products in sufficient quantity and in a timely manner. For example, in the first half of fiscal year 2012, our OEM sales declined because our next generations of mobile embedded products were in various stages of development and qualification, and because mobile OEM customers reduced their rate of card bundling and bundled lower capacity cards. If our OEM customers are not successful in selling their current or future products in sufficient volume or in a timely manner, should they decide not to use our products, should they further reduce their card bundling or bundle lower capacity cards, or should we not be able to produce our products in sufficient quantity or quality, our revenues, operating results and financial condition could be harmed.

Sales to a small number of customers represent a significant portion of our revenues, and if we were to lose one or more of our major customers or licensees, or experience any material reduction in orders from any of our customers, our revenues and operating results could suffer. Our ten largest customers represented approximately 49% and 48% of our total revenues in the three and six months ended June 30, 2013, respectively. One customer represented 16% of our total revenues in the three months ended June 30, 2013 and two customers represented 18% and 11% of our total revenues in the six months ended June 30, 2013. The composition of our major customer base has changed over time, including shifts between OEM and retail-based customers, and there have been changes in the market share concentration among our customers. We expect fluctuations in our customer and licensee base and the mix of our revenue by customer and licensee to continue as our markets and strategies evolve, which could make our revenues less predictable from period-to-period. Our sales are generally made from standard purchase orders and short-term commitments rather than long-term contracts. Accordingly, our customers, including our major customers, may generally terminate or reduce their purchases from us at any time with limited notice or penalty. If we were to lose one or more of our major customers or licensees, or experience any material reduction in orders from any of our customers or in sales of licensed products by our licensees, our revenues and operating results could suffer.

Our SSD products are more complex and rely on more sophisticated firmware than our other products, which may result in increased costs and lower gross margins due to more frequent product updates. Our SSD solutions are more complex than our traditional products due to, among other things, an increased dependence on more sophisticated firmware and customization of our products for specific OEM customers. Changes in our OEM customers' specifications for these products could require us to update the firmware for our SSD products, which would result in increased costs for processing these updates. Furthermore, our failure to update our products to comply with the new specifications may result in reduced demand from our customers for a particular SSD solution, notwithstanding the long design, qualification and test cycles we have undertaken as part of our sales process for that solution, which may harm our results of operations.

Our enterprise SSD business is characterized by sales to a limited number of customers with long design, qualification and sales processes. The enterprise SSD market is comprised of a relatively limited number of customers, with long design, qualification and test cycles prior to sales. OEM customers in the enterprise SSD market typically also require us to customize our products, which could further lengthen the sales process. We spend substantial time, money and other resources in our sales process without any assurance that our efforts will produce any customer orders. These lengthy and uncertain processes also make it difficult for us to forecast demand and timing of customer orders. Moreover, we start manufacturing our products and placing orders for materials and components based on non-binding forecasts that our OEM customers provide to us, further increasing our exposure when actual sales vary from the OEM customer's forecasts. The difficulty in forecasting demand and the customized nature of our products for certain OEMs make it difficult to anticipate our inventory requirements, which may cause us to over-purchase materials and components or over-produce finished goods, resulting in inventory write-offs, or under-produce finished goods, harming our ability to meet customer requirements and generate sales. Furthermore, due to longer customer product cycles, we may not be able to transition customers to our leading edge products, which would prevent us from benefitting from the technology transitions that enable cost reductions, which may harm our gross margins. We are continuing the process of transitioning our enterprise solutions products from non-captive memory to captive memory, and delays in the qualification of captive memory for these products may cause unexpected declines in our revenue or margins from these products.

Difficulty in forecasting demand for our products may result in excess inventory or lost sales, either of which could harm our financial results. The majority of our products are sold directly or indirectly into consumer markets, which are difficult to accurately forecast. Also, a significant portion of our quarterly sales are from orders received and fulfilled in that quarter. Additionally, we depend upon timely reporting from our customers as to their inventory levels and sales of our products in order to forecast demand for our products. The failure to accurately forecast demand for our products may result in lost sales or excess inventory and associated reserves or write-downs, any of which could harm our business, financial condition and operating results.

The long lead times for some of our purchasing or other arrangements further restrict our ability to respond to variations from our forecasts. Some of our silicon purchasing arrangements provide that the first three months of our rolling six-month projected supply requirements are fixed and we may make only limited percentage changes in the second three months of the period covered by our supply requirement projections. Our products also contain non-silicon components that have long lead-times requiring us to place orders several months in advance of anticipated demand. In addition, purchasing decisions for manufacturing tools in Flash Ventures as well as tools in our captive assembly and test manufacturing facility near Shanghai, China often need to be made several months in advance in order to ensure that the tools can be integrated into the manufacturing process when increased capacity is needed. These purchasing arrangements increase the risk of excess inventory or loss of sales in the event our forecasts vary substantially from actual demand.

We rely substantially on our ventures and strategic partnerships with Toshiba, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results. The vast majority of our NAND flash memory is supplied by Flash Ventures. In addition, we partner with Toshiba on the development of NAND flash technology and we have entered into strategic partnerships with Toshiba relating to research and development for the next technology transitions of NAND flash and alternative technologies beyond NAND flash technologies. These ventures and strategic partnerships are subject to various risks that could harm the value of our investments, our revenues and costs, our future rate of spending or our future growth opportunities, including, among others:

- under the terms of our venture agreements with Toshiba, which govern the operations of Flash Ventures, we have limited power to unilaterally direct most of the activities that most significantly impact Flash Ventures' financial performance, including technology transitions, capital investment and other manufacturing and operational activities at Flash Ventures; the process of reaching agreement with Toshiba may be time consuming and may result in decisions that could harm our future results of operations, financial condition or competitiveness;
- the terms of our arrangements with Toshiba include provisions such as exclusivity, transfer restrictions, and limited termination rights, which limit our flexibility; and
- we may not always agree with Toshiba on the NAND research and development roadmap or the technology path beyond NAND flash memory, we or Toshiba may have different priorities with respect to investment in Flash Ventures or future technologies, and divergent technology paths and investment priorities may impact our results of operations.

Our license and royalty revenues may fluctuate or decline significantly in the future due to license agreement renewals, declines in sales of the products or use of technology underlying the license and royalty revenues by our licensees, or if licensees fail to perform on a portion or all of their contractual obligations. If our existing licensees do not renew their licenses upon expiration, renew them on less favorable terms, exercise their option to terminate the license or fail to exercise their option to extend the licenses, or we are not successful in signing new licensees in the future, our license revenue, profitability, and cash provided by operating activities would be harmed. As our older patents expire, and the coverage of our newer patents may be different, it may be more difficult to negotiate or renew favorable license agreement terms or a license agreement at all. For example, in the first quarter of fiscal year 2010, our license and royalty revenues decreased sequentially primarily due to a new license agreement with Samsung that was effective in the third quarter of fiscal year 2009, and contains a lower effective royalty rate compared to the previous license agreement. To the extent that we are unable to renew license agreements under similar terms, or at all, our financial results would be harmed by the reduced license and royalty revenue and we may incur significant patent litigation costs to enforce our patents against these licensees. Our agreements may require us in certain instances to recognize license revenue related to a particular licensee all in one period instead of over time which could create additional volatility in our licensing revenues. A portion of our license and royalty revenue is based on sales of product categories as well as underlying technology, and fluctuations in the sales of those products or technology adoption rates would also result in fluctuations in the license and royalty revenue due to us under our agreements. If our licensees or we fail to perform on contractual obligations, we may incur costs to enforce or defend the terms of our licenses and there can be no assurance that our enforcement, defense or collection efforts will be effective. If we license new IP from third-parties or existing licensees, we may be required to pay license fees, royalty payments or offset existing license revenues. In addition, we may be subject to disputes, claims or other disagreements on the timing, amount or collection of royalties or license payments under our existing license agreements.

Future alternative non-volatile storage technologies or other disruptive technologies could make NAND flash memory obsolete or less attractive, and we may not have access to those new technologies on a cost-effective basis, or at all, or new technologies could reduce the demand for flash memory in a variety of applications or devices, any of which could harm our operating results and financial condition. We have a three-pronged approach towards our investments and efforts in next generation technology scaling and migration: (1) NAND scaling; (2) BiCS technology; and (3) 3D ReRAM technology. The pace at which NAND flash technology is transitioning to new generations is slowing down due to inherent technology limitations. We currently expect to be able to continue to scale our NAND flash technology through two additional generations, but beyond that there is no certainty that further technology scaling can be achieved cost effectively with the current NAND flash technology and architecture. In the first quarter of fiscal year 2011, we began investing in BiCS and other technologies. In BiCS technology, the memory cells are packed along the vertical axis as opposed to the horizontal axis as in the current NAND flash technologies. We believe BiCS technology, if successful, could enable further memory cost reductions beyond the existing NAND roadmap, until 3D ReRAM technology is developed and fully ramped into high-volume production. We continue to invest in future alternative technologies, particularly our 3D ReRAM technology, which we believe may be a viable alternative to NAND flash technology, when NAND flash technology can no longer scale at a sufficient rate, or at all. However, even when NAND flash technology can no longer be further scaled, we expect NAND flash technology and potential alternative technologies to coexist for an extended period of time. The success of our overall technology strategy is also dependent in part upon the development by third-party suppliers of advanced semiconductor materials and process technologies, such as extreme ultraviolet, or EUV. Our technology development of NAND, BiCS and 3D ReRAM is done in conjunction with Toshiba, and the success of our development could be influenced by whether we are able to agree with Toshiba on a technology path or the timing and amount of investment. There can be no assurance that we will be successful in developing BiCS, 3D ReRAM or other technologies, or that we will be able to achieve the yields, quality or capacities to be cost competitive with existing or other alternative technologies. Furthermore, we cannot guarantee that BiCS, 3D ReRAM or other technologies we develop will be sufficient alternatives for NAND flash memory, will match or exceed all of the performance characteristics of NAND flash technology, will be developed at a rate that matches market needs, will result in cost reductions that will enable us to be competitive, or will be well-suited, in a timely manner or at all, for all of the applications in the end markets that NAND flash memory currently addresses or may address in the future. Additionally, BiCS, 3D ReRAM or other technologies may require different capital equipment or manufacturing processes than existing NAND which could impact the cost reduction benefits obtainable through these technologies.

Many companies, including some of our competitors, are attempting to develop alternative non-volatile technologies such as magnetoresistive RAM, or MRAM, ReRAM, Memristor, vertical or stacked NAND, phase-change and charge-trap flash technologies and other technologies. Successful broad-based commercialization of one or more of these technologies could reduce the future revenue and profitability of NAND flash technology and could supplant the potential alternative BiCS or 3D ReRAM technologies that we are developing. In addition, we generate license and royalty revenues from NAND flash technology, and if NAND flash technology is replaced by a technology where our IP is less relevant, our license and royalty revenues would decrease. Also, we may not have access to or we may have to pay royalties to access alternative technologies that we do not develop internally. If our competitors successfully develop new or alternative technologies, and we are unable to scale our technology on an equivalent basis, or if our competitors' new or alternative technologies satisfy application-specific requirements that our technologies are not able to, we may not be able to compete effectively, and our operating results and financial condition would suffer.

Alternative technologies or storage solutions such as cloud storage, enabled by high bandwidth wireless or internet-based storage, could reduce the need for physical flash storage within electronic devices or reduce the rate by which average capacity increases in such devices, which could materially harm our operating results.

We require an adequate level of product gross margins to continue to invest in our business, and our product gross margins may vary significantly depending on a number of factors. Our ability to generate sufficient product gross margins and profitability to invest in our business is influenced by supply and demand balance in the flash memory industry, our ability to reduce our cost per gigabyte at an equal or higher rate than the price decline per gigabyte, our ability to develop new products and technologies, the rate of growth of our target markets, the competitive position of our products, the mix of our products, the continued acceptance of our products by our customers and our management of production capacity. Other factors that could result in volatility in our product gross margins include fluctuations in customer mix, as well as variations in the technologies or form factors of our products. For example, we experienced negative product gross margins for fiscal year 2008 and the first quarter of fiscal year 2009 due to sustained aggressive industry price declines as well as inventory charges primarily due to lower of cost or market write downs. If we fail to maintain adequate product gross margins and profitability, our business and financial condition would be harmed and we may have to reduce, curtail or terminate certain business activities, including funding technology development and capacity expansion. Furthermore, as we diversify the products that we sell, changes in our product mix could result in volatility in our product gross margins, since we have significant variation in our product gross margins across product lines, and some of the products that we sell have product gross margins that are significantly below our overall average.

Any disruption or shortage in our supply chain could reduce our revenues, earnings and gross margins. All of our flash memory products require silicon supply for the memory and controller components. The vast majority of our flash memory is currently supplied by Flash Ventures and to a much lesser extent by third-party silicon suppliers. Any disruption or shortage in supply of flash memory from our captive or non-captive sources, including disruptions due to disasters, work stoppages, supply chain interruptions and other factors, would harm our operating results.

The concentration of Flash Ventures in Yokkaichi, Japan, magnifies the risks of supply disruption. The Yokkaichi location and Japan in general are subject to earthquakes, typhoons and other natural disasters. Moreover, Toshiba's employees who produce Flash Ventures' products are covered by collective bargaining agreements and any strike or other job action by those employees could interrupt our wafer supply from Flash Ventures. A disruption in our captive wafer supply, including but not limited to disruptions from natural disasters, emergencies such as power outages, fires or chemical spills, or employee strikes or other job actions could cause us not to have sufficient supply to meet demand, resulting in lost sales and market share, as well as significant costs, including wafer loss. For example, the March 11, 2011 earthquake and tsunami in Japan caused a brief equipment shutdown at Flash Ventures, which resulted in some wafer loss as well as delayed or canceled deliveries of certain tools and materials from suppliers impacted by the earthquake. In addition, Flash Ventures has, from time to time, experienced power outages and power fluctuations, which have resulted in a loss of wafers and increased costs associated with bringing the facility back online.

Currently, wafers for our internally-designed controllers are manufactured by third-party foundries. In addition, we purchase packaged controllers from third-party sources, and some of our products require other non-flash memory components and materials for which we do not have captive supply, such as the DRAM included in the multi-chip package, or MCP, storage solutions that we supply for use in mobile devices. A disruption in the manufacturing operations of our controller wafer vendors, third-party controller vendors or suppliers of other non-flash memory components, such as DRAM, could result in delivery delays, harm our ability to make timely shipments of our products and harm our operating results until we could qualify an alternate source of supply for these components, which could take several quarters to complete.

Our business depends significantly upon sales through retailers and distributors, and if our retailers and distributors are not successful, we could experience reduced sales, substantial product returns or increased price protection claims, any of which would harm our business, financial condition and operating results. A significant portion of our sales is made through retailers (for our retail channel) and distributors (for both our retail and commercial channels). Except in limited circumstances, we do not have exclusive relationships with our retailers or distributors and, therefore, must rely on them to effectively sell our products. In addition, sales through retailers and distributors typically include commercial terms such as the right to return unsold inventory and protection against price declines. As a result, we do not recognize revenue until after the product has been sold through to the end user, in the case of sales to retailers, or to our distributors' customers, in the case of sales to distributors. If our retailers and distributors are not successful in selling our products, not only would our revenues decrease, but we could also experience lower gross margins due to substantial product returns or price protection claims. Furthermore, certain of our retailers and distributors are experiencing financial difficulty, and continued negative business or economic conditions could exacerbate liquidity issues for them. Negative changes in the credit-worthiness or the ability to access credit, or the bankruptcy or shutdown of any of our significant retail or distribution partners would harm our revenue and our ability to collect outstanding receivable balances. We also provide inventory on a consigned basis to certain of our retailers, and a bankruptcy or shutdown of these customers could preclude us from taking possession of our consigned inventory, which could result in inventory charges.

In transitioning to new technologies and products, we may not achieve OEM design wins, our OEM customers may delay transition to new technologies, our competitors may transition more quickly than we do, or we may experience product delays, cost overruns or performance issues that could harm our business. The transition to new generations of products, such as products containing 19 nanometer, 1Y nanometer or subsequent process technologies and/or X3 NAND memory architecture, is highly complex and requires new controllers, new test procedures and modifications to numerous aspects of our manufacturing processes, resulting in the need for extensive qualification of the new products by our OEM customers and us. In addition, our competitors may transition to these new technologies more quickly or more effectively than we are able to, which could harm our ability to compete effectively. If we fail to achieve OEM design wins with new technologies such as 19 nanometer, 1Y nanometer or the use of X3 in certain products, if our OEM customers choose to transition to these new technologies more slowly than our roadmap plans, if the demand for the products that we developed is lower than expected, if the supporting technologies to implement these new technologies are not available, or if our competitors transition to these new technologies, including X3, more quickly or more effectively than we are able to, we may be unable to achieve the cost structure required to support our profit objectives or may be unable to grow or maintain our OEM market position. Furthermore, there can be no assurance that technology transitions will occur on schedule or at the yields or costs that we anticipate, that the tools and equipment required for the technology transitions will be available on a cost-effective basis or at all, or that products based on the new technologies will meet customer specifications. The vast majority of products require controllers or firmware, and any delays in developing or sourcing controllers or firmware, or incompatibility or quality issues relating to the controllers or firmware in our products, could harm our revenues and gross margins, as well as business relationships with our customers. Any material delay in a development or qualification schedule could delay deliveries and harm our operating results.

We develop new applications, technologies and standards, which may not be widely adopted by consumers or enterprises, or, if adopted, may reduce demand for our older products. We devote significant resources to the development of new applications, technologies and standards. New applications may require significant upfront investment with no assurance of long-term commercial success or profitability. As we introduce new standards or technologies, it can take time for these new standards or technologies to be adopted, for consumers to accept and transition to these new standards or technologies and for significant sales to be generated, if at all. Failure of consumers or enterprises to adopt our new applications, standards or technologies could harm our results of operations as we fail to reap the benefits of our investments. Competitors or other market participants could seek to develop new standards for flash memory products that, if accepted by device manufacturers or consumers, could reduce demand for our products, negatively impact our license and royalty revenues, or increase license and royalty expense. If new standards are broadly accepted and we do not adopt these new standards in our products, our revenues and results of operations may be harmed.

We face competition from numerous manufacturers and marketers of products using flash memory and if we cannot compete effectively, our operating results and financial condition will suffer. We face competition from NAND flash memory manufacturers and from companies that buy NAND flash memory and incorporate it into their end products. We face different competitive pressures in different markets, and we compete to varying degrees on the basis of, among other things, price, quality and timely delivery of products, product performance, availability and differentiation, and the development of industry standards and formats. The success of our competitors may harm our future revenues or margins and may result in the loss of our key customers.

- NAND Manufacturers. We compete with NAND flash memory manufacturers, including Hynix Semiconductor, Inc., Intel Corporation, or Intel, Micron Technology, Inc., or Micron, Samsung Electronics Co., Ltd., or Samsung, and Toshiba. These competitors are large companies that may have greater and more advanced wafer manufacturing capacity, substantially greater financial, technical, marketing and other resources, better recognized brand names and more diversified and lower cost businesses than we do, which may allow them to produce flash memory chips in high volumes at low costs and to sell these flash memory chips themselves or to our competitors at a low cost. In addition, many of our competitors have more diversified semiconductor manufacturing capabilities and can internally produce integrated solutions or hybrid products that may include a combination of NAND flash, DRAM, custom ASICs or other integrated products, while our captive manufacturing capability is solely dedicated to NAND flash. These diversified capabilities may also provide these competitors with a competitive advantage not only in product design and manufacturing due to the ability to leverage know-how in DRAM, custom ASICs or other technologies, but also in a greater ability to respond to industry fluctuations due to their ability to convert their DRAM and other semiconductor manufacturing capacity or equipment to NAND flash and vice-versa. Furthermore, some of these competitors manufacture and sell products that are complementary to flash memory products, and may be able to leverage their competencies and customer relationships to gain a competitive advantage. Current and future memory manufacturer competitors could produce alternative flash or other memory technologies that could compete against our NAND flash technology or our alternative technologies, which may reduce demand or accelerate price declines for our products. Furthermore, the future rate of scaling of the NAND flash technology design that we employ may slow down significantly, which would slow down cost reductions that are fundamental to the adoption of NAND flash technology in new applications. If our scaling of NAND flash technology slows down relative to our competitors, our business and operating results would be harmed and our investments in captive fabrication facilities could be impaired.

- Flash Memory Card and USB Drive Manufacturers and Resellers. We compete with manufacturers and resellers of flash memory card and USB drives, which purchase or have a captive supply of flash memory components and assemble memory cards. We also sell flash memory in the form of white label cards, wafers or components to certain OEMs who sell flash products that may ultimately compete with our branded products in the retail or commercial channels. The sales volumes and pricing to these OEMs can be highly variable and these OEMs may be more inclined to switch to an alternative supplier based on short-term price fluctuations or the timing of product availability, which could harm our branded market share and reduce our sales and profits.

- Client Storage Solution Manufacturers. In the market for client computing SSDs, we face competition from large NAND flash producers such as Intel, Micron, Samsung and Toshiba, from third-party client SSD solution providers such as Kingston Technology Co., Inc., OCZ Technology Group, Inc., and Philips Lite-On Digital Solutions Corporation, and from hard drive manufacturers such as Seagate Technology PLC, or Seagate, and Western Digital Corporation, or WDC. In this market, we compete with these industry players largely on the basis of performance capabilities, price and product reliability. Many of the large NAND flash producers have established relationships

57

with computer manufacturers, or are computer manufacturers themselves, which gives them a competitive advantage in qualifying and integrating their client storage solutions in this market as well as the ability to leverage competencies that have been developed through these relationships in the past. Hard drive manufacturers may also have a competitive advantage in their ability to leverage their existing relationships and brand recognition with customers, as well as their ability to leverage existing technology in creating hybrid drive products. Our failure to compete effectively against these industry players could harm our business and results of operations.

- Enterprise Storage Solution Manufacturers. In the market for enterprise data center SSDs, we face competition from large NAND flash producers such as Intel, Micron, Samsung and Toshiba, from enterprise SSD solution providers such as Fusion-io, LSI Corporation, SMART Worldwide Holdings, Inc. and STEC, Inc., and from hard drive manufacturers such as Seagate and WDC. Many of these competitors have significantly more experience with the software components that are required for successful enterprise SSD solutions, and our failure to continue to develop software expertise could harm our ability to effectively compete in this market. In addition, enterprise data center SSDs is an emerging market, and many established and start-up companies are contributing to the development of this market. Our competitors in this market may be able to leverage existing resources and competencies or acquire or develop other strategic relationships with established or start-up companies before we are able to, which could give them a competitive advantage, and if we are unable to independently develop comparable capabilities, we may be unable to effectively compete.

Our ability to generate revenue or adequate margins for certain products may be limited by our ability to secure, at competitive prices or at all, components or materials required to produce those products. Our products require certain non-flash memory components and materials for which we do not have captive supply. Our ability to generate revenue or adequate margins could be impacted by an inability to source those components or materials in a cost-effective manner, or at all. For example, we supply MCP storage solutions for use in mobile devices. These MCP solutions include both NAND flash memory and DRAM; however, since we do not have a captive supply of DRAM, there could be periods in which we are unable to cost-effectively source the DRAM that we require or to source DRAM in the quantities or on the timeline that we require. In addition, costs of DRAM have increased in the past and continued increases in the future would harm our gross margins for our MCP solution products. If we are unable to source certain components or materials cost effectively, or at all, our revenue and margins may be harmed.

We may not be able to realize the potential financial or strategic benefits of business acquisitions or strategic investments, which could harm our ability to grow our business, develop new products or sell our products. We have in the past and may in the future enter into acquisitions of, or investments in, businesses in order to complement or expand our current businesses or enter into new markets. Mergers and acquisitions of high-technology companies are inherently risky and subject to many factors outside of our control and no assurance can be given that our previous or future acquisitions will be successful, will deliver the intended benefits, and will not materially harm our business, operating results or financial condition. Furthermore, negotiation and integration of acquisitions or strategic investments could divert management’s attention and other company resources.

Factors associated with past or future acquisitions or investments that could harm our growth prospects or results of operations include but are not limited to:

- difficulty in integrating the technology, products, operations or workforce of the acquired business into our business;
- difficulty in entering into new markets in which we have limited or no experience, such as software solutions, and where competitors have stronger positions;
- loss of, or the impairment of or failure to maintain and grow relationships with, key employees, vendors or customers of the acquired business;
- difficulty in operating in new and potentially disperse locations;
- disruption of our ongoing businesses or the ongoing business of the company we invest in or acquire;

- failure to realize the potential financial or strategic benefits of the transaction, including but not limited to any expected cost savings or synergies from the acquisition;
- difficulty integrating the accounting, management information, human resources and other administrative systems of the acquired business;
- disruption of or delays in ongoing research and development efforts and release of new products to market;
- diversion of capital and other resources;
- assumption of liabilities;
- issuance of equity securities that may be dilutive to our existing stockholders;
- diversion of resources and unanticipated expenses resulting from litigation arising from potential or actual business acquisitions or investments;

- failure of the due diligence processes to identify significant issues with product quality, technology and development, or legal and financial issues, among other things;
- incurring non-recurring charges, increased contingent liabilities, adverse tax consequences, depreciation or deferred compensation charges, amortization or impairment of intangible assets or impairment of goodwill, which could harm our results of operations; and
- potential delay in customer purchasing decisions due to uncertainty about the direction of our product offerings or those of the acquired business.

For example, in each of the first and second quarters of fiscal year 2013, due to an increase in overall cost estimates and delays in the development timeline related to an in-process research and development, or IPR&D, project from the acquisition of Pliant Technology, Inc., or Pliant, we performed impairment tests on the related amortizable intangible assets and indefinite-lived IPR&D intangible asset. In addition, due to continued project delays, including subsequent to the end of the second quarter of fiscal year 2013, which resulted in the same impairment indicators identified in the first quarter of fiscal year 2013, we again tested the recoverability of the amortizable intangible assets and noted that as of the end of the second quarter of fiscal year 2013, the undiscounted cash flows were in excess of the net book value of the amortizable intangible assets, indicating no impairment. The delays we experienced in the IPR&D project in both the second and third quarters of fiscal year 2013 were included in the impairment assessment we performed for the second quarter of fiscal year 2013. While these delays related to the IPR&D project did not indicate that an impairment is required at this time, additional future delays, additional increases in overall cost estimates, program cancellation or other significant events or circumstances affecting the IPR&D project could lead us to determine that the indefinite-lived IPR&D intangible asset or the amortizable intangible assets are partially or fully impaired. Due to these IPR&D project delays, we expect to assess the indefinite-lived IPR&D intangible asset for impairment at the end of the third quarter of fiscal year 2013 and on a quarterly basis until completion of the development of the technology and will continue to monitor any events or circumstances that could indicate the amortizable intangible assets are impaired. As of June 30, 2013, the net book value of the Pliant indefinite-lived IPR&D intangible asset was $36.2 million and the net book value of the related Pliant amortizable intangible assets was $96.8 million, and a potential complete impairment of both would result in a charge of up to $133.0 million.

In July 2013, we announced that we had entered into a definitive agreement to acquire SMART Storage Systems, or SMART Storage, a developer of enterprise SSDs, an acquisition that we currently expect to close in August 2013. In addition to the risks described above, additional factors associated with the acquisition of SMART Storage that could harm our ability to realize the potential financial or strategic benefits of the acquisition and thereby harm our growth prospects or results of operations include but are not limited to:

- failure of SMART Storage’s products or technologies to perform as expected or to meet customer qualification requirements;
- failure of the enterprise SSD space to grow as expected;
- delays in the timing and successful integration of SMART Storage, including the transition of the SMART Storage business from third-party sources of NAND flash memory and other components to our captive supply of these materials, which could harm our ability to achieve the expected benefits from the acquisition in a timely manner or at all;
- difficulty in maintaining SMART Storage’s supplier or vendor arrangements, upon some of which SMART Storage is significantly reliant, which could harm our ability to maintain the business after it is acquired and before it is fully integrated into our operations;
- failure to retain SMART Storage's key employees, particularly for the continued development of SMART Storage's technology; and
- difficulty in integrating SMART Storage’s technology into other product lines, which could diminish our expected benefits of the acquisition.

Our financial performance and the value of our investments depend significantly on worldwide economic conditions, which have deteriorated in many countries and regions, and may not recover in the foreseeable future. Demand for our products is harmed by negative macroeconomic factors affecting consumer and enterprise spending. Continuing high unemployment rates, low levels of consumer liquidity, risk of default on sovereign debt and volatility in credit and equity markets have weakened consumer confidence and decreased consumer and enterprise spending in many regions around the world. These and other economic factors may reduce demand for our products and harm our business, financial condition and operating results. In addition, we maintain investments, including our cash, cash equivalents and marketable securities, of various holdings, types and maturities and, given the global nature of our business, our investment portfolio includes both domestic and international investments. Credit ratings and pricing of these investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk or other factors, and declines in the credit ratings or pricing of our investments could result in a decline in the value and liquidity of our investments, including our cash, cash equivalents and marketable securities, and result in a significant impairment of our assets.

The Flash Ventures' master equipment lease obligations contain covenants, which if breached, would harm our business, operating results, cash flows and liquidity. Flash Ventures' master lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, some of the master lease agreements contain an acceleration clause for certain events of default related to us as guarantor, including, among other things, our failure to maintain a minimum stockholders' equity of at least $1.51 billion, and for one master lease agreement, which matures on July 31, 2013, our failure to maintain a minimum corporate rating of either BB- from S&P or Moody's Corporation, or Moody's, or a minimum corporate rating of BB+ from Rating & Investment Information, Inc., or R&I. As of June 30, 2013, Flash Ventures was in compliance with all of its master lease covenants. As of June 30, 2013, our R&I credit rating was BBB, two notches above the required minimum corporate rating threshold for R&I; and our S&P credit rating was BB, one notch above the required minimum corporate rating threshold for S&P.

If our stockholders' equity were to fall below $1.51 billion or both S&P and R&I were to downgrade our credit rating below the minimum corporate rating threshold, Flash Ventures would become non-compliant with certain covenants under its master equipment lease agreements and would be required to negotiate a resolution to the non-compliance to avoid acceleration of the obligations under such agreements. Such resolution could include, among other things, supplementary security to be supplied by us, as guarantor, or increased interest rates or waiver fees, should the lessors decide they need additional collateral or financial consideration. If an event of default occurs and if we fail to reach a resolution, we may be required to pay a portion or the entire outstanding lease obligations up to approximately $612 million, based upon the exchange rate at June 30, 2013, covered by our guarantee under Flash Ventures' master lease agreements, which would significantly reduce our cash position and may force us to seek additional financing, which may not be available.

We depend on our captive assembly and test manufacturing facility in China and our business could be harmed if this facility does not perform as planned. Our reliance on our captive assembly and test manufacturing facility near Shanghai, China has increased significantly and we now utilize this factory to satisfy a majority of our assembly and test requirements, to produce products with leading-edge technologies such as multi-stack die packages and to provide order fulfillment. In addition, our Shanghai, China facility is responsible for packaging and shipping our retail products within Asia, Latin America, Canada and Europe. Any delays in adding new equipment capacity, interruptions in production or the ability to ship product, or issues with manufacturing yields at our captive facility could harm our operating results and financial condition. In addition, investment decisions in adding new assembly and test capacity require significant planning and lead-time, and a failure to accurately forecast demand for our products could cause us to over-invest or under-invest in the expansion of captive assembly and test capacity in our facility, which would lead to excess capacity and under-utilization charges, in the event of over-investment, or insufficient assembly and test capacity resulting in a loss of sales and revenue opportunities, in the event of under-investment. Furthermore, if we were to experience labor unrest, or strikes, or if wages were to significantly increase, our ability to produce and ship products could be impaired and we could experience higher labor costs, which could harm our operating results, financial condition and liquidity.

We rely on our suppliers, some of which are the sole source of supply for our non-memory components, and capacity limitations of these suppliers expose our supply chain to unanticipated disruptions or potential additional costs. We do not have long-term supply agreements with many of our suppliers, certain of which are sole sources of supply for our non-memory components. From time-to-time, certain materials may become difficult or more expensive to obtain, including due to capacity constraints of these suppliers, which could impact our ability to meet demand and could harm our profitability. Our business, financial condition and operating results could be significantly harmed by delays or reductions in shipments if we are unable to obtain sufficient quantities of these components or develop alternative sources of supply in a timely manner, on competitive terms, or at all.

We depend on our third-party subcontractors and our business could be harmed if our subcontractors do not perform as planned. We rely on third-party subcontractors for a portion of our wafer testing, chip assembly, product assembly, product testing and order fulfillment. From time-to-time, our subcontractors have experienced difficulty meeting our requirements. If we are unable to increase the amount of capacity allocated to us from our current subcontractors or qualify and engage additional subcontractors, we may not be able to meet demand for our products. We do not have long-term contracts with some of our existing subcontractors, nor do we have exclusive relationships with any of our subcontractors and, therefore, cannot guarantee that they will devote sufficient resources to manufacturing our products. We are not able to directly control product delivery schedules or quality assurance. Furthermore, we manufacture on a turnkey basis with some of our subcontractors. In these arrangements, we do not have visibility and control of their inventories of purchased parts necessary to build our products or of the progress of our products through their assembly line. 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, either of which would harm our operating results.

Our products may contain errors or defects, which could result in the rejection of our products, product recalls, damage to our reputation, lost revenues, diverted development resources, increased service costs, warranty and indemnification claims and litigation. Our products are complex, must meet stringent user requirements and may contain errors or defects, and the majority of our products provide a warranty period. Errors or defects in our products may be caused by, among other things, errors or defects in the memory or controller components or firmware, including memory and components that we procure from non-captive sources. In addition, the substantial majority of our flash memory is supplied by Flash Ventures, and if the wafers from Flash Ventures contain errors or defects, our overall supply could be harmed. These factors could result in the rejection of our products, damage to our reputation, lost revenues, diverted development resources, increased customer service and support costs, indemnification of our customers' product recall and other costs, warranty claims and litigation. Generally, our OEM customers have more stringent requirements than other customers and our concentration of revenue from OEMs, especially OEMs who purchase our enterprise and client SSD products, could result in increased expenditures for product testing, or increase our service costs and potentially lead to increased warranty or indemnification claims. Furthermore, the costs of errors or defects in our embedded products may be greater than those of stand-alone, removable products due to the effect that such errors or defects may have on other components of the device in which they are embedded. We record an allowance for warranty and similar costs in connection with sales of our products, but actual warranty and similar costs may be significantly higher than our recorded estimate and harm our operating results and financial condition.

Our new products have, from time-to-time, been introduced with design and production errors at a rate higher than the error rate in our established products. We must estimate warranty and similar costs for new products without historical information and actual costs may significantly exceed our recorded estimates. Underestimation of our warranty and similar costs would harm our operating results and financial condition.

Certain of our products contain encryption or security algorithms to protect third-party content and user-generated data stored on our products. To the extent our products are hacked or the encryption schemes are compromised or breached, this could harm our business by hurting our reputation, requiring us to employ additional resources to fix the errors or defects and expose us to litigation and indemnification claims. This could potentially impact future collaboration with content providers or lead to product returns or claims against us due to actual or perceived vulnerabilities.

We are exposed to foreign currency exchange rate fluctuations that could harm our business, operating results and financial condition. A significant portion of our business is conducted in currencies other than the U.S. dollar, which exposes us to adverse changes in foreign currency exchange rates. An increase in the value of the U.S. dollar could increase the real cost to our customers of our products in those markets outside the U.S. where we sell in dollars, and a weakened U.S. dollar could increase local operating expenses and the cost of raw materials to the extent purchased in foreign currencies. These exposures may change over time as our business and business practices evolve, and they could harm our financial results and cash flows.

Our most significant exposure is related to our purchases of NAND flash memory from Flash Ventures, which are denominated in Japanese yen. Appreciation in the value of the Japanese yen relative to the U.S. dollar would increase our cost of NAND flash wafers, negatively impacting our gross margins and operating results. In addition, our investments in Flash Ventures are denominated in Japanese yen and strengthening of the Japanese yen would increase the cost to us of future funding and increase the value of our yen-denominated investments, increasing our exposure to asset impairments. Macroeconomic weakness in the U.S. or other parts of the world could lead to strengthening of the Japanese yen, which would harm our gross margins, operating results, and the cost of future Flash Venture funding and increase the risk of asset impairment. We also have foreign currency exposures related to certain non-U.S. dollar-denominated revenue and operating expenses in Europe and Asia. Additionally, we have exposures to emerging market currencies, which can be extremely volatile. We also have significant monetary assets and liabilities that are denominated in non-functional currencies.

We enter into foreign exchange forward and cross currency swap contracts to reduce the impact of foreign currency fluctuations on certain foreign currency assets and liabilities. In addition, we hedge certain anticipated foreign currency cash flows with foreign exchange forward and option contracts, primarily for Japanese yen-denominated inventory purchases. We generally have not hedged our future equity investments, distributions and loans denominated in Japanese yen related to Flash Ventures.

Our attempts to hedge against currency risks may not be successful, which could harm our operating results. In addition, if we do not successfully manage our hedging program in accordance with accounting guidelines, we may be subject to adverse accounting treatment, which could harm our operating results. There can be no assurance that this hedging program will be economically beneficial to us for numerous reasons, including that hedging may reduce volatility, but prevent us from benefiting from a favorable market trend. Further, the ability to enter into foreign exchange contracts with financial institutions is based upon our available credit from such institutions and compliance with covenants and other restrictions. Operating losses, third-party downgrades of our credit rating or instability in the worldwide financial markets, including the downgrade of the credit rating of the U.S. government, could impact our ability to effectively manage our foreign currency exchange rate risk, which could harm our business, operating results and financial condition.

Our global operations and operations at Flash Ventures and third-party subcontractors are subject to risks for which we may not be adequately insured. Our global operations are subject to many risks, including but not limited to errors and omissions, infrastructure disruptions, such as large-scale outages or interruptions of service from utilities or telecommunications providers, supply chain interruptions, third-party liabilities and fires or natural disasters. No assurance can be given that we will not incur losses beyond the limits of, or outside the scope of, the coverage of our insurance policies. From time-to-time, various types of insurance have not been available on commercially acceptable terms or, in some cases, at all. There can be no assurance that in the future we will be able to maintain existing insurance coverage or that premiums will not increase substantially. We maintain limited insurance coverage and, in some cases, no coverage at all, for natural disasters and environmental damages, as these types of insurance are sometimes not available or available only at a prohibitive cost. For example, our test and assembly facility in Shanghai, China, on which we significantly rely, may not be adequately insured against all potential losses. Accordingly, we may be subject to uninsured or under-insured losses. We depend upon Toshiba to obtain and maintain sufficient property, business interruption and other insurance for Flash Ventures. If Toshiba fails to do so, we could suffer significant unreimbursable losses, and such failure could also cause Flash Ventures to breach various financing covenants. In addition, we insure against property loss and business interruption resulting from the risks incurred at our third-party subcontractors; however, we have limited control as to how those sub-contractors run their operations and manage their risks, and as a result, we may not be adequately insured.

We and our suppliers rely upon certain rare earth materials that are necessary for the manufacturing of our products, and our business could be harmed if we or our suppliers experience shortages or delays of these rare earth materials. Rare earth materials are critical to the manufacture of some of our products. We and/or our suppliers acquire these materials from a number of countries, including the People’s Republic of China. We cannot predict whether the government of China or any other nation will impose regulations, quotas or embargoes upon the materials incorporated into our products that would restrict the worldwide supply of these materials or increase their cost. If China or any other major supplier were to restrict the supply available to us or our suppliers or increase the cost of the materials used in our products, we could experience a shortage in supply and an increase in production costs, which would harm our operating results.

If our security measures or security measures of our suppliers, vendors and partners are breached and unauthorized access to our or their information technology systems is obtained, we may lose proprietary data. Our security measures and the security measures of our suppliers, vendors and partners may be breached and our or their information technology systems accessed as a result of third-party action, including computer hackers, employee error, malfeasance or otherwise, and result in unauthorized access to our customers’ data or our data, including IP and other confidential business information. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently, we may be unable to anticipate these techniques or to implement adequate preventative measures. Furthermore, we have limited or no control over the implementation of preventative measures of our suppliers, vendors and partners. Any security breach could result in disclosure of our trade secrets or confidential customer, supplier or employee data, which could result in legal liability, harm to our reputation and other harm to our business.

We may need to raise additional financing, which could be difficult to obtain, and which, if not obtained in satisfactory amounts, may prevent us from funding Flash Ventures, increasing our wafer supply, developing or enhancing our products, taking advantage of future opportunities, engaging in acquisitions of or investments in companies, growing our business or responding to competitive pressures or unanticipated industry changes, any of which could harm our business. We currently believe that we have sufficient cash resources to fund our operations as well as our anticipated investments in Flash Ventures for at least the next twelve months; however, we may decide to raise additional funds to maintain the strength of our balance sheet or fund our operations through equity, public or private debt, or lease financings. However, we cannot be certain that we will be able to obtain additional financing on favorable terms, or at all. If we issue additional equity securities, our stockholders will experience dilution and the new equity securities may have rights, preferences or privileges senior to those of existing holders of common stock. If we raise funds through debt or lease financing, we will have to pay interest and may be subject to restrictive covenants, which could harm our business. If we cannot raise funds on acceptable terms, if and when needed, our credit rating may be downgraded, and we may not be able to develop or enhance our technology or products, fulfill our obligations to Flash Ventures, increase our wafer supply, take advantage of future opportunities, engage in acquisitions of or investments in companies, grow our business or respond to competitive pressures or unanticipated industry changes, any of which could harm our business.

We may be unable to protect our IP rights, which would harm our business, financial condition and operating results. We rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect our IP rights. In the past, we have been involved in significant and expensive disputes regarding our IP rights and those of others, including claims that we may be infringing patents, trademarks and other IP rights of third-parties. We expect that we will be involved in similar disputes in the future.

There can be no assurance that:

- any of our existing patents will continue to be held valid, if challenged;
- patents will be issued for any of our pending applications;
- any claims allowed from existing or pending patents will have sufficient scope or strength to protect us;
- 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 or technologies do not infringe on the patents of other companies.

In addition, our competitors may be able to design their products around our patents and other proprietary rights. We also have patent cross-license agreements with several of our leading competitors. Under these agreements, we have enabled competitors to manufacture and sell products that incorporate technology covered by our patents. While we obtain license and royalty revenue or other consideration for these licenses, if we continue to license our patents to our competitors, competition may increase and may harm our business, financial condition and operating results.

There are flash memory producers, flash memory card manufacturers and other companies that utilize flash memory who we believe may infringe our IP. Enforcement of our rights often requires litigation. If we bring a patent infringement action and are not successful, our competitors would be able to use similar technology to compete with us. Moreover, the defendant in such an action may successfully countersue us for infringement of their patents or assert a counterclaim that our patents are invalid or unenforceable. If we do not prevail in the defense of patent infringement claims, we could be required to pay substantial damages, cease the manufacture, use and sale of infringing products in one or more geographic locations, expend significant resources to develop non-infringing technology, discontinue the use of specific processes or obtain licenses to the technology infringed. If we are enjoined from selling our products, or if we are required to develop new technologies or pay significant monetary damages or are required to make substantial royalty payments, our business and results of operations would be harmed.

We and certain of our officers are at times involved in litigation, including litigation regarding our IP rights or that of third parties, which may be costly, may divert the efforts of our key personnel and could result in adverse court rulings, which could materially harm our business. We are often involved in litigation, including cases involving our IP rights and those of others. We are the plaintiff in some of these actions and the defendant in others. Some of the actions seek injunctions against the sale of our products and/or substantial monetary damages, which if granted or awarded, could materially harm our business, financial condition and operating results.

Litigation is subject to inherent risks and uncertainties that may cause actual results to differ materially from our expectations. Factors that could cause litigation results to differ include, but are not limited to, the discovery of previously unknown facts, changes in the law or in the interpretation of laws, and uncertainties associated with the judicial decision-making process. If we receive an adverse judgment in any litigation, we could be required to pay substantial damages and/or cease the manufacture, use and sale of products. Litigation, including IP litigation, can be complex, can extend for a protracted period of time, can be very expensive, and the expense can be unpredictable. Litigation initiated by us could also result in counter-claims against us, which could increase the costs associated with the litigation and result in our payment of damages or other judgments against us. In addition, litigation may divert the efforts and attention of some of our key personnel.

We may be obligated to indemnify our current or former directors or employees, or former directors or employees of companies that we have acquired, in connection with litigation or regulatory investigations. These liabilities could be substantial and may include, among other things, the costs of defending lawsuits against these individuals; the cost of defending shareholder derivative suits; the cost of governmental, law enforcement or regulatory investigations; civil or criminal fines and penalties; legal and other expenses; and expenses associated with the remedial measures, if any, which may be imposed.

Moreover, from time-to-time, we agree to indemnify certain of our suppliers and customers for alleged patent infringement. The scope of such indemnity varies but generally includes indemnification for direct and consequential damages and expenses, including attorneys' fees. We may be engaged in litigation as a result of these indemnification obligations. Third-party claims for patent infringement are excluded from coverage under our insurance policies. A future obligation to indemnify our customers or suppliers may harm our business, financial condition and operating results. For additional information concerning legal proceedings, see Part II, Item 1, "Legal Proceedings."

We may be unable to license, or license at a reasonable cost, IP from third parties as needed, which could expose us to liability for damages, increase our costs or limit or prohibit us from selling products. If we incorporate third-party technology into our products or if we are found to infringe the IP of others, we could be required to license IP from third-parties. We may also need to license some of our IP to others in order to enable us to obtain important cross-licenses to third-party patents. We cannot be certain that licenses will be offered when we need them, that the terms offered will be acceptable, or that these licenses will help our business. If we do obtain licenses from third parties, we may be required to pay license fees, royalty payments, or offset license revenues. In addition, if we are unable to obtain a license that is necessary to manufacture or sell our products, we could be required to redesign or stop shipping our products to one or more geographic locations, suspend the manufacture of products or stop our product suppliers from using processes that may infringe the rights of third parties. We may not be successful in redesigning our products, or the necessary licenses may not be available under reasonable terms, which would harm our business and financial results.

Changes in the seasonality of our business may result in our inability to accurately forecast our product purchase requirements. Sales of our products in the consumer electronics market are subject to seasonality. Sales have typically increased significantly in the fourth quarter of each fiscal year, sometimes followed by significant declines in the first quarter of the following fiscal year. However, the global economic environment may impact typical seasonal trends, making it more difficult for us to forecast our business. Changes in the product or channel mix of our business can also impact seasonal patterns, adding to complexity in forecasting demand. If our forecasts are inaccurate, we may lose market share or procure excess inventory or inappropriately increase or decrease our operating expenses, any of which could harm our business, financial condition and operating results. Changes in seasonality may also lead to greater volatility in our stock price and the need for significant working capital investments in receivables and inventory, including the need to build inventory levels in advance of our projected high volume selling seasons.

We are vulnerable to numerous risks related to our international operations, including political instability, and we must comply with numerous laws and regulations, many of which are complex. Currently, a large portion of our revenues are derived from our international operations, and all of our products and many of our components are produced overseas in China, Japan and Taiwan. Our revenue and future growth is also significantly dependent on international markets, and we may face difficulties entering or maintaining sales in some international markets. We are, therefore, affected by the political, economic, labor, environmental, public health and military conditions in these countries. For example, China does not currently have a comprehensive and highly developed legal system, particularly with respect to the protection of IP rights, which results in the prevalence of counterfeit goods in China, among other things, as well as piracy and degradation of our IP protection. Our efforts to prevent counterfeit products from entering the market may not be successful, and the sale of counterfeit products could harm our operating results and financial condition. In addition, customs regulations in China are complex and subject to frequent changes and, in the event of a customs compliance issue, our ability to import to, and export from, our factory in Shanghai, China could be adversely affected, which could harm our operating results and financial condition.

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

- the need to comply with foreign government regulation;
- the need to comply with U.S. regulations on international business, including the Foreign Corrupt Practices Act and rules regarding conflict minerals;
- changes in diplomatic and trade relationships or government intervention, which may impact our ability to sell to certain customers;

- reduced sales to our customers or interruption to our manufacturing processes in the Pacific Rim that may arise from regional issues in Asia, including natural disasters or labor strikes;
- imposition of regulatory requirements, tariffs, import and export restrictions and other barriers and restrictions;
- a higher degree of commodity pricing than in the U.S.;
- changes in, or the particular application of, government regulations;
- import or export restrictions that could affect some of our products, including those with encryption technology;
- duties and/or fees related to customs entries for our products, which are all manufactured offshore;
- longer payment cycles and greater difficulty in accounts receivable collection;
- adverse tax rules and regulations;
- weak protection of our IP rights;
- delays in product shipments due to local customs restrictions; and

- delays in research and development that may arise from political unrest at our development centers in Israel or other countries.

Our common stock and convertible notes prices have been, and may continue to be, volatile, which could result in investors losing all or part of their investments. The market prices of our common stock and convertible notes have fluctuated significantly in the past and may continue to fluctuate in the future. We believe that such fluctuations will continue as a result of many factors, such as financing plans, future announcements concerning us, our competitors or our principal customers regarding financial results or expectations, technological innovations, industry supply and demand dynamics, new product introductions, governmental regulations, the commencement or results of 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 and semiconductor 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 harm the market price of our common stock as well as the prices of our outstanding convertible notes.

Our success depends on our key personnel, including our senior management, and the loss of key personnel or the transition of key personnel 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. We do not have employment agreements with any of our executive officers and they are free to terminate their employment with us at any time. Our success will depend on our ability to recruit and retain additional highly-skilled personnel. We have relied on equity awards in the form of stock options and restricted stock units as one means for recruiting and retaining highly skilled talent and a reduction in our stock price may reduce the effectiveness of these equity awards in retaining employees. We also rely on cash incentive awards to motivate and retain employees. These cash incentive awards depend significantly on our financial and business performance, and variations in our financial and business performance from our expectations at the time we set the targets for such cash incentive awards could result in decreased or eliminated awards, reducing the effectiveness of these cash incentive awards in retaining employees.

Terrorist attacks, war, threats of war and government responses thereto may negatively impact our operations, revenues, costs and stock price. Terrorist attacks, U.S. military responses to these attacks, war, threats of war and any corresponding decline in consumer confidence could have a negative impact on consumer demand. Any of these events may disrupt our operations or those of our customers and suppliers and may affect the availability of materials needed to manufacture our products or the means to transport those materials to manufacturing facilities and finished products to customers. Any of these events could also increase volatility in the U.S. and world financial markets, which could harm our stock price and may limit the capital resources available to us and our customers or suppliers, or adversely affect consumer confidence. We have substantial operations in Israel including a development center in Northern Israel, near the border with Lebanon, and a research center in Omer, Israel, which is near the Gaza Strip, areas that have experienced significant violence and political unrest. Turmoil and unrest in Israel, the Middle East or other regions could cause delays in the development or production of our products and could harm our business and operating results.

Natural disasters or epidemics in the countries in which we or our suppliers or subcontractors operate could harm our operations. Our supply chain operations, including those of our suppliers and subcontractors, are concentrated in the United States, Japan, Taiwan, China and Singapore. In the past, certain of these areas have been affected by natural disasters such as earthquakes, tsunamis, floods and typhoons, and some areas have been affected by epidemics. In addition, our headquarters, which house a significant concentration of our research and development and engineering staff, are located in the San Francisco Bay Area, an area that is prone to earthquakes. If a natural disaster or epidemic were to occur in one or more of these areas, we could incur a significant work or production stoppage. The impact of these potential events is magnified by the fact that we do not have insurance for most natural disasters or epidemics, including earthquakes and tsunamis. The impact of a natural disaster or epidemic could harm our business and operating results.

Disruptions in global transportation could impair our ability to deliver or receive product on a timely basis, or at all, causing harm to our financial results. Our raw materials, work-in-process and finished products are primarily distributed via air transport. If there are significant disruptions in air transport, we may not be able to deliver our products or receive raw materials. Any natural disaster or other event that affects air transport in Asia could disrupt our ability to receive raw materials in, or ship finished product from, our Shanghai, China facility or our Asia-based contract manufacturers. As a result, our business and operating results may be harmed.

We rely on information systems to run our business and any prolonged down time could harm our business operations and/or financial results. We rely on an enterprise resource planning system, as well as multiple other systems, databases, and data centers to operate and manage our business. Any information system problems, programming errors or unanticipated system or data center interruptions could impact our continued ability to successfully operate our business and could harm our financial results or our ability to accurately report our financial results on a timely basis.

Anti-takeover provisions in our charter documents, stockholder rights plan and Delaware law could discourage or delay a change in control and 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 a stockholders' 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 discourage an acquisition of us. In addition, our certificate of incorporation grants our 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 (2,000,000 shares of preferred stock have already been reserved under our stockholder rights plan). Issuing preferred stock 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 harm 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 may not engage in any business combination with any interested stockholder, defined broadly as a beneficial owner of 15% or more of that corporation's voting stock, during the three-year period following the time that a stockholder became an interested stockholder, without certain conditions being satisfied. This provision could delay or discourage a change of control of SanDisk.

Unanticipated changes in our tax provisions or exposure to additional income tax liabilities could affect our profitability. We are subject to income and other taxes in the U.S. and numerous foreign jurisdictions. Our tax liabilities are affected by the amounts we charge for inventory, services, licenses, funding and other items in intercompany transactions. We are subject to ongoing tax audits in various jurisdictions. Tax authorities may disagree with our intercompany charges or other matters and assess additional taxes. For example, we were under a federal income tax audit by the U.S. Internal Revenue Service, or IRS, for fiscal years 2005 through 2008 and received the Revenue Agent's report in February 2012. The most significant proposed adjustments are comprised of related party transactions between our U.S. parent company and our foreign subsidiaries. We are contesting these adjustments through the IRS Appeals Office and cannot predict when a resolution will be reached. Furthermore, we are currently under a federal income tax audit by the IRS for fiscal years 2009 through 2011, and we do not expect a resolution of this audit to be reached during the next twelve months. While we regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision, tax audits are inherently uncertain and an unfavorable outcome could occur. An unanticipated unfavorable outcome in any specific period could harm our operating results for that period or future periods. The financial cost and management attention and time devoted to defending income tax positions may divert resources from our business operations, which could harm our business and profitability. IRS audits may also impact the timing and/or amount of our refund claims. In addition, our effective tax rate in the future could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws and the discovery of new information in the course of our tax return preparation process. In particular, the carrying value of deferred tax assets, which are predominantly in the U.S., is dependent on our ability to generate future taxable income in the U.S.

We may be subject to risks associated with laws, regulations and customer initiatives relating to the environment or other social responsibility issues. Production and marketing of products in certain states and countries may subject us to environmental and other regulations including, in some instances, the responsibility for environmentally safe disposal or recycling. Such laws and regulations have recently been passed in several jurisdictions in which we operate, including Japan and certain states within the U.S. In addition, climate change issues, energy usage and emissions controls may result in new environmental legislation and regulations, at the international, federal or state level, that may make it more difficult or expensive for us, our suppliers and our customers to conduct business. Any of these regulations could cause us to incur additional direct costs, as well as increased indirect costs related to our relationships with our customers and suppliers, and otherwise harm our operations and financial condition.

Government regulators or our customers may require us to comply with product or manufacturing standards that are more restrictive than current laws and regulations related to environmental matters, conflict minerals or other social responsibility initiatives. The implementation of these standards could affect the sourcing, cost and availability of materials used in the manufacture of our products. Non-compliance with these standards could cause us to lose sales to these customers and compliance with these standards could increase our costs, which may harm our operating results.

New conflict minerals regulations may cause us to incur additional expenses and could limit the supply and increase the cost of certain metals used in manufacturing our products. In August 2012, the SEC adopted new rules establishing additional disclosure and reporting requirements regarding the use of specified minerals, or conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured. These new rules will require us to determine, disclose and report whether or not such conflict minerals originate from the Democratic Republic of the Congo or any adjoining country. These new rules could affect our ability to source certain materials used in our products at competitive prices and could impact the availability of certain minerals used in the manufacture of our products, including gold, tantalum, tin and tungsten. As there may be only a limited number of suppliers of "conflict free" minerals, we cannot be sure that we will be able to obtain necessary conflict free minerals in sufficient quantities or at competitive prices. Our customers, including OEM and other customers in our commercial channel, may require that our products be free of conflict minerals, and our revenues and margins may be harmed if we are unable to provide assurances to our customers that our products are "conflict free" or to procure conflict free minerals at a reasonable price, or at all, or are unable to pass through any increased costs associated with meeting these demands. Additionally, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins of all minerals used in our products through the due diligence procedures that we implement. We may also face challenges with government regulators and our customers and suppliers if we are unable to sufficiently verify that the metals used in our products are conflict free. We expect that there may be material costs associated with complying with the disclosure requirements, such as costs related to determining the source of certain minerals used in our products, as well as costs related to possible changes to products, processes, or sources of supply as a consequence of such verification and disclosure requirements.

In the event we are unable to satisfy regulatory requirements relating to internal controls, or if our internal control over financial reporting is not effective, our business could suffer. In connection with our certification process under Section 404 of the Sarbanes-Oxley Act, we have identified in the past and will, from time-to-time in the future, identify deficiencies in our internal control over financial reporting. There can be no assurance that individually or in the aggregate these deficiencies would not be deemed to be a material weakness or significant deficiency. A material weakness or significant deficiency in internal control over financial reporting could have a materially adverse impact on our reported financial results and the market price of our stock could significantly decline. Additionally, adverse publicity related to the disclosure of a material weakness in internal controls could harm our reputation, business and stock price. Any internal control or procedure, no matter how well designed and operated, can only provide reasonable assurance of achieving desired control objectives and cannot prevent human error, intentional misconduct or fraud.

We have significant financial obligations related to Flash Ventures, which could impact our ability to comply with our obligations under our 1.5% Convertible Senior Notes due 2017. We have entered into agreements to guarantee or provide financial support with respect to lease and certain other obligations of Flash Ventures in which we have a 49.9% ownership interest. As of June 30, 2013, we had guarantee obligations for Flash Ventures' master lease agreements denominated in Japanese yen of approximately $612 million based on the exchange rate at June 30, 2013. In addition, we have significant commitments for the future fixed costs of Flash Ventures, and we will incur significant obligations with respect to Flash Forward as well as continued investment in Flash Partners and Flash Alliance. Due to these and our other commitments, we may not have sufficient funds to make payments under or repay the notes.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities. The table below summarizes information about our purchases of equity securities registered pursuant to Section 12 of the Exchange Act during the three months ended June 30, 2013.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
April 1, 2013 to April 28, 2013	677,567	$53.12	677,567	$890,374,341
April 29, 2013 to May 26, 2013	3,796,714	55.05	3,796,714	681,365,236
May 27, 2013 to June 30, 2013	596,756	59.14	596,756	646,073,086
Total	5,071,037	55.27	5,071,037	

(1) Our Board of Directors has authorized up to $1.25 billion for stock repurchases in the open market or otherwise. This purchase plan will expire on October 26, 2016.
(2) Does not include amounts paid for commissions.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The information required by this item is set forth on the exhibit index which follows the signature page of this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

SANDISK CORPORATION
(Registrant)

Dated: July 29, 2013	By: /s/ Judy Bruner Judy Bruner Executive Vice President, Administration and Chief Financial Officer (Principal Financial Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Title	Incorporated by Reference Form	File No.	Exhibit No.	Filing Date	Provided Herewith
3.1	Restated Certificate of Incorporation of the Registrant.	S-1	33-96298	3.2	8/29/95	
3.2	Certificate of Amendment of the Restated Certificate of Incorporation of the Registrant dated December 9, 1999.	10-Q	000-26734	3.1	8/16/00	
3.3	Certificate of Amendment of the Restated Certificate of Incorporation of the Registrant dated May 11, 2000.	S-3	333-85686	4.3	4/5/02	
3.4	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of the Registrant dated May 26, 2006.	8-K	000-26734	3.1	6/1/06	
3.5	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of the Registrant dated May 27, 2009.	8-K	000-26734	3.1	5/28/09	
3.6	Certificate of Designations for the Series A Junior Participating Preferred Stock, as filed with the Delaware Secretary of State on April 24, 1997.	8-K/A	000-26734	3.5	5/16/97	
3.7	Certificate of Amendment to the Certificate of Designations of Series A Junior Participating Preferred Stock, as filed with the Delaware Secretary of State on September 24, 2003.	8-A	000-26734	3.2	9/25/03	
3.8	Amended and Restated Bylaws of the Registrant dated December 20, 2012.	8-K	000-26734	3.1	12/20/12	
4.1	Rights Agreement, dated as of September 15, 2003, by and between the Registrant and Computershare Trust Company, Inc.	8-A	000-26734	4.2	9/25/03	
4.2	Amendment No. 1 to Rights Agreement, dated as of November 6, 2006, by and between the Registrant and Computershare Trust Company, Inc.	8-A/A	000-26734	4.2	11/8/06	
4.3	Indenture (including form of Notes) with respect to the Registrant's 1.0% Convertible Senior Notes due 2013, dated as of May 15, 2006, by and between the Registrant and The Bank of New York.	8-K	000-26734	4.1	5/15/06	
4.4	Indenture (including form of Notes) with respect to the Registrant's 1.5% Convertible Senior Notes due 2017, dated as of August 25, 2010, by and between the Registrant and The Bank of New York Mellon Trust Company, N.A.	8-K	000-26734	4.1	8/25/10	
10.1	The Registrant's 2013 Incentive Plan	DEF 14A	000-26734	Annex A	4/26/13	
10.2	The Registrant's Form of Notice of Grant of Stock Option					X
10.3						X

	The Registrant's Form of Global Stock Option Agreement					
10.4	The Registrant's Form of Global Restricted Stock Unit Issuance Agreement					X
10.5	The Registrant's Form of Notice of Grant of Stock Option (Director Grants)					X
10.6	The Registrant's Form of Stock Option Agreement (Director Grants)					X
10.7	The Registrant's Form of Restricted Stock Unit Issuance Agreement (Director Grants)					X
10.8	The Registrant's Non-Employee Director Compensation Policy	8-K	000-26734	99.2	6/18/13	
12.1	Computation of ratio of earnings to fixed charges.					X
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
101.INS	XBRL Instance Document.**					X
101.SCH	XBRL Taxonomy Extension Schema Document.**					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.**					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.**					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.**					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.**					X

* Furnished herewith.

** Pursuant to Rule 406T of Regulation S-T, the XBRL files hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.