FORM 10-K405

Annual report pursuant to section 13 and 15(d), Regulation S-K Item 405

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SANDISK CORP

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Mailing Address
140 CASPIAN COURT
SUNNYVALE CA 94089

Business Address
140 CASPIAN COURT
SUNNYVALE CA 94089
4085620500

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

X Annual report pursuant to Section 13 or 15(d) of the Securities
---------- Exchange Act of 1934 for the fiscal year ended December 31, 1998 or

Transition report pursuant to Section 13 or 15(d) of the Securities
---------- Act of 1934

Commission File No. 0-26734

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

Delaware	77-0191793
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
140 Caspian Court, Sunnyvale, California	94089
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code: (408) 542-0500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.001 par value
(Title of Class)

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 X No
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [X].

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on March 2, 1998 as reported on the NASDAQ National Market System, was approximately $462,651,732. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 15, 1999, Registrant had 26,819,100 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting to be held on May 12, 1999 are incorporated by reference into Part III.

SANDISK CORPORATION

1998 FORM 10-K ANNUAL REPORT

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PART I

PART I

ITEM 1. BUSINESS

Certain statements in this discussion of the Company's business and elsewhere in this Annual Report on Form 10-K for 1998 are forward looking statements based on current expectations, and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward looking statements. Such risks and uncertainties are set forth below under "Factors That May Affect Future Results".

SanDisk designs, manufactures and markets flash memory data storage products used in a wide variety of electronic systems. The Company has optimized its flash memory storage solution, known as "system flash," to address the needs of many emerging applications in the consumer electronics and industrial/communications markets. Since its inception, the Company has been actively involved in all aspects of flash memory process development, chip design, controller development and system-level integration to ensure the creation of fully-integrated, broadly interoperable products that are compatible with both existing and new system platforms. The Company believes its core technical competencies are in high-density flash memory process and design, controller design, system-level integration, compact packaging and low-cost system test. The Company's products include removable CompactFlash(TM) products, FlashDisk cards and MultiMediaCard products, and embedded FlashDrives and Flash ChipSet products. SanDisk has applied its technology to the markets for digital cameras and other consumer electronics devices such as smart phones, personal digital assistants ("PDA") and MP3 portable music players. The Company's customers in 1998 included Arrow Electronics, Inc. ("Arrow"), Canon Inc. ("Canon"), COMPUSA, Inc. ("COMPUSA"), Eastman Kodak Company ("Kodak"), Epson Hanbai Co., Ltd. ("Epson Hanbai"), Hewlett-Packard Company ("Hewlett-Packard"), IBM Corporation ("IBM"), Kyocera America, Inc. ("Kyocera"), Matsushita Electric Industrial Co., Ltd. ("MEI"), Mitsubishi Plastic Co. Ltd. ("Mitsubishi

Plastic"), NEC USA Inc. ("NEC USA"), Norand Corporation ("Norand"), Psion Computers PLC ("Psion"), Staples Inc. ("Staples") and Telxon Corporation ("Telxon"). The Company currently has patent cross-license agreements with Hitachi Ltd. ("Hitachi"), Intel Corporation ("Intel"), Samsung Electronics Company Ltd. ("Samsung"), Sharp Electronics Corporation ("Sharp"), Silicon Storage Technology, Inc. ("SST") and Toshiba Corporation ("Toshiba").

Industry Background

The traditional data storage market encompasses several types of memory and storage devices designed primarily for specific components of computer systems. Dynamic random access memory ("DRAM") provides main system memory; static random access memory ("SRAM") provides specialized and high speed memory; hard disk drives provide high capacity data storage; and floppy disk drives permit low capacity removable data storage. In recent years, digital computing and processing have expanded beyond the boundaries of desktop computer systems to include a broader array of electronic systems. These new devices include digital cameras, personal digital assistants, highly portable computers, digital audio recorders, wireless base stations, network computers, communication switches, cellular telephones, mobile communication systems, handheld data collection terminals, medical monitors, pay telephones and other electronic systems. These emerging applications have storage requirements that are not well addressed by traditional storage solutions. These requirements include small form factor size, high reliability, low power consumption and the capability to withstand high levels of shock and vibration and extreme temperature fluctuations. Because storage products based on flash semiconductor technology meet those requirements, these devices and systems represent new market opportunities for flash storage systems.

In the late 1980s, a new memory technology, known as flash memory, was developed as an extension of ultraviolet erasable programmable read-only memory ("EPROM"). Flash memory is non-volatile, unlike DRAM and SRAM, requiring no power to retain data and is electrically reprogrammable, unlike EPROM. Flash memory has the potential to satisfy the requirements for a variety of data storage applications although the most common types of flash memory, "socket flash" and "linear flash," are not well suited for many purposes.

Socket flash is being used as a replacement for EPROMs in applications such as embedded firmware or microcode storage in computer systems. Typical chip densities for socket flash range from 1Mbit to 32Mbit. Socket flash is well suited for read often/write infrequently applications, as the erase times are relatively slow (typically one second per block or sector). In addition, socket flash has not been optimized for defect management. With frequent erase/write operations, bits in flash storage media deteriorate over time. As a result, the longevity and durability of socket flash chips in frequent erase/write applications is limited. Also, socket flash chips, because they are optimized for fast read access rather than low cost, are relatively large and expensive.

More recently, technology known as linear flash has been developed that permits socket flash chips to be used in data storage applications with the use of separate flash file system software. While linear flash cards provide a low-cost mass storage solution, they provide limited built-in intelligence, and rely instead on the host microprocessor and specialized software to manage the socket flash chips as a mass data storage device. This limits the portability of linear flash cards between different systems, as well as their ability to be upgraded for use in future generation products. A linear flash card used for data storage in one system may not be usable in other systems because of potential incompatibilities in the host processors, as well as the operating system software used in the two systems. Furthermore, because of differences in the socket flash of various suppliers, linear flash cards from one manufacturer may not function properly with flash file system software designed for linear flash cards from other manufacturers.

Customers in the consumer electronics and industrial/communications markets are seeking data storage solutions that satisfy requirements such as small form factor, high reliability, low power consumption and the capability to withstand high levels of shock and vibration and extreme temperature fluctuations, which are not well addressed by traditional storage solutions such as hard disk drives and DRAM, or by linear flash cards based on socket flash memory chips.

The SanDisk Solution

The Company has optimized its flash memory storage solution known as "system flash," to address the needs of many emerging applications in the consumer electronics and industrial/communications markets. Since its inception, the Company has been actively involved in all aspects of flash memory process development, chip design, controller development and system-level integration to ensure the creation of fully-integrated, broadly interoperable products that are compatible with both existing and new system platforms. The Company believes its

core technical competencies are in high-density flash memory process and design, controller design, system-level integration, compact packaging and low-cost system test. To achieve compatibility among various electronic platforms regardless of the host processor or operating system used, the Company has developed new capabilities in flash memory chip design, created a new intelligent controller and developed an architecture that can leverage advances in flash memory process technology to ensure a scaleable, high-yielding, cost-effective and highly reliable manufacturing process.

The Company's products offer the following features:

Small form factor. The Company's FlashDisk cards are small and lightweight with a length of 85.6 mm, width of 54.0 mm, thickness of 5.0 mm (PCMCIA Type II) or 10.5 mm (PCMCIA Type III) and weight of less than 2.0 ounces. The Company's CompactFlash products weigh about one-half ounce and are approximately the size of a matchbook (36.4 mm x 42.8 mm x 3.3 mm). The Company's MultiMediaCard products are approximately the size of a quarter coin (32 mm x 24 mm x 1.4 mm) and weigh less than two grams.

Non-volatility. SanDisk products store information in non-volatile memory cells that do not require power to retain information.

High degree of ruggedness. SanDisk's devices have an operating shock rating of 2,000 Gs for CompactFlash and 1,000 Gs for all other products (equivalent to being able to withstand ten foot and eight

foot drops onto concrete, respectively). The Company's products are also designed to tolerate extreme temperatures and humidity.

Low power consumption. During read/write operations, SanDisk's products use less power than the 1.8 inch and 2.5 inch rotating disk drives found in many portable computers. At all other times during system operation, the Company's products require virtually no power. Depending upon the end product making use of the Company's flash data storage, this can translate into longer battery life.

High reliability. SanDisk's products utilize sophisticated error detection and correction algorithms and dynamic defect management techniques to provide high data reliability and endurance.

High performance. The Company believes that the access times of the Company's products meet or exceed the read and write data rates of the majority of consumer and industrial/communication applications.

The flash process and flash memory chip designs developed by the Company in cooperation with its development partners make the Company's products scaleable over several generations of semiconductor fabrication processes. This feature has allowed the Company to significantly reduce its cost per megabyte of capacity as each new process generation is qualified. By maintaining the same basic design parameters, each generation of the Company's products maintains full compatibility with prior generations. This chip architecture has allowed the Company to significantly reduce cell size and thereby chip size. This has permitted increased storage capacity in PC Card, CompactFlash and MultiMediaCard platforms. The Company's proprietary flash process requires some modifications to the typical CMOS semiconductor fabrication process, but can be implemented on existing advanced fabrication lines without the need for special materials or equipment. The Company has successfully implemented its processes at United Silicon, Inc. ("USIC") and United Silicon Corporation ("USC"), subsidiaries of United Microelectronics Corporation ("UMC") and at Matsushita Electronics Corporation ("Matsushita").

The Company also has developed core competencies in low-cost micropackaging technology as well as low-cost batch testing, both of which are important elements in building high capacity, high reliability flash cards at a competitive cost.

SanDisk's Business Strategy

The Company is pursuing the following strategies:

Enable New Products in Large and Emerging Markets; Develop and Promote Industry Standards. The Company develops products that it believes will have applications in large, emerging markets such as the markets for digital cameras, PDAs, smart phones and MP3 portable music players. The Company believes that the widespread acceptance of universal industry standards is important to the development of the market for flash data storage. The Company designs its products to be compatible with existing industry standards and, where appropriate, develops and promotes new standards. The Company was one of the

founding members of PCMCIA, where it has worked to establish the ATA standard interface which is globally supported by all PCMCIA card slots. The Company developed the CompactFlash format and was one of the founding members of the CompactFlash Association ("CFA"), an organization established in October 1995 to promote CompactFlash as a small form factor flash data storage standard. The Company believes that this format is becoming the de facto industry standard storage platform for digital cameras, where it is used instead of traditional film. The Company's CompactFlash, FlashDisk, FlashDrive and Flash ChipSet products are compatible with IDE and ATA standard interfaces used in all IBM compatible PCs and are compatible with Windows 95, Windows 98, Windows NT, Windows CE, Macintosh System 8.0 and other operating systems. The interoperability afforded by adherence to these industry standards enables users of flash data storage cards to transfer data quickly and easily from one device to another, such as from a digital camera to a desktop computer system equipped with a PCMCIA or CompactFlash slot.

In November 1997, the Company along with Siemens AG introduced the MultiMediaCard format which was designed to meet the requirements of the mobile communications industry for a small form factor storage card

with a simple high performance serial interface. The Company is committed to making MultiMediaCard a broadly supported industry standard. The Company believes that working with industry groups to develop widely-adhered-to standards will lead to the acceptance of the Company's products in large markets. The Company is a founding member of the MultiMediaCard Association.

Maintain Technology Leadership. The Company believes that it was the first to develop and introduce removable flash data storage cards and that it has led the industry with several technological innovations. The Company believes that its technological expertise in flash memory design and process engineering, intelligent controllers and system-level integration, in conjunction with its relationships with its semiconductor manufacturing partners, provides it with a competitive advantage. The Company is actively developing advanced flash data storage technologies designed to enable it to continue to meet evolving customer requirements for flash data storage system products. The Company has developed double density ("D2") flash, which is a technological innovation that allows each flash memory cell to store two bits of information instead of the traditional single bit per cell, effectively doubling the amount of storage capacity on approximately the same size chip. The Company plans to use this technology to achieve a significant reduction in the cost per megabyte of flash data storage.

Reduce Cost Per Megabyte of Flash Data Storage. The Company is focused on reducing the cost per megabyte of its products in order to increase the number of applications for these products and to enhance the Company's ability to address new markets. The Company has designed its patented flash memory technology and integrated intelligent controller to increase the amount of usable flash storage per wafer. The Company works closely with its manufacturing partners to increase the amount of storage capacity per wafer by utilizing very small flash memory cells, to realize high yields through the built-in ability to utilize partial die and to facilitate the migration to smaller geometry manufacturing processes through several generations of flash technology.

Leverage Intellectual Property. The Company has cross-licensed its flash technology, including its patent portfolio, to selected third parties. The Company believes that permitting other flash memory providers to use its technology will facilitate the development of its target markets, will provide a second source of supply of CompactFlash, which is required by many OEM customers, and can serve as a significant source of license fees and royalty revenues for the Company. To date, the Company has entered into patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba, and intends to pursue opportunities to enter into additional licenses.

Applications and Markets for Flash Data Storage

The Company is targeting the consumer electronics and the industrial communications markets for its flash data storage products.

The Company's products are used in consumer electronics applications such as digital cameras, PDAs, highly portable computers, audio recorders, portable MP3 music players, video and electronic games, and in industrial/communications applications such as POS terminals, transportation, medical instrumentation, automation, telecommunications switches, PHS base stations, cellular base stations and routers. The Company's customers in 1998 included Arrow, Canon, CompUSA, Kodak, Epson Hanbai, Hewlett-Packard, IBM, Kyocera, MEI, Mitsubishi Plastic, NEC USA, Norand, Psion, Staples and Telxon.

Consumer Electronics. The increasing trend towards the use of digital technology in consumer electronics devices has created requirements for new data

storage products. For example, a number of major camera and imaging companies have introduced digital cameras that the Company believes will enable professionals and consumers to eliminate the need for standard 35mm photographic film by replacing it with re-usable compact digital data storage devices. Removable and embedded flash data storage products such as the Company's CompactFlash, MultiMediaCard and Flash ChipSet products, are used in PDAs, highly portable computers, digital audio recorders, network computers, cellular telephones, two-way pagers, next-generation smart telephones, digital audio samplers and other devices. These data storage devices need to have a very small form factor, must be lightweight, shock and vibration tolerant, non-volatile and interoperable with computer systems and software that can process and manipulate data, audio and digital images.

Industrial/Communications Market. Emerging applications in the industrial market encompass a wide variety of electronic systems used by personnel such as inventory controllers, service technicians, route salesmen, delivery crews, meter readers, car-rental service employees, physicians, real estate agents, insurance agents and public safety officers. The systems used by these workers are often subjected to rough handling, used in a variety of temperature and humidity conditions and required to operate for extended periods of time without external power sources or frequent battery changes. The information collected by these individuals is critical to the successful operation of their business or agency and hence must be stored reliably regardless of the operating environment. In addition, the information is frequently processed by a central computer system at some point (typically the end of the work day or night) and must therefore be easily transferable.

The communications market has applications that are beginning to require new types of data storage. For example, communications switches and cellular base stations require data storage in environments such as subway stations or outdoor telephone booths that are subject to shock and vibration and a wide range of temperature and humidity conditions.

In the fiscal years ended December 31, 1998, 1997 and 1996, product sales to the Company's top 10 customers accounted for approximately 59%, 67%, and 71%, respectively, of the Company's product revenues. In 1998, one customer accounted for 10% of the Company's total revenues. In 1997, no single customer accounted for greater than 10% of total revenues. During 1996, one customer accounted for approximately 26% of the Company's total revenues. The Company expects that sales of its products to a limited number of customers will continue to account for a substantial portion of its revenues for the foreseeable future. The Company has also experienced significant changes in the composition of its major customer base from year to year and expects this pattern to continue as certain customers increase or decrease their purchases of the Company's products as a result of fluctuations in market demand for such customers' products. Sales to the Company's customers are generally made pursuant to standard purchase orders rather than long-term contracts. The loss of, or significant reduction in purchases by the Company's major customers, could have a material adverse effect on the Company's business, financial condition and results of operations. See "Factors That May Affect Future Results - Sales to a Small Number of Customers Represent a Significant Portion of Our Revenues."

Products

SanDisk's storage products are high capacity, solid-state, non-volatile flash memory devices which comply with PC Card ATA and/or IDE industry standards. The Company offers a broad line of flash data storage system products in terms of capacities, form factors, operating voltage and temperature ranges. The Company's current product families include removable CompactFlash, FlashDisk and MultiMediaCard products, embedded FlashDrive products and Flash ChipSets. All products use the Company's proprietary 512 byte sector erase flash memory chips and intelligent controller. The Company's products are compatible with the majority of today's computing and communications systems that are based on industry standards. The Company's products, as of December 31, 1998, are listed in the following table:

<TABLE>
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Product Family	Form Factor	Uncompressed Capacity (in million bytes)
CompactFlash (Removable)	36.4 mm x 42.8 mm x 3.3 mm	4, 8, 10, 15, 20, 30, 40, 48, 64, 80, 96
FlashDisk (Removable)	PC Card Type II	4, 8, 10, 20, 40, 60, 85, 110, 150, 220, 280 350, 440
Flash ChipSet (Embedded)	2 chips	4, 8, 16, 32

FlashDrive (Embedded)	1.8 inches, 2.5 inches 3.5 inches	20, 40, 60, 80, 100, 220, 350, 440
MultiMediaCard (Removable)	32 mm x 24 mm x 1.4 mm	4, 8, 16

</TABLE>

Unlike rotating disk drives, the Company's flash products are solid-state devices. The Company's products are very reliable. They have no moving parts that are subject to mechanical failure. The Company's products are non-volatile, meaning that no on-going source of power is required in order for the products to retain data, images or audio indefinitely. Flash is noiseless, considerably lighter, more rugged and consumes substantially less power than a rotating disk drive. The Company's CompactFlash, MultiMediaCard and Flash ChipSet, are small enough to be used in many of the newer, miniaturized electronic systems being developed today.

CompactFlash. The Company's CompactFlash products provide full PC Card ATA functionality but are only one-fourth the size of a standard Type II PC card. CompactFlash's compact size, ruggedness and low-power requirements and its ability to operate at either 3.3V or 5V make it well-suited for a range of current and next-generation, small form factor consumer applications such as digital cameras, PDAs, personal communicators, pagers and audio recorders. CompactFlash products provide interoperability with systems based upon the PC Card ATA standard by using a low-cost passive Type II adapter. CompactFlash cards are available in capacities ranging from 4MB to 96MB.

FlashDisk. The Company's FlashDisk products are used in storage, data backup and data transport applications. FlashDisk products are available in Type II form factor with capacities ranging from 4MB to 440MB.

Flash ChipSet. The Flash ChipSet product provides a very small footprint, solid-state ATA mass storage system. The Flash ChipSet product consists of a single chip ATA controller and a flash memory chip and is available in 4MB, 8MB, 16MB and 32MB capacities. It provides full PC Card, ATA and IDE disk drive compatibility in a chip set format.

FlashDrive. The Company's FlashDrives in 1.8 inch, 2.5 inch and 3.5 inch form factors are targeted at applications that require embedded data storage devices. FlashDrives offer rugged, portable, low-power data storage and are "plug and play" replacements for rotating IDE drives making them ideal for mobile computers, communication devices and other systems that require embedded storage. Capacities of the Company's FlashDrive products range between 20MB and 440MB.

MultiMediaCard. In November 1997, the Company introduced a new removable storage card product family, the MultiMediaCard. The MultiMediaCard measures 32 millimeters ("mm") by 24 mm by 1.4 mm and weighs less than two grams. MultiMediaCard is targeted at the emerging markets for mobile smart phones, advanced pagers, consumer multimedia devices, digital audio recorders, portable MP3 music players and other products that need removable data storage in a small form factor. MultiMediaCard is available in storage capacities of 4MB, 8MB and 16MB. The Company began shipping its MultiMediaCard product in the second half of 1998. There can be no assurance that MultiMediaCard will receive substantial market acceptance. Any failure by SanDisk's customers to accept the Company's MultiMediaCard products could cause a material adverse effect on the Company's business, financial condition and results of operations. See "Factors That May Affect Future Results - Our Business Depends on Emerging Markets and New Products."

Technology

Since its inception, the Company has focused its research and development efforts on developing highly reliable and cost-effective flash memory storage products to address a number of emerging markets. The Company has been actively involved in all aspects of this development, including flash memory process development, chip design, controller development and system-level integration, to ensure the creation of fully-integrated, broadly interoperable products that are compatible with both older and newly developed system platforms. The Company believes its core technical competencies are in high density flash memory process and design, controller design, system-level integration, compact packaging and low-cost system test.

To achieve compatibility among various electronic platforms regardless of the host processors or operating systems used, the Company developed new capabilities in flash memory chip design, created a new intelligent controller and developed an architecture that could leverage advances in process technology to ensure a scaleable,

high-yielding, cost-effective and highly reliable manufacturing process. The Company believes that these technical competencies and the Company's system design approach have enabled it to introduce flash data storage products that are better suited for its targeted market than linear flash cards based on socket flash chips.

The Company designs its products to be compatible with industry-standard IDE and ATA interfaces used in all IBM compatible PCs. To achieve this design, the Company uses a 512 byte memory sector size that required a departure from the typical socket flash chip design. By decreasing the sector size to be the same as the sector size of all 3.5 inch, 2.5 inch and 1.8 inch hard disk drives, the Company was able to achieve compatibility with DOS and Windows.

The Company's patented intelligent controller coupled with the intelligent controller's advanced defect management system permits the Company's products to achieve a high level of reliability and longevity. This defect management system, which currently resides on a single proprietary controller chip, is able to detect bit "wearout," a common problem with flash memory, both immediately following manufacture and late in the product's life. Late bit failure can occur several years into the life of a product and can be difficult to detect with traditional flash technology. The Company's defect management system automatically detects bits that have failed or are likely to fail due to the number of erase/write cycles such bits have undergone and switches memory to spare good bits incorporated into the design. The system also allows the automatic substitution of entire sectors or major blocks of the memory chip. Additionally, the controller generates an error correcting code which is stored simultaneously with the data and is used to detect and correct any errors when the data is read. This design permits the Company's products to maintain error-free operation for hundreds of thousands of erase/write cycles and reduces manufacturing costs by allowing the Company to incorporate partial die with less than 100% of the physical bits on each chip into the products without loss of functionality.

The flash process and flash memory chip designs developed by the Company in cooperation with its development partners make the Company's products scaleable over several generations of semiconductor fabrication processes. This feature has allowed the Company to significantly reduce its cost per megabyte of capacity as each new process generation is qualified. By maintaining the same basic design parameters, each generation of the Company's products maintains full compatibility with prior generations. This chip architecture, which incorporates three polysilicon layers and one metal layer, as well as a virtual ground array and a split gate transistor cell, has allowed the Company to significantly reduce cell size and thereby chip size. This has permitted increased storage capacity in all of the Company's products. The Company's patented flash process requires some modifications to the typical CMOS semiconductor fabrication process, but can be implemented on existing advanced fabrication lines without the need for special materials or equipment.

D2 is a technological innovation which allows each flash memory cell to store two bits of information instead of the traditional single bit per cell employed by standard binary flash technology. The D2 flash technology is highly complex, and the write speed of D2 flash products is typically slower than the Company's current binary flash products. In addition, D2 flash involves several techniques never proven in a high volume production environment. The Company is currently ramping down production of its 80Mbit D2 designs in preparation for the next generation 256Mbit D2 design, which is expected to have write speeds matching the write speed of the Company's binary products. There can be no assurance that the write speed of D2 flash will be accepted by SanDisk's customers. Any failure by SanDisk's customers to accept the Company's D2 flash products, or any failure to successfully establish volume production of the D2 flash product, could cause a material adverse affect on the Company's business, financial condition and results of operations. See "Factors That May Affect Future Results - Our Business Depends on Emerging Markets and New Products."

The Company also has developed core competencies in low-cost micropackaging technology as well as low-cost batch testing, both of which are important elements in building high capacity flash cards to high reliability standards at a competitive cost.

Strategic Manufacturing Relationships

An important element of the Company's strategy has been to establish strategic relationships with leading technology companies that can provide the

Company with access to leading edge semiconductor manufacturing capacity and participate in the development of certain products. This enables the Company to concentrate its resources on the product design and development areas where the Company believes it has competitive advantages and eliminates the high cost of owning and operating a semiconductor wafer fabrication facility. The Company has developed strategic relationships with USIC and USC, semiconductor manufacturing facilities founded by UMC in Taiwan, and with Matsushita in Japan.

All of the Company's products require silicon wafers which are currently supplied by USIC, USC and Matsushita. Most of the Company's wafers are currently manufactured using 0.4 and 0.35 micron process technology. The Company has been informed by its manufacturing partners that they are experiencing a significant increase in demand for wafers from other customers, which, if this continues, may create capacity shortages, longer lead-times and higher wafer prices. Any delays in wafer availability or uncompetitive wafer pricing would have a material adverse effect on the Company's business, financial condition and results of operations.

The Company invested $51.2 million in USIC, which represents an ownership interest of approximately 10% in the venture, and guarantees the Company access to approximately 12.5% of the facility's wafer output. USIC is expected to have a total wafer capacity of between 20,000 to 25,000 wafers per month by the end of 1999.

Under the general terms of the Company's wafer supply agreements with its foundry partners, the Company is obligated to provide a monthly rolling forecast of anticipated purchase orders. Except in limited circumstances and subject to acceptance by the foundries, the estimates for a portion of the forecast, generally three months, constitute a binding commitment and the estimates for the remaining months may not increase or decrease by more than a certain percentage from the previous months forecast. These requirements limit the Company's ability to react to any significant fluctuations in demand for its products. The Company is dependent upon its foundry partners to deliver wafers and to maintain acceptable yields and quality.

The Company believes that shipments of wafers from its foundry partners will be sufficient to meet the Company's anticipated requirements for wafers for the foreseeable future. The Company's ability to increase its revenue and net income in future periods is dependent on receiving an uninterrupted supply of wafers from its manufacturing partners.

The Company's reliance on third-party wafer manufacturers involves several material risks, including shortages of manufacturing capacity, reduced control over delivery schedules, quality assurance, production yields and costs. In addition, as a result of the Company's dependence on foreign wafer manufacturers, the Company is subject to the risks of conducting business internationally, including exchange rate fluctuations. See "Factors That May Affect Future Results - We Depend on Third Party Foundries for Silicon Wafers."

The Company has also developed strategic manufacturing relationships with Motorola and NEC, who supply the microcontroller for the Company's products. The small form factor of this single chip integrated controller is necessary to produce the Company's CompactFlash products, as well as its Flash ChipSet products. To reduce its reliance on Motorola as its sole source of microcontrollers, the Company has developed a strategic manufacturing relationship with NEC as an alternate source of controller chips. Any interruption of supply of the Company's controller chips from Motorola or NEC could have a material adverse effect on the Company's business, financial condition and results of operations. See "Factors That May Affect Future Results - We Depend on Our Suppliers and Third Party Subcontractors."

The Company is continuing to identify and establish second sources for its key single and sole source component vendors and subcontractors as sales volumes increase, although there can be no assurance these efforts will be successful. During the next several quarters, if the demand for the Company's products exceeds its suppliers ability to deliver needed components or subassemblies, the Company may be unable to meet customer demand.

Assembly and Test

The Company tests wafers at its headquarters in Sunnyvale, California and at the UMC facility in Taiwan. Substantially all of the tested wafers are then shipped to the Company's third party memory assembly subcontractors: Silicon Precision Industries Co., Ltd. ("SPIL") in Taiwan and Mitsui in Japan. Testing of assembled memory devices is performed at the Company headquarters in Sunnyvale, California and at SPIL in Taiwan. The assembly and test processes are monitored by statistical process control and quality audits by the Company's personnel.

The Company performs final assembly, testing and configuration of its

products at its headquarters in Sunnyvale, California. The Company has made substantial capital investments and has established in-house surface mount lines for the assembly of the printed circuit boards used in the Company's CompactFlash and FlashDisk products. In the second quarter of 1999, the Company expects to commence final assembly and test operations for a portion of its CompactFlash products at a subcontractor in China. The subcontract relationship will provide additional final assembly and test capacity. During the second half of 1998, the Company established in house manufacturing capacity for the production of the MultiMediaCard products. In the second quarter of 1999, the Company expects to begin assembly and test operations for its MultiMediaCard production at a subcontractor in Taiwan. The Company currently anticipates that it will continue to make substantial capital investments to further enhance its assembly capabilities. See "Factors That May Affect Future Results - We Depend on Third Party Foundries for Silicon Wafers."

The Company's customers have demanding requirements for quality and reliability. To maximize quality and reliability, the Company monitors electrical and inspection data from its wafer foundries and assembly subcontractors. The Company monitors wafer foundry production for consistent overall quality, reliability and yield levels. Most of the Company's major component suppliers and subcontractors have ISO 9001 or 9002 certification.

Seagate Relationship

In January 1993, Seagate acquired a 25% ownership interest in the Company. Seagate has the right to nominate one director to the Company's Board of Directors. Thomas F. Mulvaney, Seagate's Senior Vice President, General Counsel and Secretary, serves as Seagate's nominee to the Company's Board of Directors. The Shareholder Rights Plan, adopted by the Board of Directors on April 21, 1997, permits Seagate to continue to hold its ownership interest in the Company without triggering the provisions of the plan. At December 31, 1998, Seagate had an ownership interest of approximately 23% in the Company.

Research and Development

The Company believes that its future success will depend on the continued development and introduction of new generations of flash memory chips, controllers and products designed specifically for the flash data storage market. To date, the Company has developed and put into production flash data storage products utilizing semiconductor devices with the following memory capacity and geometries: 4Mbit (0.9 micron), 8Mbit (0.8 micron), 16Mbit (0.5 micron), 32Mbit (0.5, 0.4 and 0.35 micron), 64Mbit (0.35 micron), 64Mbit D2 flash (0.5 micron) and 80Mbit D2 flash (0.35 micron). In addition, the Company has developed several generations of controllers for these flash memory chips. Currently, a majority of the Company's products utilize the 64Mbit device. Because of the complexity of its products, the Company has periodically experienced significant delays in the development and volume production ramp up of its products. There can be no assurance that similar delays will not occur in the future.

The Company, along with its current foundry partners (in separate design efforts), is developing a new process to manufacture 128Mbit and 256Mbit D2 flash chips employing 0.28 micron and 0.24 micron geometries. The Company expects to begin customer shipments of 128Mbit flash products by mid 1999 and 256Mbit by the end of 1999. To date, the Company has not successfully completed the qualification of such a process and there can be no assurance that the Company will be able to successfully commence volume production with such a process at these foundries in the future. The Company has periodically experienced delays in the development of new

processes at its foundry partners and such delays may occur again in the future. The Company's foundry partners may also experience delays in establishing development capabilities for new processes and these delays may have a material adverse effect on the Company's business, financial condition and results of operations. See "Factors That May Affect Future Results - We Face Risk in Transitioning to New Processes and Products."

Research and development expenses were $18.2 million, $13.6 million, and $10.2 million for the fiscal years ended December 31, 1998, 1997 and 1996, respectively. As of December 31, 1998, the Company had 92 full-time employees engaged in research and development activities, including 11 in its Israel design center. The Company expects to increase its 1999 spending on process and design research and development to accelerate future transitions into 0.28 micron, 0.24 micron, and 0.18 micron geometries.

Sales and Distribution

The Company markets its products using a direct sales organization, distributors and manufacturers' representatives. The Company also sells products to various customers on a private label basis and under the SanDisk brand in the retail channel. The Company's sales efforts are organized as follows:

Direct Sales Force. The Company's direct sales force is located in Maitland, Florida; Herndon, Virginia; Dublin, Ohio; Irvine, California; Sunnyvale, California; Branford, Connecticut; Hannover, Germany; Paris, France; Amsterdam, the Netherlands; Hong Kong; and Yokohama and Osaka, Japan. This organization supports major OEM customers and the Company's distribution and manufacturers' representative partners.

Distributors. In the United States, the Company's products are sold through Arrow Electronics Inc., Avnet Inc. and Bell MicroProducts Inc. to OEM customers for a wide variety of industrial applications. In addition, the Company has distributors in various regions of the world including Europe, Japan, Australia, New Zealand, Taiwan, Korea and Hong Kong.

Independent Manufacturers' Representatives. In the United States, Canada and Europe, the Company's direct sales force is supported in its sales efforts by more than 30 independent firms. These domestic and international firms receive a commission for providing support to the Company's direct sales force and distributors in the industrial distribution, OEM and retail channels. The manufacturers' representative companies sell the Company's products as well as products from other manufacturers.

OEMs. The Company provides private label products to OEMs in the United States and the Pacific Rim.

Retail. The Company entered the retail channel in 1997 and is shipping SanDisk brand name product directly to retail superstores, office clubs and selected retail distributors. SanDisk products are available in more than 7,000 stores worldwide. Eleven independent manufacturers' representative firms are supporting the Company's sales efforts in the retail channel.

Customer Service and Technical Support

The Company provides customers with comprehensive product service and support. The Company provides technical support through its application engineering group located in the United States and Japan. The Company works closely with its customers to monitor the performance of its product designs, to provide application design support and assistance and to gain insight into customer's needs to help in the definition of subsequent generations of products.

The Company's support package is generally offered with product sales and includes technical documentation and application design assistance. During an OEM's production phase, the Company provides failure analysis and replacement of defective components. In some cases, the Company offers additional support which includes training, system-level design, implementation and integration support. The Company believes that tailoring

the technical support level to its customers' needs is essential for the success of product introductions and to achieve a high level of satisfaction among its customers.

The Company generally provides a one-year warranty on its products.

Patents and Licenses

The Company relies on a combination of patents, trademarks, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect its intellectual property rights. The Company vigorously protects and defends its intellectual property rights. In the past, the Company has been involved in significant disputes regarding its intellectual property rights and believes it may be involved in similar disputes in the future.

In 1988, the Company developed the concept of emulation of a hard disk drive with flash solid-state memory. The first related patents were filed in 1988 by Dr. Eli Harari and exclusively licensed to the Company. The Company currently owns or has exclusive rights to seventy two United States and fourteen foreign issued patents, and over forty seven patent applications pending in the United States, as well as twenty pending in foreign patent offices. The Company intends to seek additional international and United States patents on its technology. The Company believes some of its patents are fundamental to the implementation of flash data storage systems, as well as the implementation of D2 flash, independent of the flash technology used. However, there can be no

assurance that any patents held by the Company will not be invalidated, that patents will be issued for any of the Company's pending applications or that any claims allowed from existing or pending patents will be of sufficient scope or strength or be issued in the primary countries where the Company's products can be sold to provide meaningful protection or any commercial advantage to the Company. Additionally, competitors of the Company may be able to design around the Company's patents.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which has resulted in significant and often protracted and expensive litigation. To preserve its intellectual property rights, the Company believes it may be necessary to initiate litigation against one or more third parties, including but not limited to those the Company has already notified of possible patent infringement. In addition, one or more of these parties may bring suit against the Company. For example, in March 1998, the Company filed a complaint in federal court against Lexar Media, Inc. ("Lexar") for infringement of a fundamental flashdisk patent. Lexar has disputed the Company's claim of patent infringement, claimed SanDisk's patent is invalid or unenforceable and asserted various counterclaims including unfair competition, violation of the Lanham Act, patent misuse, interference with prospective economic advantage, trade defamation and fraud. SanDisk has denied each of Lexar's counterclaims. In July 1998, the federal district court denied Lexar's request to have the case dismissed on the grounds the Company failed to perform an adequate prefiling investigation. Discovery in the Lexar suit commenced in August 1998. The claims construction phase commenced in February 1999. The Company intends to vigorously enforce its patents, but there can be no assurance that these efforts will be successful. See "Factors That May Affect Future Results - Risks Associated with Patents, Proprietary Rights and Related Litigation."

In the event of an adverse result in any such litigation, the Company could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to the infringing technology. Any litigation, whether as a plaintiff or as a defendant, would likely result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is ultimately determined in favor of the Company. In addition, the results of any litigation matter are inherently uncertain.

In the event the Company desires to incorporate third party technology into its products or is found to infringe on others' patents or intellectual property rights, the Company may be required to license such patents or intellectual property rights. The Company may also need to license some or all of its patent portfolio to be able to obtain cross-licenses to the patents of others. The Company currently has patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba. From time to time, the Company has also entered into discussions

with other companies regarding potential cross-license agreements for the Company's patents. However, there can be no assurance that licenses will be offered or that the terms of any offered licenses will be acceptable to the Company. If the Company obtains licenses from third parties, it may be required to pay license fees or make royalty payments, which could have a material adverse effect on the Company's gross margins. The failure to obtain a license from a third party for technology used by the Company could cause the Company to incur substantial liabilities and to suspend the manufacture of products or the use by the Company's foundries of processes requiring the technology, or to expend substantial resources redesigning its products to eliminate the infringement. There can be no assurance that the Company would be successful in redesigning its products or that such licenses would be available under reasonable terms. Furthermore, any such development or license negotiations could require substantial expenditures of time and other resources by the Company.

As is common in the industry, the Company agrees to indemnify certain of its suppliers and customers for alleged patent infringement. The scope of such indemnity varies, but may in some instances include indemnification for damages and expenses, including attorneys' fees. The Company may from time to time be engaged in litigation as a result of such indemnification obligations.

In its efforts to maintain the confidentiality and ownership of trade secrets and other confidential information, the Company requires all employees (regular and temporary), consultants, foundry partners, certain customers, suppliers and partners to execute confidentiality and invention assignment agreements upon commencement of a relationship with the Company and extending for a period of time beyond termination of the relationship. There can be no assurance that these agreements will provide meaningful protection for the Company's trade secrets or other confidential information in the event of unauthorized use or disclosure of such information. See "Factors That May Affect Future Results - Our Operating Results May Fluctuate Significatly."

Backlog

The Company manufactures and markets primarily standard products. Sales are generally made pursuant to standard purchase orders. The Company includes in its backlog only those customer orders for which it has accepted purchase orders and assigned shipment dates within the upcoming twelve months. Since orders constituting the Company's current backlog are subject to changes in delivery schedules, backlog is not necessarily an indication of future revenue. In addition, there can be no assurance that the current backlog will necessarily lead to revenues in any future period. As of December 31, 1998, the Company's total backlog was $13.4 million compared to $18.6 million at December 31, 1997. Bookings visibility continues to be limited with more than 50% of the Company's quarterly product revenues coming from turns business. The Company believes that the current situation will continue until the new markets addressed by the Company's products enter a more predictable growth phase and demand begins to create longer lead times. See "Factors That May Affect Future Results - Fluctuations in Operating Results."

Competition

The flash data storage markets in which the Company competes are characterized by intense competition, rapid technological change, evolving industry standards, rapidly declining average selling prices and rapid product obsolescence. The Company's competitors include many large domestic and international companies that have greater access to wafer fab capacity, substantially greater financial, technical, marketing and other resources, broader product lines and longer standing relationships with customers than the Company. The Company's primary competitors include flash chip producers such as Advanced Micro Devices, Inc. ("AMD"), Atmel Corporation ("Atmel"), Hitachi, Intel, Micron Technology, Inc. ("Micron"), Mitsubishi Electronic Corporation ("Mitsubishi"), Samsung, Sharp and Toshiba, other companies using data storage techniques such as socket flash, linear flash and system flash components, as well as package assemblers such as Kingston Technology Company ("Kingston"), Lexar Media, Inc. ("Lexar"), M-Systems, Inc. ("M-Systems"), Simple Technology Inc. ("Simple"), SMART Modular Technologies, Inc. ("SMART Modular"), Sony Corporation ("Sony"), TDK Corporation ("TDK"), Matsushita Battery, Inc. ("Matsushita Battery") and Viking Components, Inc. ("Viking") that combine controllers

and flash memory chips developed by others into flash data storage cards. Approximately twenty-five companies have been certified by the CompactFlash Association to manufacture and sell their own brand of CompactFlash. The Company believes that other manufacturers, such as Toshiba and Samsung, will also seek to enter the CompactFlash market in the future.

Competing products promoting industry standards that are different from SanDisk's have been introduced, including Intel's Miniature Card, Toshiba's Smart Media (Solid-State Floppy Disk Card), Sony Corporation's Memory Stick, and Panasonic's recently introduced Mega Storage cards and M-Systems Diskonchip(TM) for embedded storage applications. In addition, in 1997 Sony introduced a digital camera that has no flash memory and instead uses a standard floppy disk for storing pictures. A manufacturer of digital cameras that designs-in any one of these alternative competing standards will eliminate CompactFlash from use in its product, as each competing standard is mechanically and electronically incompatible with CompactFlash. In addition, the Company faces competition from Intel's 64Mbit and Hitachi's 256Mbit multilevel cell flash devices. The Company's double density flash ("D2 flash") and these multilevel cell flash products are competing technological innovations that allow each flash memory cell to store two bits of information instead of the traditional single bit stored by the industry standard binary flash technology. In November 1997, Iomega Corporation ("Iomega") announced its Clik drive, a miniaturized, mechanical, removable disk drive that may compete directly with SanDisk's flash card products. In September 1998, IBM announced a type II CompactFlash card containing its 1" microdrive. The IBM product will compete directly with the Company's high capacity CompactFlash products. In October 1998, M-Systems introduced their Diskonchip 2000 product which is expected to compete against our Flash ChipSet products in embedded storage applications.

The Company expects competition to increase in the future from existing competitors and from other companies that may enter the Company's existing or future markets with similar or alternative data storage solutions that may be less costly or provide additional features. Due to the high price sensitivity in the market for consumer products, aggressive price competition has been experienced for these applications. Such competition could result in lost sales and lower gross margins in the future, if the Company's average selling prices

decrease faster than its costs.

The Company has entered into patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba, pursuant to which each party may manufacture and sell products that incorporate technology covered by each party's patents related to flash memory devices. As the Company continues to license its patents to certain of its competitors, competition will increase. As a result of the above factors, the Company expects to face substantially more competition in the future than it has to date. Increased competition could have a material adverse effect on the Company's business, financial condition and results of operations. The Company believes that its ability to compete successfully depends on a number of factors, which include price and quality, product performance and availability, success in developing new applications for system flash technology, adequate foundry capacity, efficiency of production, timing of new product announcements or introductions by the Company, its customers and its competitors, the ability of the Company's competitors to incorporate their flash data storage systems into their customers' products, the number and nature of the Company's competitors in a given market, successful protection of intellectual property rights and general market and economic conditions. The Company believes that it competes favorably with other companies with respect to these factors. There can be no assurance that the Company will be able to compete successfully against current and future competitors or that competitive pressures faced by the Company will not materially adversely affect its business, financial condition or results of operations. See "Factors That May Affect Future Results - Our Markets are Highly Competitive."

Employees

As of December 31, 1998, the Company had 477 regular, full-time employees and 66 temporary employees, including 92 in research and development, 74 in sales and marketing, 50 in finance and administration and 327 in operations. The Company's success is dependent on its retention of key technical, sales and marketing employees and members of senior management. Additionally, the Company's success is contingent on its ability to attract and recruit skilled employees in a very competitive market. None of the Company's employees are

represented by a collective bargaining agreement and the Company has never experienced any work stoppage. The Company believes that its employee relations are good.

Factors That May Affect Future Results

Our business, financial condition and results of operations could be impacted by a number of factors including the risk factors listed below.

OUR OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY

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

- Unpredictable demand for our products
- Decline in our average selling prices due to competitive pricing pressures
- Seasonality in sales of products for consumer electronics applications
- Changes in product and customer mix
- Market acceptance of new or enhanced versions of our products
- Changes in our distribution channels
- Timing of license and royalty revenue recognition
- Fluctuations in product costs, particularly due to fluctuations in manufacturing yields and utilization
- Availability of foundry capacity
- Variations in manufacturing cycle times
- Increased research and development expenses
- Exchange rate fluctuations
- Changes in general economic conditions, in particular the economic recession in Japan

When we order silicon wafers from our foundries, we have to estimate the number of silicon wafers needed to fill product orders several months into the future. If we overestimate this number, we build excess inventories which affects our gross margins and operating results. For example, in the second quarter of 1998, our product gross margins declined to 12% from 30% in the previous quarter due in part to a write down of inventory to reflect inventory at net realizable value. Because our largest volume product, CompactFlash, is

sold into an emerging consumer market, it is very difficult to accurately forecast future sales. If sales fall below our forecast, our operating results could be adversely affected if we are unable to reduce our operating expenses. More than 50% of our quarterly sales are from orders received and fulfilled in the same quarter. In addition, our product order backlog may fluctuate substantially from quarter to quarter.

Due to anticipated growth, we increased our expense levels in 1998, including expenses associated with the expansion of our in-house assembly and test operations. Operating expenses are expected to continue to increase as a result of the need to hire additional personnel to support expected growth in sales unit volumes, marketing and sales efforts and research and development activities. These expenses cannot be readily scaled back over the short term. If revenue does not increase proportionately to operating expenses, or if revenues decrease or do not meet expectations for a particular period, our business, financial condition and results of operations will be adversely affected.

Product mix varies quarterly, which affects our overall average selling prices and gross margins. Our CompactFlash products, which currently represent the marjority portion of our product revenues, have lower average selling prices and gross margins than our higher capacity FlashDisk and FlashDrive products. We believe that sales of CompactFlash products may become an even more significant percentage of our product revenues as consumer applications, such as digital cameras, become more popular. Dependence on CompactFlash sales, together with lower pricing caused by competition, has caused average selling prices to decline substantially over

the past year. This trend is expected to continue. Average selling prices decreased by 28% in 1998 compared to 1997.

One of our strategies is to cross-license our patents to other manufacturers of flash products. Under such arrangements, we earn license fees and royalties on individually negotiated terms. The timing of revenue recognition from these payments is dependent on either the terms of each contract or on the timing of product shipments by the third parties. This causes license and royalty revenue to fluctuate significantly. Because this revenue has higher gross margins than product revenue, gross margins and net income fluctuate more with changes in license and royalty revenue than with changes in product revenue.

OUR BUSINESS DEPENDS UPON CONSUMER PRODUCTS

In 1998, we received more product revenue and shipped more units of products destined for consumer electronics applications, principally digital cameras, than for any other applications. We believe that these products will encounter intense competition and be more price sensitive than products sold into our other target markets. In addition, we must spend more on marketing and promotion in consumer markets to establish brand name recognition and preference.

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

OUR BUSINESS DEPENDS ON EMERGING MARKETS AND NEW PRODUCTS

In order for demand for our products to grow, the markets for new products that use CompactFlash and the MultiMediaCard, such as smart phones and MP3 portable music players, must develop and grow. If sales of these products do not grow, our product revenues and profit margins could level off or decline. To remain competitive, we intend to develop new products with increased memory capacity at a lower cost per megabyte. The success of this new product strategy will depend upon, among other things, the following:

- Our ability to successfully develop new products with higher memory capacities at a lower cost per megabyte;

- The development of new applications or markets for our flash data storage products;

- The extent to which prospective customers design our products into their products and successfully introduce their products;

- The extent to which our products or technologies become obsolete or noncompetitive due to products or technologies developed by others.

If our new applications or target markets fail to develop, or if our

products are not accepted by the market, our business, financial condition and results of operations could suffer.

THERE IS SEASONALITY IN OUR BUSINESS

The sales of our products, in particular the sale of CompactFlash Products, in the consumer electronics applications market are subject to seasonality. As a result, product sales are impacted by seasonal purchasing patterns with higher sales in the second half of each year as compared to the first half of each such year. In addition, we historically experience a decrease in orders in the first quarter from Japanese OEM customers primarily due to the fact that most customers in Japan operate on a fiscal year ending in March and prefer to delay purchases until the beginning of their next fiscal year. For example, our product revenues were 24% lower in the first quarter of 1998 than in the fourth quarter of 1997, mostly due to these seasonal factors and the Asian economic crisis.

OUR MARKETS ARE HIGHLY COMPETITIVE

We compete in an industry characterized by intense competition, rapid technological changes, evolving industry standards, declining average selling prices and rapid product obsolescence. Our competitors include many large domestic and international companies that have greater access to foundry capacity, substantially greater financial, technical, marketing and other resources, broader product lines and longer standing relationships with customers. Our primary competitors include flash chip producers such as Advanced Micro Devices, Inc., Atmel Corporation, Hitachi Ltd., Intel Corporation, Micron Technology, Inc., Mitsubishi Electronic Corporation, Samsung Electronics Company Ltd., Sharp Electronics Corporation and Toshiba Corporation. Other competitors include companies using data storage techniques such as socket flash, linear flash and system flash components, as well as package or card assemblers such as Lexar Media, Inc., M-Systems, Inc., Simple Technology Inc., SMART Modular Technologies, Inc., Sony Corporation, Kingston Technology Company, TDK Corporation, Matsushita Battery, Inc. and Viking Components, Inc., which combine controllers and flash memory chips developed by others into flash storage cards. Approximately 25 companies have been certified by the CompactFlash Association to manufacture and sell their own brand of CompactFlash. We believe that other manufacturers will enter the CompactFlash market in the future.

In addition, competing products have been introduced that promote industry standards that are different from our CompactFlash product, including Intel's Miniature Card, Toshiba's Smart Media (Solid-State Floppy Disk Card), Sony Corporation's Memory Stick, Panasonic's recently introduced Mega Storage cards and M-Systems' Diskonchip(TM) for embedded storage applications. Each competing standard is mechanically and electronically incompatible with CompactFlash. If a manufacturer of digital cameras or other consumer electronic devices designs-in one of these alternative competing standards, CompactFlash will be eliminated from use in that product.

We also face competition from products based on multilevel cell flash technology such as Intel's 64Mbit flash chip and Hitachi's 256Mbit flash chip. These products compete with our D2 multilevel cell flash technology. Multilevel cell flash is a technological innovation that allows each flash memory cell to store two bits of information instead of the traditional single bit stored by the industry standard flash technology. In November 1997, Iomega Corporation announced its Clik drive, a miniaturized, mechanical, removable disk drive, and claims that it will compete directly with our flash card products. In September 1998, IBM introduced the microdrive, a rotating disk drive in a type II CompactFlash format. Initially, this product will compete directly with our type II CompactFlash memory cards, when we introduce these products in 1999, for use in high end professional digital cameras. In October 1998, M-Systems introduced their Diskonchip 2000 product which is expected to compete against our Flash ChipSet products in embedded storage applications.

According to independent industry analysts, Sony's Mavica digital camera captured approximately 40% of the United States market for digital cameras in the first and second quarters of 1998. The Mavica uses a standard floppy disk to store digital images and therefore uses no CompactFlash (or any other flash) cards. Our sales prospects for CompactFlash cards will be significantly reduced if other manufacturers adopt the Mavica format and it becomes the new "defacto standard." Also, our MultiMediaCard products are expected to face stiff competition from Toshiba's SmartMedia flash cards and Sony's flash Memory Stick. Although the Memory Stick is proprietary to Sony, if it is adopted and achieves widespread use in future products, sales of our MultiMediaCard and CompactFlash products may decline.

Furthermore, we expect to face competition from existing companies and from other companies that may enter the existing or future markets that have similar or alternative data storage solutions which may be less costly or provide additional features. Price is an important competitive factor in the

market for consumer products. Increased price competition could lower gross margins if our average selling prices decrease faster than costs and could also result in lost sales.

We have entered into patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba. Under these agreements, each party may manufacture and sell products that incorporate technology covered by the other party's patents related to flash memory devices. As we continue to license our patents to certain

competitors, competition will increase and may cause harm to our business, financial condition and results of operations.

Other competitive factors include:

- Product performance and availability
- Adequate foundry capacity
- Efficiency of production
- Our timing of new product announcements or introductions
- Successful protection of intellectual property rights
- General market and economic conditions

OUR AVERAGE SALES PRICES HAVE DECLINED

In 1998, the average selling prices of our products declined 28% compared to 1997. Because flash data storage markets are characterized by intense competition, we expect that pricing pressures from our customers will increase. This will likely result in a further decline in average sales prices for our products. We believe that we can offset declining average sales prices by achieving manufacturing cost reductions and developing new products that incorporate advanced features and can be sold at higher average gross margins. However, if we are unable to achieve such cost reductions or remain price competitive, this could result in lost sales, declining gross margins, and as a result, our business, financial condition and results of operations could suffer.

From time to time the semiconductor industry has experienced a significant down turn and is currently beginning to recover from one of its most severe down cycles. During most of 1998, the semiconductor industry experienced significant production over capacity. This "buyers market" put margin pressures on all flash memory suppliers. We believe product gross margins will remain under pressure in the first half of 1999 until the more favorable cost structure of our 128Mbit flash chip design begins to have a favorable impact on the cost per megabyte of our products.

WE FACE RISKS ASSOCIATED WITH OUR INTERNATIONAL OPERATIONS

Our sales are primarily denominated in United States dollars. As a result, if the value of the US dollar increases relative to foreign currencies, our products could become less competitive in international markets. For example, our products are relatively more expensive in Asia because of the recent economic conditions in Asia and the weakness of many Asian currencies relative to the US dollar. This has resulted in a decrease in our sales in that region. In 1998, sales to Japan declined to 31.6% of total product sales from 38.1% in 1997. This resulted primarily from the Japanese economic crisis and market recession. If the current market conditions in Japan do not improve, or if they decline further, our results of operations may suffer.

Currently, all of our wafers are produced by foundries located outside the United States and the majority are purchased in United States dollars. Because we currently invoice certain customers in Japanese Yen, fluctuations in currencies could adversely affect our business, financial condition and results of operations. Our international business activities could also be limited or disrupted by any of the following:

- The need to comply with foreign government regulation;

- General geopolitical risks, such as political and economic instability, potential hostilities and changes in diplomatic and trade relationships;

- Imposition of regulatory requirements, tariffs, import and export restrictions, and other barriers and restrictions;

- Longer payment cycles and greater difficulty in accounts receivable collection;

- Potentially adverse tax consequences;

- Less protection of our intellectual property rights.

In 1999, we will begin using third-party subcontractors in China for the assembly and testing of our components. As a result, our business could be harmed by the effect of political, economic, legal and other uncertainties in China. Under its current leadership, the Chinese government has been pursuing economic reform policies, including the encouragement of foreign trade and investment and greater economic decentralization. The Chinese government may not continue to pursue such policies and, even if it continued, such policies may not be successful. The Chinese government may significantly alter the policies from time to time. In addition, China does not currently have a comprehensive and highly developed system of laws, particularly with respect to the protection of intellectual property rights. As a result, enforcement of existing and future laws and contracts is uncertain, and the implementation and interpretation of such laws may be inconsistent.

SALES TO A SMALL NUMBER OF CUSTOMERS REPRESENT A SIGNIFICANT PORTION OF OUR REVENUES

Most of our revenue comes from a small number of customers. For example, sales to the Company's top 10 customers accounted for approximately 59%, 67%, and 71%, respectively, of the Company's product revenues for 1998, 1997, and 1996. If we were to lose any of these customers or experience any reductions in orders from these customers, our revenues and operating results would suffer. Our sales are generally made by standard purchase orders rather than long-term contracts. In addition, the composition of our major customer base changes from year to year as the market demand for our customers' products change.

WE DEPEND ON THIRD PARTY FOUNDRIES FOR SILICON WAFERS

All of our products require silicon wafers. We rely on USC and USIC in Taiwan and Matsushita Electronic Corporation in Japan for supplying our silicon wafers. We depend on our foundries to (1) allocate a portion of their foundry capacity to our needs, (2) produce acceptable quality wafers with acceptable manufacturing yields and (3) deliver our wafers on a timely basis at a competitive price. If our foundries are unable to satisfy these requirements, our business, financial condition and operating results may suffer.

Under the wafer supply agreements with our foundries, we are obligated to provide monthly rolling forecasts for our anticipated wafer purchases. Generally, the estimates for the first three months of each forecast are binding commitments. The estimates for the remaining months may only be changed by a certain percentage from the previous month's forecast. This limits our ability to react to fluctuations in demand for our products and could cause us to have excess inventory. In addition, if we are unable to obtain scheduled quantities of wafers with acceptable price and yields from any foundry, our business, financial condition and results of operations could be adversely affected.

WE DEPEND ON OUR SUPPLIERS AND THIRD PARTY SUBCONTRACTORS

We rely on our vendors, some of which are sole source suppliers, for several of our critical components. We do not have long-term supply agreements with any of these vendors. Our business, financial condition and operating results could be harmed by delays or reductions in shipments if we are unable to develop alternative sources or to obtain sufficient quantities of these components. For example, we rely on Motorola, Inc. and NEC to supply certain designs of critical microcontrollers.

We also rely on third-party subcontractors to assemble, and sometimes test the memory components for our products. We have no long-term contracts with these subcontractors and cannot directly control product delivery schedules. This could lead to product shortages or quality assurance problems which could increase the manufacturing costs of our products and have adverse effects on our operating results.

WE FACE RISK IN TRANSITIONING TO NEW PROCESSES AND PRODUCTS

Successive generations of our products incorporate semiconductor devices with greater memory capacity per chip. We are continually involved in joint development efforts with our foundries to produce semiconductor

devices based upon smaller geometry manufacturing processes. Two important factors that enable us to decrease the costs per megabyte of our flash data storage products are the development of higher capacity semiconductor devices and the implementation of smaller geometry manufacturing processes. A number of

challenges exist in achieving a lower cost per megabyte, including (1) lower yields are often associated with the early production of new semiconductor devices, (2) problems with design and manufacturing of products that will incorporate these devices and (3) production delays. Because our products are complex, we periodically experience significant delays in the development and volume production ramp up of our products. Similar delays could occur in the future and could harm our business, financial condition and results of operations.

We have developed new products based on D2 flash technology, a new flash architecture designed to store two bits in each flash memory cell. We introduced our 80Mbit D2 flash chip in November 1997 and began customer shipments in the third quarter of 1998. We expect production volumes to be limited, however, because of more advanced 256Mbit flash memory designs currently planned for production by the end of 1999. These new advanced designs are expected to have faster write speeds than the 80Mbit D2 flash. We believe that D2 flash will help us increase the capacity and decrease the costs of certain products, enabling us to maintain our competitive advantage, broaden our target markets and attract strategic partners. High density flash memory, such as D2 flash, is a complex technology that requires tight manufacturing controls and effective test screens. Problems from the shift to volume production for new flash products could impact both reliability and yields and result in increased manufacturing costs. We may not be able to manufacture reliable and cost effective D2 flash products in commercial volumes and with yields sufficient to result in lower costs per megabyte. Furthermore, D2 flash technology needs significantly improved write speed so that it can be usefully applied to market applications such as digital cameras. We may not be able to achieve the requisite write speed in our future D2 products.

WE MUST ACHIEVE ACCEPTABLE WAFER MANUFACTURING YIELDS

The fabrication of our products requires wafers to be produced in a highly controlled and clean environment. Semiconductor companies that supply our wafers sometimes have experienced problems achieving acceptable wafer manufacturing yields. Semiconductor manufacturing yields are a function of both our design technology and the foundry's manufacturing process technology. Low yields may result from design errors or manufacturing failures. Yield problems may not be determined or improved until an actual product is made and can be tested. As a result, yield problems may not be identified until the wafers are well into the production process. The risks associated with yields are even greater because we rely on independent offshore foundries for our wafers which increases the effort and time required to identify, communicate and resolve manufacturing yield problems. We cannot be certain that our foundries will achieve or maintain acceptable manufacturing yields. If the foundries cannot achieve the planned yields, it could negatively affect our business, financial condition and results of operations.

RISKS ASSOCIATED WITH PATENTS, PROPRIETARY RIGHTS AND RELATED LITIGATION

We rely on a combination of patents, trademarks, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. In the past, we have been involved in significant disputes regarding our intellectual property rights and claims that we may be infringing third parties' intellectual property rights. We expect that we will be involved in similar disputes in the future. We cannot assure you (1) that any of our patents will not be invalidated, (2) that patents will be issued for any of our pending applications, (3) that any claims allowed from existing or pending patents will have sufficient scope or strength or (4) that our patents will be issued in the primary countries where our products are sold in order to protect our rights and potential commercial advantage. In addition, our competitors may be able to design around our patents.

From time to time, it may be necessary to initiate litigation against third parties to preserve our intellectual property rights. These parties could in turn bring suit against us. Such a situation occurred in March of 1998. We filed a complaint in federal court against Lexar for infringement of a fundamental flash disk patent. Lexar disputed this claim and asserted that our patent was invalid or unenforceable, as well as asserting various counterclaims including unfair competition, violation of the Lanham Act, patent misuse, interference with prospective economic advantage, trade defamation and fraud. We have denied all of these counterclaims. In July 1998, the federal district

court denied Lexar's request to have the case dismissed. Discovery in this suit began in August 1998. Currently the case is in the claims construction phase. See "Item 3. Legal Proceedings."

We intend to vigorously enforce our patents but we cannot be sure that our efforts will be successful. If we were to have an adverse result in any such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes

or obtain licenses to the infringing technology. Any litigation is likely to result in significant expense to us, as well as divert the efforts of our technical and management personnel.

If we decide to incorporate third party technology into our products or if we are found to infringe on others' intellectual property, we could be required to license intellectual property from a third party. We may also need to license some of our intellectual property to others in order to enable us to obtain cross-licenses to third party patents. Currently, we have patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba and we are in discussions with other companies regarding potential cross-license agreements. We cannot be certain that licenses will be offered when we need them, or that the terms offered will be acceptable. If we do obtain licenses from third parties, we may be required to pay license fees or royalty payments. In addition, if we are unable to obtain a license that is necessary to the manufacture of our products, we could be required to suspend the manufacture of products or stop our foundries from using processes that may infringe the rights of third parties. We cannot assure you that we would be successful in redesigning our products or that the necessary licenses will be available under reasonable terms.

We have historically indemnified various suppliers and customers for alleged patent infringement. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorney's fees. We may periodically engage in litigation as a result of these indemnification obligations. Our insurance policies exclude coverage for third party claims for patent infringement. Any future obligation to indemnify our customers or suppliers could have a negative affect on our business, financial condition or results of operations.

OUR RAPID GROWTH MAY STRAIN OUR OPERATIONS

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

WE DEPEND UPON CERTAIN KEY PERSONNEL

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

OUR STOCK PRICE MAY BE VOLATILE

The market price of our stock has fluctuated in the past and is likely to fluctuate in the future. For example, in the twelve month period ending December 31, 1998, our stock price fluctuated from a low of $5.125 to a high of $26.25. We believe that such fluctuations could continue as a result of future announcements concerning us, our competitors or principal customers regarding technological innovations, new product introductions,

governmental regulations, litigation or changes in earnings estimates by analysts. In addition, in recent years the stock market has experienced significant price and volume fluctuations and the market prices of the securities of high technology companies have been especially volatile. These fluctuations as well as general economic, political and market conditions may have an adverse affect on the market price of our Common Stock.

YEAR 2000 ISSUES MAY HARM OUR BUSINESS

Many existing computer systems and applications may not function properly when using dates beyond December 31, 1999. We have established a Year 2000 Risk Management program to assess the impact that the Year 2000 issue may have on our business. Based on our assessment to date, all of our flash memory and connectivity products are Year 2000 compliant. Other Year 2000 issues that we face include:

- Assessment and remediation of the tertiary business information systems

- Assessment and remediation of the computer systems used for facilities control, machine control and manufacturing testing

- Year 2000 compliance of our key suppliers and customers

Our estimated total costs for Year 2000 compliance issues are not expected to have a material adverse affect on our business. However, the failure of our key suppliers and customers to take proper remedial efforts could harm our business, financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Year 2000 Readiness Disclosure."

WE HAVE ANTI-TAKEOVER PROVISIONS

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

ITEM 2. PROPERTIES

The Company's principal facilities are presently located in a 104,000 square foot building in Sunnyvale, California. Approximately one half of the space is dedicated to production activities. The remaining space is used for administrative, marketing and development activities. The Company occupies this space under a lease agreement that expires in July 2001. The Company has also entered into a lease agreement for an adjacent 50,000 square foot building, which is currently being prepared for occupancy. The Company plans to move certain administrative, sales and marketing functions into this building in the second quarter of 1999. The lease on this additional space expires in July 2001. The Company believes that its facilities will be adequate to meet its near term needs and that additional space will be available as required. The Company also leases domestic sales offices in Herndon, Virginia; Irvine, California; Branford, Connecticut; Dublin, Ohio and Maitland, Florida, as well as foreign sales offices in Hannover, Germany; Paris, France; Amsterdam, the Netherlands; Yokohama and Osaka, Japan; Hong Kong and a design center in Tefen, Israel.

ITEM 3. LEGAL PROCEEDINGS

To preserve its intellectual property rights, the Company believes it may be necessary to initiate litigation against one or more third parties, including but not limited to those the Company has already notified of possible patent infringement. In addition, one or more of these parties may bring suit against the Company.

In March 1998, the Company filed a complaint in federal court against Lexar Media, Inc. ("Lexar") for infringement of a fundamental flashdisk patent. Lexar has disputed the Company's claim of patent infringement, claimed SanDisk's patent is invalid or unenforceable and asserted various counterclaims including unfair competition, violation of the Lanham Act, patent misuse, interference with prospective economic advantage, trade defamation and fraud. SanDisk has denied each of Lexar's counterclaims.

In July 1998, the federal district court denied Lexar's request to have the case dismissed on the grounds the Company failed to perform an adequate prefiling investigation. Discovery in the Lexar suit commenced in August 1998. The claims construction phase commenced in February 1999. The Company intends to vigorously enforce its patents, but there can be no assurance that these efforts will be successful.

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

discontinue the use of certain processes. Any litigation, whether as a plaintiff or as a defendant, would likely result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is ultimately determined in favor of the Company. In addition, the results of any litigation are inherently uncertain. For example, in 1995, the Company informed Samsung that the Company believed Samsung infringed certain of its patents. In response, Samsung filed a complaint accusing the Company of infringing two of its patents. The Company then filed a complaint against Samsung with the United States International Trade Commission (the "ITC") alleging that Samsung and its U.S. sales arm were importing and selling products that infringed two of the Company's patents. After a hearing on this matter, the ITC issued an order that both SanDisk patents were valid and that Samsung had infringed such patents, and prohibited the import, sale, marketing, distribution or advertising of Samsung's infringing flash memory circuits in the United States. In August 1997, the Company and Samsung entered into a settlement agreement resolving all aspects of this dispute, pursuant to which the parties agreed to cross-license certain patents and Samsung agreed to make license and royalty payments to the Company. While the Company believes it achieved a favorable result in this matter, the expense and diversion of management attention in connection with its resolution was substantial. In addition, the Company has notified several large flash suppliers that the Company believes certain of their existing or announced products infringe certain of the Company's patents.

In the event the Company desires to incorporate third party technology into its products or is found to infringe on others' patents or intellectual property rights, the Company may be required to license such patents or intellectual property rights. The Company may also need to license some or all of its patent portfolio to be able to obtain cross-licenses to the patents of others. The Company currently has patent cross-license agreements with Hitachi, Intel, Samsung, Sharp, SST and Toshiba. From time to time, the Company has also entered into discussions with other companies regarding potential cross-license agreements for the Company's patents. However, there can be no assurance that licenses will be offered or that the terms of any offered licenses will be acceptable to the Company. If the Company obtains licenses from third parties, it may be required to pay license fees or make royalty payments, which could have a material adverse effect on the Company's gross margins. The failure to obtain a license from a third party for technology used by the Company could cause the Company to incur substantial liabilities and to suspend the manufacture of products or the use by the Company's foundries of processes requiring the technology, or to expend substantial resources redesigning its products to eliminate the infringement. There can be no assurance that the Company would be successful in redesigning its products or that such licenses would be available under reasonable terms. Furthermore, any such development or license negotiations could require substantial expenditures of time and other resources by the Company.

As is common in the industry, the Company agrees to indemnify certain of its suppliers and customers for alleged patent infringement. The scope of such indemnity varies, but may, in some instances, include

indemnification for damages and expenses, including attorneys' fees. The Company may from time to time be engaged in litigation as a result of such indemnification obligations. Third party claims for patent infringement are excluded from coverage under the Company's insurance policies. There can be no assurance that any future obligation to indemnify the Company's customers or suppliers, will not have a material adverse effect on the Company's business, financial condition and results of operations. See "Business - Patents and Licenses."

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 1998.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company, who are elected by and serve at the discretion of the Board of Directors, are as follows:

Name	Age	Position
Dr. Eli Harari	53	President, Chief Executive Officer and Director
Cindy Burgdorf	51	Chief Financial Officer, Senior Vice President, Finance and Administration and Secretary
Leon Malmed	61	Senior Vice President, Marketing and Sales
Daniel Auclair	52	Senior Vice President, Business Development and Intellectual Property
Ralph Hudson	54	Senior Vice President, Worldwide Operations
Jocelyn Scarborough	54	Vice President, Human Resources

Dr. Harari, the founder of the Company, has served as President and Chief Executive Officer and as a director of the Company since June 1988. Dr. Harari founded Wafer Scale Integration, a privately held semiconductor company, in 1983 and was its President and Chief Executive Officer from 1983 to 1986, and Chairman and Chief Technical Officer from 1986 to 1988. From 1973 to 1983, Dr. Harari held various management positions with Honeywell Inc., Intel and Hughes Aircraft Microelectronics. Dr. Harari holds a Ph.D. degree in Solid State Sciences from Princeton University.

Ms. Burgdorf joined the Company as Chief Financial Officer, Vice President, Finance and Secretary in June 1994 and has served as Senior Vice President, Finance and Administration since July 1995. From 1992 to 1994, Ms. Burgdorf was Vice President of Operations Administration and Vice President of Materials and Planning at Maxtor Corp. ("Maxtor"). From 1978 to 1992, Ms. Burgdorf held various financial management positions including Corporate Controller, Group Controller of the Components Group and director of the worldwide customer satisfaction program at Intel. Ms. Burgdorf is a Certified Public Accountant and holds a B.S. degree in Business Administration from San Jose State University.

Mr. Malmed joined the Company as Vice President, Worldwide Marketing and Sales in December 1992 and has served as Senior Vice President, Marketing and Sales since July 1995. From 1991 to 1992, Mr. Malmed was Executive Vice President of Marketing/Sales at SyQuest Technology, Inc., a manufacturer of removable-cartridge disk drives. From 1990 to 1991, Mr. Malmed was Senior Vice President, Sales and Marketing at Prairetek, Inc., a manufacturer of disk drives. From 1983 to 1990, Mr. Malmed held various management positions at Maxtor. Mr. Malmed holds a B.S. degree in Mechanical Engineering from the University of Paris.

Mr. Auclair has served as Vice President, Systems Engineering from 1990 to June 1993, Vice President, Engineering and Technology from June 1993 to July 1995, Senior Vice President, Operations and Technology from July 1995 to January 1998 and has served as Senior Vice President Business Development and Intellectual Property since January 1998. From 1988 to 1990, Mr. Auclair was Vice President of Engineering at Anamartic, a company that utilizes wafer scale technology to build DRAM mass storage systems. From 1984 to 1988, Mr. Auclair was Vice President and General Manager of the OMTI division of Scientific Micro Systems, a supplier of disk controllers and disk controller chips to the disk drive industry. Mr. Auclair holds a B.S. degree in Engineering Physics from the University of Maine and an M.S. degree in Computer Science from the University of Santa Clara.

Mr. Ralph Hudson joined the company as Senior Vice President of World Wide Operations in August of 1998. He was previously, President of RJ Hudson Consulting from 1997 to 1998, Vice President of Operations for USRobotics/3Com's Network Work Systems Division from 1996 to 1997, Senior Vice President and General Manager for Bell and Howell from 1993 to 1996 and held various senior management positions with Data General from 1977 to 1993 where he was Vice President of World Wide Operations from 1989 to 1993. Prior to this he held various management and senior management position with NCR Corporation from 1967 to 1977. Mr. Hudson holds a B.S. Degree in Industrial Engineering from Allied Institute of Technology.

Ms. Scarborough joined the Company as Vice President of Human Resources in March 1999. She was previously President of Scarborough and Associates from 1997 to 1999 and Vice President of Human Resources for the California State Automobile Association from 1994 to 1997. From 1973 to 1993, Ms. Scarborough held various management positions, including Director of Human Resources and Organization Development, at Digital Equipment Corporation. Ms. Scarborough holds a B.S. degree in Psychology from Gordon College.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND
RELATED STOCKHOLDER MATTERS

Market Price of Common Stock

The Company's Common Stock is traded on the Nasdaq National Market under the symbol SNDK. SanDisk's initial public offering of stock was November 8, 1995 at $10.00 per share. The following table lists the high and low sales price for each quarter during the last three years.

	High	Low
Fiscal year 1996		
First quarter	$21.75	$12.00
Second quarter	$17.00	$10.625
Third quarter	$16.25	$ 9.625
Fourth quarter	$16.125	$11.25
Fiscal year 1997		
First quarter	$13.875	$ 8.875
Second quarter	$14.875	$ 9.625
Third quarter	$36.625	$14.75
Fourth quarter	$40.00	$15.75
Fiscal year 1998		
First quarter	$26.25	$15.75
Second quarter	$25.125	$12.25
Third quarter	$14.75	$ 7.50
Fourth quarter	$15.00	$ 5.125

As of March 15, 1999, there were approximately 212 stockholders of record. The Company has never declared or paid any cash dividends on its Common Stock and does not expect to pay cash dividends on its Common Stock in the foreseeable future. In addition, the Company's existing line of credit agreement currently prohibits the payment of cash dividends without the bank's consent. The Company currently intends to retain its earnings, if any, for use in its business.

ITEM 6: SANDISK CORPORATION SELECTED FINANCIAL DATA
(In thousands, except per share data)

<TABLE>
<CAPTION>

Year Ended December 31,	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>
Revenues					
Product	$ 103,190	$ 105,675	$ 89,599	$ 61,589	$ 35,378
License and royalty	32,571	19,578	8,000	1,250	-
Total revenues	135,761	125,253	97,599	62,839	35,378
Cost of revenues	80,311	72,280	58,707	36,613	28,074
Gross profits	55,450	52,973	38,892	26,226	7,304
Operating income (loss)	12,810	19,680	12,474	7,777	(4,781)
Net income (loss)	11,836	19,839	14,485	9,065	(4,287)
Net income (loss) per share (pro forma for 1995 and 1994)					
Basic	$ 0.45	$ 0.87	$ 0.65	$ 0.48	$ (0.25)
Diluted	$ 0.43	$ 0.79	$ 0.60	$ 0.45	$ (0.25)
Shares used in per share calculations (pro forma for 1995 and 1994)					
Basic	26,298	22,880	22,162	18,747	17,463
Diluted	27,672	24,970	24,206	20,328	17,463

At December 31,	1998	1997	1996	1995	1994
Working capital	$ 138,471	$ 134,298	$ 77,029	$ 68,002	$ 20,971
Total assets	255,741	245,467	108,268	92,147	31,861
Long term debt, less current portion	-	-	-	-	93
Total stockholders' equity	207,838	191,374	87,810	72,381	23,672

</TABLE>

The Company is restricted in paying cash dividends under the terms of its line of credit agreement and paid no cash dividends during the five-year period. (See Note 3 of the Notes to the Consolidated Financial Statements)

See Notes to the Consolidated Financial Statements and Management's Discussion

and Analysis of Financial Condition and Results of Operations.

SanDisk Corporation
SUPPLEMENTARY Quarterly Data
(Unaudited. In thousands except per share data)

Quarterly/1998	1st	2nd	3rd	4th
Revenues				
Product	$ 25,426	$ 23,480	$ 24,143	$ 30,141
License and royalty	8,676	7,881	7,935	8,079
Total revenues	34,102	31,361	32,078	38,220
Gross profits	16,330	10,801	13,238	15,081
Operating income	6,004	370	2,633	3,803
Net income	4,703	1,053	2,506	3,574
Net income per share				
Basic	$ 0.18	$ 0.04	$ 0.09	$ 0.13
Diluted	$ 0.17	$ 0.04	$ 0.09	$ 0.13

Quarterly/1997	1st	2nd	3rd	4th
Revenues				
Product	$ 18,194	$ 23,922	$ 30,219	$ 33,340
License and royalty	3,250	3,425	5,925	6,978
Total revenues	21,444	27,347	36,144	40,318
Gross profits	8,479	10,972	16,009	17,513
Operating income	1,540	3,391	7,233	7,516
Net income	2,125	3,690	6,802	7,222
Net income per share				
Basic	$ 0.09	$ 0.16	$ 0.30	$ 0.30
Diluted	$ 0.09	$ 0.15	$ 0.27	$ 0.27

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this discussion and analysis are forward looking statements based on current expectations, and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward looking statements. Such risks and uncertainties are set forth in "Item 1: Business - Factors That May Affect Future Results." The following discussion should be read in conjunction with the Company's consolidated financial statements and the notes thereto.

OVERVIEW

The Company was founded in 1988 to develop and market flash data storage systems. The Company sells its products to the consumer electronics and industrial/communications markets. During the course of 1998, the percentage of the Company's product sales attributable to the consumer electronics market, particularly sales of CompactFlash for use in digital camera applications, increased substantially. This increase in sales to the consumer market resulted in a shift to lower capacity products, which typically have lower average selling prices and gross margins than higher capacity products. In addition, these products are frequently sold into the retail channel, which usually has shorter customer order lead-times than the other channels used by the Company, thereby decreasing the Company's ability to accurately forecast future production needs. Subject to market acceptance of its CompactFlash products, the Company believes these products will continue to represent a majority of the Company's sales as the popularity of consumer applications, including digital cameras, increases. The percentage of sales attributable to orders received and fulfilled in the same quarter has increased over time and, in response, the Company is continuing to work to shorten its manufacturing cycle times.

The Company's operating results are affected by a number of factors

including the volume of product sales, the timing of significant orders, competitive pricing pressures, the ability of the Company to match supply with demand, changes in product and customer mix, market acceptance of new or enhanced versions of the Company's products, changes in the channels through which the Company's products are distributed, timing of new product announcements and introductions by the Company and its competitors, the timing of license and royalty revenues, fluctuations in product costs, availability of foundry capacity, variations in manufacturing cycle times, fluctuations in manufacturing yields and manufacturing utilization, increased research and development expenses, and exchange rate fluctuations. In addition, as the proportion of the Company's products sold for use in consumer electronics applications increases, the Company's revenues may become subject to seasonal declines in the first quarter of each year. See "Item 1: Business - Factors That May Affect Future Results - Our Operating Results May Fluctuate Significantly" and "There is Seasonality in Our Business."

Beginning in late 1995, the Company adopted a strategy of licensing its flash technology, including its patent portfolio, to selected third party manufacturers of flash products. To date, the Company has entered into patent cross-license agreements with six companies, and it intends to pursue opportunities to enter into additional licenses. The Company's current license agreements provide for the payment of license fees, royalties, or a combination thereof, to the Company. The timing and amount of these payments can vary substantially from quarter to quarter, depending on the terms of each agreement and, in some cases, the timing of sales of products by the other parties. As a result, license and royalty revenues have fluctuated significantly in the past and are likely to continue to fluctuate in the future. Given the relatively high gross margins associated with license and royalty revenues, gross margins and net income are likely to fluctuate more with changes in license and royalty revenues than with changes in product revenues.

SanDisk markets its products using a direct sales organization, distributors, manufacturers' representatives, private label partners, OEMs and retailers. The Company expects that sales through the retail channel will comprise an increasing share of total revenues in the future, and that a substantial portion of its sales into the retail channel will be made to participants that will have the right to return unsold products. The Company does not recognize revenues from these sales until the products are sold to the end customers. See "Item 1: Business - Sales and Distribution."

Historically, a majority of the Company's sales have been to a limited number of customers. Product sales to the Company's top 10 customers accounted for approximately 59%, 67%, and 71%, respectively, of the Company's product revenues for 1998, 1997, and 1996. In addition, revenues from one customer in 1998 exceeded 10% of total revenues. No single customer accounted for greater than 10% of revenues in 1997 and in 1996 one customer accounted for 26% of total revenues. The Company expects that sales of its products to a limited number of customers will continue to account for a substantial portion of its product revenues for the foreseeable future. The Company has also experienced significant changes in the composition of its customer base from year to year and expects this pattern to continue as market demand for such customers' products fluctuates. The loss of, or significant reduction in purchases by major customers, could have a material adverse effect on the Company's business, financial condition and results of operations. See "Item 1: Business - Factors That May Affect Future Results - Sales to a Small Number of Customers Represent a Significant Portion of Our Revenues" and "Business - Sales and Distribution."

Due to the emerging nature of the Company's target markets and certain planned product transitions, the Company has had difficulty forecasting future inventory levels required to meet customer demand. As a result of both contractual obligations and manufacturing cycle times, the Company has been required to order wafers from its foundries several months in advance of the ultimate shipment of its products. Under the Company's wafer supply agreements, there are limits on the number of wafers the Company can order and the Company's ability to change that quantity is restricted. Accordingly, the Company's ability to react to significant fluctuations in demand for its products is limited. As a result, the Company has not been able to match its purchases of wafers to specific customer orders and therefore the Company has from time to time taken write downs for potential excess inventory purchased prior to the receipt of customer orders. For example, in the second quarter of 1998, the Company's product gross margins were negatively impacted by such an inventory write down. These adjustments decrease gross margins in the quarter reported and have resulted, and could in the future result, in fluctuations in gross margins on a quarter to quarter basis. See "Item 1: Business - Factors That May Affect Future Results - Our Operating Results May Fluctuate Significantly."

Export sales are an important part of the Company's business, constituting 56%, 57%, and 55% of the Company's total revenues in 1998, 1997, and 1996, respectively. In 1998, product sales to Japan declined 19% from the prior year, due in part to the Asian economic crisis. While a majority of the Company's revenues from sales to Japan and other Asian countries are derived from OEM

customers who plan to export a portion of their products to countries outside of Asia, the Asian economic crisis may continue to adversely effect the Company's revenues to the extent that demand for the Company's products in Asia declines. Given the recent economic conditions in Asia and the weakness of many Asian currencies relative to the United States dollar, the Company's products may be relatively more expensive in Asia, which could result in a decrease in the Company's sales in that region. The Company may also experience pressure on its gross margins as a result of increased price competition from Asian competitors. While most of the Company's sales are denominated in U.S. Dollars, the Company invoices certain Japanese customers in Japanese Yen and is subject to exchange rate fluctuations on these transactions. A portion of the Company's purchases of wafers are denominated in Japanese Yen. While this percentage has been decreasing, exchange rate fluctuations can affect the Company's business, financial condition and results of operations. See "Item 1: Business - Factors That May Affect Future Results - We Face Risks Associated with International Operations."

For the foreseeable future, the Company expects to realize a significant portion of its revenues from recently introduced and new products. Typically new products initially have lower gross margins than more mature products because the manufacturing yields are lower at the start of manufacturing each successive product generation. In addition, manufacturing yields are generally lower at the start of manufacturing any product at a new foundry. To remain competitive, the Company is focusing on a number of programs to lower its manufacturing costs, including development of future generations of D2 flash and advanced technology wafers. There can be no assurance that such products or processes will be successfully developed by the Company or that development of such processes will lower manufacturing costs. In addition, the Company anticipates that price competition will increase in the future, which could result in decreased average selling prices and lower gross margins. See "Item 1: Business - Factors That May Affect Future Results -We Must Achieve Acceptable Manufacturing Yields."

YEAR 2000 READINESS DISCLOSURE

The Company is aware of problems associated with computer systems as the year 2000 approaches. Year 2000 problems are the result of common computer programming techniques that result in systems that do not function properly when manipulating dates later than December 31, 1999. The issue is complex and wide ranging. The problem may affect transaction processing computer applications used by the Company for accounting, distribution, manufacturing, planning and communications. The problem may also affect embedded systems such as building security systems, machine controllers and production test equipment. Year 2000 problems with these systems may affect the ability or efficiency with which the Company can perform many significant functions, including but not limited to: order processing and fulfillment, material planning, product assembly, product test, invoicing and financial reporting. While there can be no guarantee of unaffected operation, the completed implementation of the Company's new Management Information System, and the completed assessment of its embedded systems, indicates limited exposure in these areas. The Year 2000 problem may also affect the computer systems of the Company's suppliers and customers, potentially disrupting their operations. Year 2000 problems with the Company's business partners may impact the Company's sources of supply and demand.

Year 2000 Readiness. The Company has a Year 2000 Risk Management program to assess the impact of the Year 2000 issue on SanDisk, and to coordinate remediation activities. The Company completed the evaluation of its products for Year 2000 compliance in the third quarter of 1998. The Company's FlashDisk, FlashDrive, Flash ChipSet, CompactFlash, MultiMediaCard, and ImageMate product lines do not perform date related processing, do not contain real time clock circuitry and therefore are Year 2000 ready. SanDisk storage and connectivity products are used as components in a variety of host systems. The firmware, operating system, and application software of these host systems are designed and manufactured by others. SanDisk makes no claim with regard to the Year 2000 readiness of host systems designed by others in which SanDisk's products are used. Independent system designers make derivative works from the SanDisk Host Developer's Toolkit ("Toolkit") source code product. Sample date related subroutines and data structures are included in the Toolkit for use by system designers. Designers modify the sample routines in order to fit the specific requirements of their host operating system. The designer is responsible for the formatting and processing logic associated with the date values that pass through the Toolkit subsystem and for the Year 2000 readiness of the systems in which the Toolkit is used. SanDisk makes no claims with regard to the Year 2000 readiness of host firmware and operating systems designed by others that contain derivative works of the Host Developer's Toolkit.

The Year 2000 remediation of the Company's transaction processing systems was completed with the installation and testing of the Company's new management information system in the fourth quarter of 1998. The new system is a commercially available, fully integrated MRP II (Materials Requirement Planning and Accounting system) software application. This system is used for Accounting, Order Processing, Planning, Inventory Control, Shop Floor Control and

Distribution.

The assessment and remediation of Year 2000 problems in tertiary business information systems is on-going. Well over 90% of the Company's investment in desktop PC hardware is known to be Year 2000 compliant, and proven remediation solutions have been identified for the remaining 10%. The majority of the software used on these systems and network servers are recent versions of vendor supported, commercially available products. Upgrading these applications as Year 2000 compliant patches are released by the respective vendors has not been a significant burden on the Company and is expected to be completed before the end of 1999.

The assessment of Year 2000 problems in computer systems used for facilities control, machine control, and manufacturing testing is complete, and remediation is on-going. The most significant Year 2000 issue in this area has been found to be related to older wafer test equipment. This equipment is not expected to be in use in the year 2000. The Company is phasing in new Year 2000 compliant wafer test equipment in conjunction with the introduction of new generations of flash memory.

The Company has begun its assessment of Year 2000 risks related to suppliers, customers and other third parties. Inquiries will be made of all critical suppliers and an assessment made of their Year 2000 readiness. SanDisk will also contact its significant customers regarding their Year 2000 readiness in order to understand the

potential for any disruptions in their ordering patterns. Completion of this review will depend on the responsiveness of the Company's vendors and customers, over which the Company has no control.

Year 2000 Risk Management Program Costs. The cost of the Year 2000 project related to upgrading the Company's core management information system was approximately $1.0 million, $400,000 of which was related to the purchase of software and hardware which was capitalized by the Company. The Company estimates it will cost an additional $250,000 to upgrade application software and replace non-compliant personal computer systems. The Company would have incurred the majority of these costs, in spite of Year 2000 issues, due to the need to upgrade its management information system, application software and personal computers to support the Company's growth. The Company's Year 2000 remediation projects will be funded from operating cash flows. No material projects have been deferred in order to complete the Company's Year 2000 assessment and remediation projects. The additional expenses related to the management of the Year 2000 compliance program and completing the assessment of the Company's internal and external risks are not expected to be material to the Company's quarterly operating results.

The costs and time schedule for the Year 2000 problem abatement are based on management's best estimates for the remediation of Year 2000 problems uncovered to date. These estimates were derived utilizing numerous assumptions, including that the most significant Year 2000 risks have already been identified, that certain resources will continue to be available, that third party plans will be fulfilled, and other factors. However, there can be no guarantee that these estimates will be achieved or that the anticipated time schedule will be met and actual results could differ materially from those anticipated.

Contingency Plans. Specific contingency plans for systems that pose significant risk to on-going operations are being developed under the auspices of the Company's Year 2000 Risk Management program. Should previously undetected Year 2000 problems be found in other systems, these systems will either be upgraded, replaced, turned off, or operated in place with manual procedures to compensate for their deficiencies. While the Company believes that these alternative plans would be adequate to meet the Company's needs without materially impacting its operations, there can be no assurance that such alternatives would be successful or that the Company's results of operations would not be materially adversely affected by the delays and inefficiencies inherent in conducting operations in this manner.

Risks Related to Year 2000 Readiness. Success of the Company's Year 2000 compliance efforts depend, in part, on the success of its key suppliers and customers in dealing with their Year 2000 issues. The Company does not have any control over the remediation efforts of its key suppliers and customers and is not aware of the extent to which they have resolved their Year 2000 compliance issues. The Company currently purchases several critical components from single or sole source vendors. Disruptions in the supply of components from any of these sole source suppliers due to Year 2000 issues, could cause delays in the Company's fulfillment of customer orders which could result in reduced or lost revenues. Furthermore, the Company's sales have historically been to a limited number of customers. Any disruption in the purchasing patterns of these customers or potential customers due to Year 2000 issues could cause a decline in the Company's revenues. There can be no assurance that the Company and its

key suppliers and customers will identify and remediate all significant Year 2000 problems on a timely basis. Furthermore, there can be no assurance that the Company's insurance will cover losses from business interruptions arising from Year 2000 problems of the Company or its suppliers. Year 2000 compliance problems of the Company's key suppliers and customers could adversely affect the Company's, business, financial condition and results of operations.

The foregoing statements regarding the Company's Year 2000 readiness are based upon management's best estimates at the present time, which were derived utilizing assumptions regarding future events, including the continued availability of certain resources, third party modification plans and other factors. There can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, the nature and amount of programming required to upgrade or replace each of the affected programs, the rate and magnitude of related labor and consulting costs and the success of the Company's external customers and suppliers in addressing the Year

2000 issue. The Company's evaluation is on-going and it expects that new and different information will become available to it as the evaluation continues. Consequently, there is no guarantee that all material elements will be Year 2000 ready in time.

RESULTS OF OPERATIONS

Product Revenues. SanDisk's product revenues declined 2% to $103.2 million in 1998 from $105.7 million in 1997. The decrease consisted of an increase in unit shipments of 34% which was offset by a decline in average selling prices of 28%. Fiscal year 1997 product revenues increased 18% from $89.6 million in 1996. The increase of $16.1 million consisted of a 146% increase in units shipped offset by a 51% decline in average selling prices.

In 1998 and 1997, the largest increase in unit volume came from sales of CompactFlash products, primarily for use in digital cameras and other consumer electronics applications. CompactFlash products represented approximately 68% of all units shipped and 50% of product revenues in 1998 compared to 73% of all units shipped and 49% of product revenues in 1997. In 1997, the Company experienced a significant shift in product mix from PCMCIA flash cards to CompactFlash cards, which have lower capacities. This contributed to the decline in average selling prices in 1997. The Company anticipates that lower capacity products will continue to represent a significant portion of its sales as consumer applications such as digital cameras become more popular. Sales of these lower capacity products generally have lower average selling prices and gross margins than higher capacity products. The mix of products sold varies from quarter to quarter and may vary in the future, affecting the Company's overall average selling prices and gross margins.

The Company has experienced and expects to continue to experience seasonality in its product sales. Due to the shift in product mix towards CompactFlash products which are sold primarily for consumer electronics applications, the Company expects that its product sales will be increasingly impacted by seasonal purchasing patterns, with higher sales in the second half of each year as compared to the first half of each such year. In the past, the Company has experienced a reduction in order quantities in the first quarter from Japanese OEM customers, reflecting the fact that most customers in Japan operate on a fiscal year ending in March and prefer to delay purchases until the beginning of their next fiscal year. In addition, the effects of the Asian economic crisis on the Company's revenues is uncertain. The Company's ability to adjust its operating expenses is limited in the short term due to a number of factors described herein and in "Factors That May Affect Future Results." As a result, if product revenues are lower than anticipated, the Company's results of operations will be adversely affected. SanDisk's backlog at the end of 1998 was $13.4 million, compared to $18.6 million in 1997 and $5.8 million in 1996. See "Item 1: Business - Factors That May Affect Future Results - Our Operating Results May Fluctuate Significantly" and "There is Seasonality in Our Business."

License and Royalty Revenues. The Company currently earns patent license fees and royalties under six cross-license agreements with Hitachi, Intel, Sharp, Samsung, SST and Toshiba. License and royalty revenue from patent cross-license agreements was $32.6 million in 1998, up from $19.6 million in 1997, and $8.0 million in 1996. The increase in license and royalty revenues in 1998 was partially due to the recognition of a full year of revenues under the Hitachi, Toshiba and Samsung agreements, which were entered into in the third quarter of 1997. Revenues from licenses and royalties increased to 24% of total revenues in 1998 from 16% in 1997 from and 8% in 1996.

Gross Profits. In fiscal 1998, gross profits increased to $55.5 million, or 40.8% of total revenues, from $53.0 million, or 42.3% of total revenues in 1997,

and $38.9 million, or 39.8% of total revenues in 1996. In 1998 and 1997, the growth in overall gross profits resulted from an increase in license and royalty revenues, which was partially offset by a decline in gross profit from product sales. Product gross profits declined as a percentage of product revenues to 22.2% in 1998 compared to 31.6% in 1997 and 34.5% in 1996. The decline in 1998 was primarily due to competitive pricing pressures. The decline in 1997 was primarily due to the shift in product mix to CompactFlash products that have lower average selling prices and gross margins than the Company's FlashDisk products. This decline was partially offset by cost reductions related to the Company's shift to in-house assembly and test. The Company anticipates that lower capacity products will continue to represent a significant portion of its sales as consumer applications such as digital cameras become more popular. The Company is currently working on

many cost reduction programs to strengthen product gross margins in 1999. There can be no assurance that the Company will be successful in these efforts. Also, increased competition may negatively affect gross margins in 1999.

Research and Development. Research and development expenses consist principally of salaries and payroll related expenses for design and development engineers, prototype supplies and contract services. Research and development expenses increased to $18.2 million in 1998 from $13.6 million in 1997 and $10.2 million in 1996. As a percentage of revenues, research and development expenses represented 13.4% in 1998, 10.8% in 1997, and 10.4% in 1996. In 1998 and 1997, the increase in research and development expenses was primarily due to an increase in salaries and payroll-related expenses associated with additional personnel. Increased depreciation due to capital equipment additions and higher project related expenses also contributed to the growth in research and development expenses in both years. The Company expects research and development expenses to continue to increase, in absolute dollars and perhaps as a percentage of revenue, to support the development of new generations of flash data storage products.

Sales and Marketing. Sales and marketing expenses include salaries, sales commissions, benefits and travel expenses for the Company's sales, marketing, customer service and applications engineering personnel. These expenses also include other selling and marketing expenses, such as independent manufacturer's representative commissions, advertising and tradeshow expenses. Sales and marketing expenses increased to $16.9 million in 1998 from $12.6 million in 1997 and $8.8 million in 1996. The increase in 1998 was primarily due to increased marketing and sales expenses related to the development of the retail channel. Increased salaries and payroll related expenses associated with additional personnel also contributed significantly to the increase in 1998 and 1997. Sales and marketing expenses increased to 12.5% of total revenues in 1998 compared to 10.0% in 1997 and 9.0% in 1996 primarily due to increased marketing expenses related to the development of the retail channel. The Company expects sales and marketing expenses to increase as sales of its products grow and as it further develops the retail channel for its products.

General and Administrative. General and administrative expenses include the cost of the Company's finance, information systems, human resources, shareholder relations, legal and administrative functions. General and administrative expenses were $7.5 million in 1998 compared to $7.1 million in 1997 and $7.4 million in 1996. The increase in 1998 was primarily due to increased consulting expenses related to the implementation of the Company's new management information system and an increase in bad debt expense. The decrease in 1997 was primarily due to a decrease in legal fees which was partially offset by increased salaries and payroll related expenses associated with increased personnel, higher recruiting expenses, increased allowance for doubtful accounts and higher consulting expenses. General and administrative expenses represented 5.5% of total revenues in 1998 compared to 5.7% of revenues in 1997, and 7.6% in 1996. The Company expects general and administrative expenses to increase as the general and administrative functions grow to support the overall growth of the Company. General and administrative expenses could also increase substantially in the future if the Company pursues litigation to defend its patent portfolio. See "Factors That May Affect Future Results - Risks Associated with Patents, Proprietary Rights and Related Litigation."

Interest and Other Income, Net. Interest and other income, net, was $5.7 million in 1998, $3.7 million in 1997, and $3.2 million in 1996. The increase in 1998 is primarily due to higher investment balances as a result of the investment of proceeds from the sale of common stock in the Company's November 1997 follow on public offering.

Provision for Income Taxes. The Company's 1998, 1997, and 1996 effective tax rates were approximately 36.0%, 15.0%, and 7.3% respectively. The Company's 1998 tax rate is substantially higher than its 1997 rate due to the utilization of all remaining federal and state tax credit carryforwards in 1997. The Company's 1997 effective tax rate is substantially higher than its 1996 rate due to the utilization of all remaining federal net operating loss carryforwards in 1996.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 1998, the Company had working capital of $138.5 million, which included $15.4 million in cash and cash equivalents and $119.1 million in short-term investments. The Company has a line of credit facility with a commercial bank under which it can borrow up to $10.0 million at the bank's prime rate. This line of credit facility expires in July 1999. As of December 31, 1998, the Company had $1.0 million committed under the line of credit facility for standby letters of credit. The facility contains covenants that require the Company to maintain certain financial ratios and levels of net worth, and prohibits the payment of cash dividends to stockholders. The Company is currently in compliance with all covenants in the line of credit agreement. The Company intends to either renew its line of credit or negotiate a new line of credit upon the expiration of its current line.

Operating activities provided $13.4 million of cash in 1998 primarily from net income, a reduction in inventory of $6.7 million and an increase in other accrued liabilities of $1.5 million, which were partially offset by a decrease in accounts payable of $7.2 million and an increase in prepaid and other assets of $5.3 million. Cash provided by operations was $26.8 million in 1997 and $13.4 million in 1996.

Net cash used in investing activities of $23.0 million in 1998 consisted of a second investment in the USIC foundry of $10.9 million, $7.5 million of capital equipment purchases and net purchases of investments of $4.6 million. In 1997 net cash used in investing activities of $108.9 million consisted of net purchases of investments of $59.0 million, an investment of $40.3 in the USIC foundry and $9.6 million of capital equipment purchases. In 1996, cash used for investing purposes of $22.2 million included net purchases of short term investments of $13.8 million and capital equipment purchases of $8.4 million.

During 1998, cash provided by financing activities of $4.2 million was primarily from the sale of common stock through the SanDisk stock option and employee stock purchase plans. Financing activities provided $83.7 million of cash in 1997, primarily from the sale of common stock in the Company's November 1997 follow on public offering and $0.8 million in 1996 primarily from the sale of common stock through the SanDisk stock option and employee stock purchase plans.

Depending on the demand for the Company's products, the Company may decide to make additional investments, which could be substantial, in assembly and test manufacturing equipment or foundry capacity to support its business in the future. Management believes the existing cash and cash equivalents, short-term investments and available line of credit will be sufficient to meet the Company's currently anticipated working capital and capital expenditure requirements for the next twelve months.

IMPACT OF CURRENCY EXCHANGE RATES

The Company currently purchases wafers from Matsushita under purchase contracts denominated in Japanese Yen. A portion of the Company's revenues are also denominated in Japanese Yen. Foreign exchange exposures arising from the Company's Japanese Yen denominated commitments and related accounts payable are offset to the extent the Company has Japanese Yen denominated accounts receivable and cash balances. To the extent such foreign exchange exposures are not offset, the Company enters into foreign exchange forward contracts to hedge against changes in foreign currency exchange rates. At December 31, 1998, one forward contract with a notional amount of $4.3 million was outstanding. Future exchange rate fluctuations could have a material adverse effect on the Company's business, financial condition and results of operations.

Item 7a. Market Risk Disclosure Information

Interest Rate Risk. The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio. The primary objective of the Company's investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in widely diversified short-term investments, consisting primarily of investment grade securities, substantially all of which either mature within the next twelve months or have characteristics of short-term investments. A hypothetical 50

basis point increase in interest rates would result in an approximate $390,000 (less than 0.4%) in the fair value of the Company's available-for-sale

securities.

Foreign Currency Risk. The Company enters into foreign exchange contracts to reduce the impact of currency fluctuations on firm purchase order commitments for inventory. Gains and losses on these foreign currency investments would generally be offset by corresponding losses and gains on the related hedging instruments, resulting in negligible net exposure to the Company. A substantial majority of the Company's revenue, expense and capital purchasing activity are transacted in U.S. dollars. However, the Company does enter into transactions in other currencies, primarily the Japanese Yen. To protect against reductions in value and the volatility of future cash flows caused by changes in foreign exchange rates, the Company has established a hedging program. Currency forward contracts are utilized in these hedging programs. The Company's hedging programs reduce, but do not always entirely eliminate, the impact of foreign currency exchange rate movements. An adverse change of 10% in exchange rates would result in a decline in income before taxes of approximately $431,000.

All of the potential changes noted above are based on sensitivity analyses performed on the Company's financial positions at December 31, 1998.

ITEM 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SANDISK CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

Contents

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
SanDisk Corporation

We have audited the accompanying consolidated balance sheets of SanDisk Corporation as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SanDisk Corporation at December 31, 1998 and 1997 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Ernst & Young LLP

SanDisk Corporation
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

December 31,	1998	1997
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,384	$ 20,888
Short-term investments	119,074	114,037
Accounts receivable, net of allowance for doubtful accounts of $1,069 in 1998 and $756 in 1997	20,400	19,352
Inventories	8,922	15,648
Deferred tax assets	15,900	17,060
Prepaid expenses and other current assets	6,694	1,406
Total current assets	186,374	188,391
Property and equipment, net	17,542	15,892
Investment in foundry	51,208	40,284
Deposits and other assets	617	900
Total assets	$ 255,741	$ 245,467
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,938	$ 14,111
Accrued payroll and related expenses	3,768	4,674
Income taxes payable	4,668	3,812
Other accrued liabilities	5,077	3,529
Deferred revenue	27,452	27,967
Total current liabilities	47,903	54,093
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value Authorized shares: 4,000,000 Issued: none	-	-
Common stock, $0.001 par value Authorized shares: 40,000,000 Issued and outstanding: 26,628,110 in 1998 and 25,865,229 in 1997	27	26
Capital in excess of par value	186,093	181,895
Retained earnings	21,247	9,411
Accumulated other comprehensive income	471	42
Total stockholders' equity	207,838	191,374
Total liabilities and stockholders' equity	$ 255,741	$ 245,467

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

SanDisk Corporation
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

Years Ended December 31,	1998	1997	1996
Revenues			
Product	$ 103,190	$ 105,675	$ 89,599
License and royalty	32,571	19,578	8,000
Total revenues	135,761	125,253	97,599
Cost of revenues	80,311	72,280	58,707
Gross profits	55,450	52,973	38,892

Operating expenses			
Research and development	18,174	13,577	10,181
Sales and marketing	16,933	12,568	8,792
General and administrative	7,533	7,148	7,445
Total operating expenses	42,640	33,293	26,418
Operating income	12,810	19,680	12,474
Interest and other income, net	5,681	3,660	3,154
Interest expense	-	-	(3)
Income before taxes	18,491	23,340	15,625
Provision for income taxes	6,655	3,501	1,140
Net income	$ 11,836	$ 19,839	$ 14,485
Net income per share			
Basic	$ 0.45	$ 0.87	$ 0.65
Diluted	$ 0.43	$ 0.79	$ 0.60
Shares used in computing net income per share			
Basic	26,298	22,880	22,162
Diluted	27,672	24,970	24,206

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

SanDisk Corporation
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)
<TABLE>
<CAPTION>

	Shares	Common Stock Amount	Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at December 31, 1995	22,005	$ 22	$ 97,272	$ (24,913)	$ -	$ 72,381
Net income	-	-	-	14,485	-	14,485
Unrealized gain on available for sale securities	-	-	-	-	5	5
Comprehensive income						14,490
Exercise of stock options for cash	168	-	95	-	-	95
Issuance of stock pursuant to employee stock purchase plan	92	-	783	-	-	783
Exercise of common stock warrants	62	-	-	-	-	-
Income tax benefit from stock options exercised	-	-	61	-	-	61
Balance at December 31, 1996	22,327	22	98,211	(10,428)	5	87,810
Net income	-	-	-	19,839	-	19,839
Unrealized gain on available for sale securities	-	-	-	-	37	37
Comprehensive income						19,876
Exercise of stock options for cash	357	1	583	-	-	584
Issuance of stock pursuant to employee stock purchase plan	126	-	1,189	-	-	1,189
Exercise of common stock warrants	55	-	-	-	-	-
Sale of common stock, net of issuance costs	3,000	3	79,414	-	-	79,417
Income tax benefit from stock options exercised	-	-	2,498	-	-	2,498
Balance at December 31, 1997	25,865	26	181,895	9,411	42	191,374
Net income	-	-	-	11,836	-	11,836
Unrealized gain on available for sale securities	-	-	-	-	429	429
Comprehensive income						12,265
Exercise of stock options for cash	630	-	930	-	-	930
Issuance of stock pursuant to						

employee stock purchase plan	130	1	1,474	-	-	1,475
Exercise of common stock warrants	3	-	-	-	-	-
Income tax benefit from stock options exercised	-	-	1,761	-	-	1,761
Compensation expense related to modification of stock options	-	-	33	-	-	33
Balance at December 31, 1998	26,628	$ 27	$ 186,093	$ 21,247	$ 471	$ 207,838

</TABLE>

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

SanDisk Corporation
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
<TABLE>
<CAPTION>

Years Ended December 31,	1998	1997	1996
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net income	$ 11,836	$ 19,839	$ 14,485
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	5,839	3,985	2,347
Deferred tax	1,160	(16,055)	(1,000)
Compensation related to modification of stock option terms	33	-	-
Changes in assets and liabilities:			
Accounts receivable	(1,048)	(7,467)	(3,457)
Inventory	6,726	(6,018)	781
Prepaid expenses and other current assets	(5,288)	(1,122)	(250)
Deposits and other assets	283	(9)	(271)
Accounts payable	(7,174)	6,516	(1,458)
Accrued payroll and related expenses	(906)	1,817	911
Income taxes payable	856	1,997	1,441
Other accrued liabilities	1,548	990	149
Deferred revenue	(515)	22,315	(253)
Total adjustments	1,514	6,949	(1,060)
Net cash provided by operating activities	13,350	26,788	13,425
Cash flows from investing activities:			
Purchases of short-term investments	(137,822)	(148,954)	(47,977)
Proceeds from short-term investments	133,214	89,919	34,157
Acquisition of property and equipment	(7,489)	(9,592)	(8,378)
Investment in foundry	(10,923)	(40,284)	-
Net cash used in investing activities	(23,020)	(108,911)	(22,198)
Cash flows from financing activities:			
Sale of common stock and warrants, net of repurchases	4,166	83,688	939
Principal payments under capital leases	-	-	(98)
Net cash provided by financing activities	4,166	83,688	841
Net increase (decrease) in cash and cash equivalents	(5,504)	1,565	(7,932)
Cash and cash equivalents at beginning of year	20,888	19,323	27,255
Cash and cash equivalents at end of year	$ 15,384	$ 20,888	$ 19,323
Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	$ -	$ -	$ 3
Cash paid for income taxes	$ 8,277	$ 15,172	$ 451

</TABLE>

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

NOTE 1: ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations

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

Supplier and Customer Concentrations

A limited number of customers historically have accounted for a substantial portion of the Company's revenues. In 1998, one customer accounted for more than 10% of the Company's total revenues. In 1997, no single customer accounted for greater than 10% of total revenues. During 1996, one customer accounted for approximately 26% of the Company's total revenues. Sales of the Company's products will vary as a result of fluctuations in market demand. Further, the flash data storage markets in which the Company competes are characterized by rapid technological change, evolving industry standards, declining average selling prices and rapid technological obsolescence.

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

Under each of the Company's wafer supply agreements, the Company is obligated to provide a monthly rolling forecast of anticipated purchase orders. Except in limited circumstances and subject to acceptance by the foundries, the estimates for the first three months of each forecast constitute a binding commitment and the estimates for the remaining months may not increase or decrease by more than a certain percentage from the previous month's forecast. These restrictions limit the Company's ability to react to significant fluctuations in demand for its products. As a result, the Company has not been able to match its purchases of wafers to specific customer orders, and therefore the Company has taken write downs for potential excess inventory purchased prior to the receipt of customer orders and may be required to do so in the future. These adjustments decrease gross margins in the quarter reported and have resulted, and could in the future result in fluctuations in gross margins on a quarter to quarter basis. To the extent the Company inaccurately forecasts the number of wafers required, it may have either a shortage or an excess supply of wafers, either of which could have a material adverse effect on the Company's business, financial condition and results of operations. Additionally, if the Company is unable to obtain scheduled quantities of wafers from any foundry with acceptable yields, the Company's business, financial condition and results of operations could be negatively impacted.

In additiona, certain key components, are purchased from single source vendors for which alternative sources are currently not available. Shortages could occur in these essential materials due to an interruption of supply or increased demand in the industry. If the Company were unable to procure certain of such materials, it would be required to reduce its manufacturing operations which could have a material adverse effect upon its results of operations.

Use of Estimates

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

Basis of Presentation

The Company's fiscal year ends on the Sunday closest to December 31. Fiscal year 1998 ended on December 27, 1998. Fiscal years 1997 and 1996 ended on

December 28, 1997 and December 29, 1996, respectively. For ease of presentation, the accompanying financial statements have been shown as ending on the last day of the calendar month.

Principles of Consolidation

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

Foreign Currency Transactions

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

Reclassifications

Certain reclassifications, none of which affected net income, have been made to prior year's amounts to conform to the current year's presentation.

Cash Equivalents and Short-Term Investments

Cash equivalents consist of short-term, highly liquid financial instruments with insignificant interest rate risk that are readily convertible to cash and have maturities of three months or less from the date of purchase. Cash equivalents and short-term investments consist of money market funds, taxable commercial paper, certificates of deposit, U.S. government agency obligations, corporate / municipal notes and bonds with high-credit quality, money market preferred stock and auction rate preferred stock. The fair market value, based on quoted market prices, of cash equivalents and short-term investments is substantially equal to their carrying value at December 31, 1998 and 1997.

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

All cash equivalents and short-term investments as of December 31, 1998 and 1997 are classified as available-for-sale securities and consist of the following:

	December 31, 1998	December 31, 1997
	(In thousands)	
Cash equivalents:		
Money market fund	$ 1,389	$ 115
Commercial paper	9,178	2,000
Municipal notes	-	5,800
U.S. government agency obligations	-	694
Corporate notes / bonds	2,251	1,650
Total	$ 12,818	$ 10,259
Short term investments:		
U.S. government agency obligations	$ -	$ 7,463
Municipal notes / bonds	91,073	54,059
Corporate notes / bonds	12,550	24,429
Money market preferred stock	-	4,000
Certificates of deposit	-	4,036
Auction rate preferred stock	15,451	20,050
Total	$ 119,074	$ 114,037

Unrealized holding gains and losses on available-for-sale securities at December 31, 1998 and 1997 were $471,000 and $42,000, respectively. Gross realized gains and losses on sales of available-for-sale securities during the years ended December 31, 1998 and 1997 were immaterial.

Debt securities at December 31, 1998 and 1997, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers of the securities may have the right to prepay obligations.

	December 31, 1998	1997
Short-term investments:	(In thousands)	
Due in one year or less	$ 93,983	$ 68,937
Due after one year through two years	25,091	45,100
Total	$119,074	$114,037

Inventories

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

	December 31, 1998	1997
	(In thousands)	
Raw materials	$ 2,710	$ 3,289
Work-in-process	3,818	10,340
Finished goods	2,394	2,019
	$ 8,922	$15,648

Given the volatility of the market, the Company makes inventory provisions for potentially excess and obsolete inventory based on backlog and forecasted demand. However, backlog is subject to revisions, cancellations and

rescheduling. Actual demand may differ from forecasted demand and such differences may have a material effect on the Company's financial position and results of operations.

Property and Equipment

Property and equipment consist of the following:

	December 31, 1998	1997
	(in thousands)	
Machinery and equipment	$ 30,008	$ 23,919
Software	3,413	2,450
Furniture and fixtures	1,173	875
Leasehold improvements	2,120	1,981
Property and equipment, at cost	36,714	29,225
Accumulated depreciation and amortization	(19,172)	(13,333)
Property and equipment, net	$ 17,542	$ 15,892

Depreciation and Amortization

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

Investment in Foundry

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

Revenue Recognition

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

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

Patent license and royalty revenue is recognized when earned. In 1998 and 1997, the Company received payments under these cross license agreements, portions of which were recognized as revenue and portions of which are deferred revenue. Recognition of deferred revenue is expected to occur in future periods as the Company meets certain obligations as provided in the various agreements.

Net Income Per Share

The Company determines net income per share in accordance with Financial Accounting Stardards Statement 128, Earnings Per Share.

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

	1998	1997	1996
Numerator:			
Numerator for basic and diluted net income per share - net income	$11,836	$19,839	$14,485
Denominator for basic net income per share:			
Weighted average common shares	26,298	22,880	22,162
Shares used in computing basic net income per share	26,298	22,880	22,162
Basic net income per share	$ 0.45	$ 0.87	$ 0.65
Denominator for diluted net income per share:			
Weighted average common shares	26,298	22,880	22,162
Dilutive effect of employee stock options and warrants to purchase common stock	1,374	2,090	2,044
Shares used in computing diluted net income per share	27,672	24,970	24,206
Diluted net income per share	$ 0.43	$ 0.79	$ 0.60

Options and warrants to purchase 901,443; 257,008, and 64,962 shares of common stock in 1998, 1997 and 1996, respectively, have been omitted from the earnings per share calculation, as their effect is antidilutive.

Stock Based Compensation

The Company accounts for employee stock based compensation under APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Pro forma net income and net income per share are disclosures required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," and are included in Note 5.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement 133, Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted in years beginning after June 15, 1999. Because of the Company's minimal use of derivatives, management does not anticipate that the adoption of the new Statement will have a significant effect on earnings or the financial

position of the Company.

NOTE 2: FINANCIAL INSTRUMENTS

Concentration of Credit Risk

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

Off Balance Sheet Risk

In connection with the credit agreement discussed in Note 3, the Company has a foreign exchange contract line in the amount of $15.0 million at December 31, 1998. Under this line, the Company may enter into forward exchange contracts which require the Company to sell or purchase foreign currencies. One forward exchange contract in the amount of $4.3 million was outstanding at December 31, 1998. There were no forward exchange contracts outstanding at December 31, 1997. Foreign currency translation losses of $34,000 were deferred at December 31, 1998 in connection with this forward contract.

Certain of the Company's purchase commitments and balance sheet accounts are denominated in Japanese Yen. Foreign exchange exposures arising from the Company's yen denominated purchase commitments and related accounts payable are mitigated to the extent the Company has yen denominated current assets. To the extent such foreign exchange exposures are not mitigated, the Company enters into foreign exchange contracts to hedge against changes in foreign currency exchange rates. The effects of movements in currency exchange rates on these instruments are recognized when the related operating revenues and expenses are recognized. The impact of movements in currency exchange rates on foreign exchange contracts substantially mitigates the related impact on the underlying items hedged. The Company had net transaction gains (losses) of approximately $412,000, ($7,000) and ($193,000) for the years ended December 31, 1998, 1997 and 1996, respectively. These amounts are included in interest and other income, net, in the statement of income.

Note 3: Line of Credit

The Company has a credit agreement (the Agreement) with a bank, which expires in July 1999 and is collateralized by certain assets of the Company. Under the provisions of the Agreement, the Company may borrow up to $10.0 million on a revolving line of credit at the bank's prime interest rate (7.75% at December 31, 1998). Amounts under the revolving line of credit can be applied to the issuance of letters of credit of up to $10.0 million. At December 31, 1998, $1.0 million in letters of credit were outstanding. In addition, under the Agreement, the Company also has a $15.0 million foreign exchange contract line (see Note 2) under which the Company may enter into forward exchange contracts. No amounts were outstanding under the revolving line of credit portion of the Agreement, and $4.3 million was outstanding under the foreign exchange contract portion of the line at December 31, 1998. The Agreement contains covenants that require the Company to maintain certain financial ratios and levels of net worth. The agreement also does not permit the payment of cash dividends to stockholders. As of December 31, 1998, the Company was in compliance with the covenants. Based on available collateral and outstanding letters of credit, the amount available under the Agreement at
December 31, 1998 was approximately $9.0 million.

Note 4: Commitments and Contingencies

Commitments

The Company leases its headquarters and sales offices under operating leases that expire at various dates through 2001. Future minimum lease payments under operating leases at December 31, 1998 are as follows:

Year Ending December 31, (in thousands)	
1999	$ 1,968
2000	1,733
2001	978

2002	-
2003	-
Thereafter	-
Total	$ 4,679

Rental expense under all operating leases was $1.7 million, $1.3 million and $1.1 million for the years ended December 31, 1998, 1997 and 1996, respectively.

Contingencies

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

To preserve its intellectual property rights, the Company believes it may be necessary to initiate litigation with one or more third parties, including but not limited to those the Company has notified of possible patent infringement. In addition, one or more of these parties may bring suit against the Company. Any litigation, whether as a plaintiff or as a defendant, would likely result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is ultimately determined in favor of the Company.

In March 1998, the Company filed a complaint in federal court against Lexar Media, Inc. ("Lexar") for infringement of a fundamental flashdisk patent. Lexar has disputed the Company's claim of patent infringement, claimed SanDisk's patent is invalid or unenforceable and asserted various counterclaims including unfair competition, violation of the Lanham Act, patent misuse, interference with prospective economic advantage, trade defamation and fraud. SanDisk has denied each of Lexar's counterclaims.

In July 1998, the federal district court denied Lexar's request to have the case dismissed on the grounds the Company failed to perform an adequate prefiling investigation. Discovery in the Lexar suit commenced in August 1998. The claims construction phase commenced in February 1999. The Company intends to vigorously enforce its patents, but there can be no assurance that these efforts will be successful.

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

In October 1995, Samsung Electronics Company Ltd. filed a complaint against the Company in the Northern District of California accusing the Company of infringing two Samsung patents, seeking declaratory relief with respect to five Company patents and alleging unspecified damages for certain other related claims. On January 11, 1996, the Company filed a complaint against Samsung with the United States International Trade Commission alleging that Samsung and its U.S. sales arm, were importing and selling products that infringe two of the

Company's patents. On February 26, 1997, the Administrative Law Judge assigned to the case issued an Initial Determination finding both SanDisk patents valid and infringed and further finding a violation of Section 337 of the Trade Act. On June 2, 1997, the Commission issued a limited exclusion order prohibiting the unlicensed entry of infringing flash memory circuits, and carriers and circuit boards containing such circuits, that are manufactured by or on behalf of Samsung. On August 14, 1997, in connection with the settlement of all disputes between them, the Company and Samsung announced the signing of a patent cross-license agreement for flash memory related patents. Under the agreement, the Company and Samsung have licensed each others patents covering the design and manufacture of flash memory products.

From time to time the Company agrees to indemnify certain of its suppliers and customers for alleged patent infringement. The scope of such indemnity varies but may in some instances include indemnification for damages and expenses, including attorneys fees. The Company may from time to time be engaged in litigation as a result of such indemnification obligations. Third party

claims for patent infringement are excluded from coverage under the Company's insurance policies. There can be no assurance that any future obligation to indemnify the Company's customers or suppliers, will not have a material adverse effect on the Company's business, financial condition and results of operations.

Litigation frequently involves substantial expenditures and can require significant management attention, even if the Company ultimately prevails. In addition, the results of any litigation matters are inherently uncertain. Accordingly, there can be no assurance that any of the foregoing matters, or any future litigation, will not have a material adverse effect on the Company's business, financial condition and results of operations. See "Item 1: Business - Factors That May Affect Future Results - Risks Associated with Patents, Proprietary Rights and Related Litigation."

NOTE 5: STOCKHOLDERS' EQUITY

Stock Benefit Plan

The 1989 Stock Benefit Plan, in effect through August 1995, comprised two separate programs, the Stock Issuance Program and the Option Grant Program. The Stock Issuance Program allowed eligible individuals to immediately purchase the Company's common stock at a fair value as determined by the Board of Directors. Such shares may be fully vested when issued or may vest over time as determined by the Board of Directors. Under the Option Grant Program, eligible individuals were granted options to purchase shares of the Company's common stock at a fair value, as determined by the Board of Directors, of such shares on the date of grant. The options generally vest over a four-year period, expiring no later than ten years from the date of grant. Unexercised options are canceled upon the termination of employment or services. Options that are canceled under this plan will be available for future grants under the 1995 Stock Option Plan. There were no shares available for option grants under this plan at December 31, 1998.

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

1995 Non-employee Directors Stock Option Plan

In August 1995, the Company adopted the 1995 Non-employee Directors Stock Option Plan (the Directors' Plan). The Company reserved 200,000 shares of common stock for issuance thereunder. Under this plan, automatic option grants are made at periodic intervals to eligible non-employee members of the Board of Directors. Initial option grants vest over a four-year period. Subsequent annual grants vest one year after date of grant. All options granted under the Non-employee Directors Stock Option Plan expire ten years after the date of grant. At December 31, 1998, a total of 136,000 options had been granted at exercise prices ranging from $9.50 to $20.875 per share.

On July 17, 1998, the Board of Directors approved an option cancellation/regrant program. Under the cancellation/regrant program, employees could elect to exchange their stock options with exercise prices in excess of $12.00 per share for new options priced at $10.00 per share, the market price of the Company's common stock on the date of implementation, August 21, 1998. Under the new options, shares become exercisable six to twelve months later than under the old higher-priced options. The new options have a maximum term of ten years from the August 21, 1998, grant date. Officers and directors of the Company were not eligible for participation in the option cancellation/regrant program. Options covering a total of approximately 903,423 shares were canceled and regranted in connection with the program. The number of options shown as granted and canceled in the table below reflect this exchange of options. Such options had a weighted average exercise price before repricing of $20.661, and the new options were granted at an exercise price of $10.00.

A summary of activity under all stock option plans follows:

<TABLE>
<CAPTION>

	Total Available for Future Grant/ Issuance	Total Outstanding	Weighted Average Exercise Price
		(Shares in thousands)	
<S>	<C>	<C>	<C>
Balance at December 31, 1995	1,176	2,458	$2.67
Granted	(922)	922	$12.35

Exercised	-	(168)	$0.57
Canceled	68	(68)	$8.46
Balance at December 31, 1996	322	3,144	$5.49
Increase in authorized shares	2,550	-	
Granted	(912)	912	$20.59
Exercised	-	(358)	$1.63
Canceled	145	(145)	$9.83
Balance at December 31, 1997	2,105	3,553	$9.58
Granted	(2,222)	2,222	$11.94
Exercised	-	(630)	$1.48
Canceled	1,019	(1,019)	$20.08
Balance at December 31, 1998	902	4,126	$9.50

</TABLE>

At December 31, 1998, options outstanding were as follows:

<TABLE>
<CAPTION>

	Options Outstanding			Options Exercisable	
Range of Excercise Prices	Number Outstanding as of December 31, 1998	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable as of December 31, 1998	Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>
$ 0.15 - $ 4.50	648,626	5.45	$1.4472	648,626	$1.4472
$ 6.56 - $ 9.50	707,049	7.30	$7.0006	564,384	$6.8299
$10.00 - $11.63	1,075,555	9.39	$10.1734	116,269	$10.7072
$12.00 - $14.63	1,512,922	9.10	$12.3693	339,935	$12.1688
$17.25 - $21.88	181,975	9.02	$19.9861	58,281	$20.1208
$ 0.15 - $21.88	4,126,127	8.29	$9.4959	1,727,495	$6.5688

</TABLE>

Employee Stock Purchase Plan

In August 1995, the Company adopted the Employee Stock Purchase Plan (the Purchase Plan). The Company has reserved 883,333 shares of common stock for issuance thereunder. Under the Purchase Plan, qualified employees are entitled to purchase shares through payroll deductions at 85% of the fair market value at the beginning or end of the offering period, whichever is lower. As of December 31, 1998, shares issued under the Purchase Plan totaled 347,889.

In April 1997, the stockholders (i) increased the shares available for future issuance under the 1995 Stock Benefit Plan by 2,500,000 shares, (ii) increased the shares available for future issuance under the 1995 Non-Employee Directors Stock Option Plan by 50,000 and (iii) increased the shares available for future issuance under the Employee Stock Purchase Plan by 450,000.

Accounting for Stock Based Compensation

The Company has elected to follow APB 25 and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123 "Accounting for Stock-Based Compensation," requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net income and earnings per share is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of this Statement. For all grants subsequent to December 31, 1994 that were granted prior to the Company's initial public offering in November 1995, the fair value of these options was determined using the minimum value method with a weighted average risk free interest rate of 6.32% and an expected life of 5 years. The fair value for the options granted subsequent to the Company's initial public offering in November 1995 was estimated at the date of grant using a Black-Scholes single option pricing model with the following weighted average assumptions: risk-free interest rates of 4.84%, 6.24%, and 6.23% for 1998, 1997, and 1996,

respectively; a dividend yield of 0.0%, a volatility factor of the expected market price of the Company's common stock of 0.60, 0.655, and 0.588 for 1998, 1997, and 1996, respectively; and a weighted-average expected life of the option of 5 years. The weighted average fair value of those options granted were $6.65, $12.45, and $6.98 for 1998, 1997, and 1996, respectively.

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

Under the 1995 Employee Stock Purchase Plan, the Company is authorized to issue up to 883,333 shares of common stock to participating employees. Under the terms of the Plan, employees can choose to have up to 10% of their annual base earnings withheld to purchase the Company's common stock. The purchase price of the stock is 85% of the lower of the subscription date fair market value and the purchase date fair market value. Approximately 65% of eligible employees have participated in the plan in 1998 and 75% and 86% in 1997 and 1996, respectively. Under the Plan, the Company sold 129,742; 125,797 and 92,350 shares to employees in 1998, 1997 and 1996, respectively. Pursuant to APB 25 and related interpretations, the Company does not recognize compensation cost related to employee purchase rights under the Plan. To comply with the pro forma reporting requirements of SFAS 123, compensation cost is estimated for the fair value of the employees' purchase rights using the Black-Scholes model with the following assumptions for those rights granted in 1998, 1997, and 1996: dividend yield of 0.0%; and expected life of 6 months; expected volatility factor of .65 and 1.02 in 1998, 0.63 and 0.89 in 1997, and 0.588 in 1996; and a risk free interest rate ranging from 5.36% to 6.08%. The weighted average fair value of those purchase

rights granted in February 1996, August 1996, February 1997, August 1997, February 1998 and August 1998 were $2.47, $2.52, $3.42, $4.69, $7.00 and $4.50 respectively.

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

	Years ended December 31,		
	1998	1997	1996
	(in thousands, except per share amounts)		
Pro forma net income	$ 5,178	$ 17,156	$ 13,553
Pro forma net income per share			
Basic	$ 0.20	$ 0.75	$ 0.61
Diluted	$ 0.19	$ 0.69	$ 0.56

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

Shareholder Rights Plan

On April 21, 1997, the Company adopted a shareholder rights plan (the Rights Agreement). Under the Rights Agreement, rights were distributed as a dividend at the rate of one right for each share of common stock of the Company held by stockholders of record as of the close of business on April 28, 1997. The rights will expire on April 28, 2007 unless redeemed or exchanged. Under the Rights Agreement, each right will initially entitle the registered holder to buy one one-hundredth of a share of Series A Junior Participating Preferred Stock for $65.00. The rights will become exercisable only if a person or group (other than Seagate Technology, Inc., which is permitted to maintain its 25 percent stake in the Company) acquires beneficial ownership of 15 percent or more of the Company's common stock or commences a tender offer or exchange offer upon consummation of which such person or group would beneficially own 15 percent or more of the Company's common stock.

Warrants

The Company has periodically granted warrants in connection with the sale of its stock and certain lease and bank agreements. The Company has the following

warrants outstanding to purchase capital stock at December 31, 1998:

Issuance Date	Capital Stock	Number of Shares	Price Per Share	Expiration Date
May 1990	Common	12,094	$6.615	November 2000
June 1991	Common	6,666	$6.615	November 2000
November 1991	Common	13,363	$6.615	November 2000

During 1998, the Company issued 3,010 shares of common stock for no proceeds in the net issuance of shares upon the exercise of 3,788 warrants with an exercise price of $3.30 per share.

Note 6: Retirement Plan

Effective January 1, 1992, the Company adopted a tax-deferred savings plan, the SanDisk 401(k) Plan, for the benefit of qualified employees. The plan is designed to provide employees with an accumulation of funds at retirement. Qualified employees may elect to make contributions to the plan on a monthly basis. The Company may make annual contributions to the plan at the discretion of the Board of Directors. No contributions were made by the Company for the years ended December 31, 1998, 1997 and 1996.

Note 7: Income Taxes

The provision for income taxes consists of the following:

	December 31,		
	1998	1997	1996
	(in thousands)		
Current:			
Federal	$ 1,413	$12,131	$ 1,701
State	651	2,662	42
Foreign	2,936	5,263	397
	5,000	20,056	2,140
Deferred:			
Federal	1,305	(13,205)	(1,000)
State	350	(3,350)	-
	1,655	(16,555)	(1,000)
Provision for income taxes	$ 6,655	$ 3,501	$ 1,140

The tax benefits associated with stock options reduces taxes currently payable as shown above by $1,761,000, $2,498,000 and $61,000 in 1998, 1997 and 1996, respectively. Such benefits are credited to capital in excess of par when realized.

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

	December 31,		
	1998	1997	1996
Tax at U.S. statutory rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	3.5	(1.9)	-
Operating losses utilized	-	-	(17.4)
Research credit	(1.9)	(3.8)	(5.6)
Valuation allowance	-	(14.9)	(8.0)
Foreign taxes in excess of U.S. rate	-	0.4	2.1
Other individually immaterial items	5.5	0.2	1.2
Tax exempt interest income	(6.1)	-	-
	36.0%	15.0%	7.3%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Significant components of

the Company's deferred tax assets as of December 31, 1998 and 1997 are as follows:

	December 31, 1998	1997
	(In thousands)	
Deferred tax assets:		
Inventory reserves	$ 2,700	$ 3,338
Deferred revenue	10,300	9,913
Accruals and reserves	2,900	3,970
Other	-	334
Total deferred tax assets	$15,900	$17,555

Note 8: Related Party Transactions

In January 1993, the Company entered into a joint cooperation agreement with a stockholder. Under the terms of the agreement, the stockholder had a nonexclusive right to distribute flash memory products produced by the Company. There were no revenues attributable to this agreement in 1998, 1997 and 1996. The agreement was terminated by consent of both parties in 1998.

The Company has invested $51.2 million in United Silicon, Inc., a semiconductor manufacturing subsidiary of United Microelectronics Corporation in Taiwan. The transaction gives the Company an equity stake of approximately 10% in the facility (which is accounted for on the cost basis) and guarantees access to approximately 12.5% of the wafer output from the facility. In 1998, the Company purchased wafers from USIC totaling approximately $11.6 million.

Note 9: Segment Information

The Company adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, in fiscal 1998. SFAS No. 131 supersedes SFAS No. 14, Financial Reporting for Segments of a Business Enterprise and establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in deciding how to allocate resources and in assessing performance.

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

Geographic Information: Information regarding geographic areas for the years ended December 31, 1998, 1997 and 1996 are as follows:

	Years Ended December 31, (In thousands)		
Revenues:	1998	1997	1996
United States	$ 60,113	$ 53,820	$43,999
Japan	46,276	51,677	43,947
Europe	9,810	10,774	5,339
Other foreign countries	19,562	8,982	4,314
Total	$135,761	$125,253	$97,599

Long Lived Assets:	1998	1997	1996
United States	$ 16,779	$ 15,422	$ 9,932
Japan	445	246	130
Europe	9	3	2
Other foreign countries	51,517	40,505	221
Total	$ 68,750	$ 56,176	$10,285

Revenues are attributed to countries based on the location of the customers. Long lived assets in other foreign countries includes the investment in USIC of

$51.2 million in 1998 and $40.3 million in 1997.

Major Customers

In 1998, revenues from one customer represented approximately $14.0 million of consolidated revenues. In 1997, there were no customers who accounted for more than 10% of total revenue. In 1996, revenues from one customer represented approximately $25.1 million of consolidated revenues.

Note 10: Accumulated Other Comprehensive Income

As of January 1, 1998, the Company adopted Statement No. 130, Reporting Comprehensive Income. Statement 130 establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company's net income or shareholders' equity. Statement 130 requires unrealized gains or losses on the Company's available-for-sale securities, which prior to adoption were reported separately in shareholders' equity, to be included in other comprehensive income. Comprehensive income consists of net income and other comprehensive income. Prior year financial statements have been reclassified to conform to the requirements of Statement 130.

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

	1998	1997	1996
		(in thousands)	
Accumulated other comprehensive income at beginning of year:			
Unrealized gain	$ 42	$ 5	$ -
Change of accumulated other comprehensive income during the year			
Unrealized gain on available-for-sale securities	$ 429	$ 37	$ 5
Accumulated other comprehensive income at year end	$ 471	$ 42	$ 5

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

Item 10. Directors and Executive Officers of the REGISTRANT

Directors. Reference is made to the information regarding directors appearing under the caption "Election of Directors" on pages 6 - 8 of the Company's definitive Proxy Statement dated March 24, 1999 for its Annual Meeting of Stockholders (the Proxy Statement), which information is incorporated in this Form 10-K by reference. Information regarding executive officers is set forth under "Executive Officers of the Registrant" in Part I of this 10-K.

Item 11. Executive Compensation

The information required by this item is set forth under "Executive Compensation and Related Information" in the Company's Proxy Statement for the Annual Meeting of Stockholders, which is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

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The information required by this item is set forth under "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement for the Annual Meeting of Stockholders, which is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item is set forth under "Compensation Committee Interlocks and Insider Participation" and "Certain Transactions" in the Company's Proxy Statement for the Annual Meeting of Stockholders, which is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report

1) All financial statements

2) Financial statement schedules

All other schedules have been omitted because the required information is not present or not present in amounts sufficient to require submission of the schedules, or because the information required is included in the consolidated financial statements or notes thereto.

3) Exhibits required by Item 601 of Regulation S-K

Exhibit Number	Exhibit Title
3.1	Certificate of Incorporation of the Registrant, as amended to date./2/
3.2	Form of Amended and Restated Certificate of Incorporation of the Registrant./2/
3.3	Bylaws of the Registrant, as amended./2/
3.4	Form of Amended and Restated Bylaws of the Registrant /2/
3.5	Certificate of Designation for the Series A Junior Participating Preferred Stock, as filed with the Delaware Secretary of State on April 24, 1997./4/
4.1	Reference is made to Exhibits 3.1, 3.2, 3.3 and 3.4./2/
4.3	Amended and Restated Registration Rights Agreement, among the Registrant and the investors and founders named therein, dated March 3, 1995./2/
4.5	Series F Preferred Stock Purchase Agreement between Seagate Technology, Inc. and the Registrant, dated January 15, 1993./2/
4.8	Rights Agreement, dated as of April 18, 1997, between the Company and Harris Trust and Savings Bank./4/
9.1	Amended and Restated Voting Agreement, among the Registrant and the investors named therein, dated March 3, 1995./2/
10.10	License Agreement between the Registrant and Dr. Eli Harari, dated September 6, 1988./2/
10.13	1989 Stock Benefit Plan./2/
10.14	1995 Stock Option Plan./2/
10.15	Employee Stock Purchase Plan./2/
10.16	1995 Non-Employee Directors Stock Option Plan./2/
10.18	Lease Agreement between the Registrant and G.F. Properties, dated March 1, 1996./3/

10.21 Amendment to Lease Agreement between the Registrant and G.F. Properties,

dated April 3, 1997./5/

10.23 Foundry Venture Agreement between the Registrant and United Microelectronics Corporation, dated June 27, 1997./1, 6/

10.24 Written Assurances Re: Foundry Venture Agreement between the Registrant and United Microelectronics Corporation, dated September 13, 1995./1, 6/

10.25 Side Letter between Registrant and United Microelectronics Corporation, dated May 28, 1997./1, 6/

10.27 Clarification letter with regards to Foundry Venture Agreement between the Registrant and United Microelectronics Corporation dated October 24, 1997./7/

10.28 Lease Agreement between the Registrant and G.F. Properties, dated June 10, 1998./8/

10.29 Trade Finance Agreement between the Registrant and Union Bank of California, dated July 15, 1998./9/

21.1 Subsidiaries of the Registrant.

23.1 Consent of Ernst & Young, LLP, Independent Auditors.

27.1 Financial Data Schedule for the year ended December 31, 1998. (In EDGAR format only)

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1. Confidential treatment granted as to certain portions of these exhibits.
2. Previously filed as an Exhibit to the Registrant's Registration Statement on Form S-1 (No. 33-96298).
3. Previously filed as an Exhibit to the Registrant's 1995 Annual Report on Form 10-K.
4. Previously filed as an Exhibit to the Registrant's Current Report on Form 8-K/A dated April 18, 1997.
5. Previously filed as an Exhibit to the Registrant's Form 10-Q for the quarter ended June 30, 1997.
6. Previously filed as an Exhibit to the Registrant's Current Report on form 8-K dated October 16, 1997.
7. Previously filed as an Exhibit to the Registrant's Form 10-Q for the quarter ended September 30, 1997.
8. Previously filed as an Exhibit to the Registrant's Form 10-Q for the quarter ended June 30, 1998.
9. Previously filed as an Exhibit to the Registrant's Form 10-Q for the quarter ended September 30, 1998.

Consent of Ernst & Young LLP, Independent Auditors

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 33-96298 and No. 333-32039) pertaining to the SanDisk Corporation 1995 Stock Option Plan, 1995 Non-Employee Directors Stock Option Plan and Employee Stock Purchase Plan of SanDisk Corporation of our report dated January 22, 1999, with respect to the consolidated financial statements and schedule of SanDisk Corporation included in this Annual Report (Form 10-K) for the year ended December 31, 1998.

/s/ Ernst & Young LLP

San Jose, California
March 24, 1999

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

By: /s/ Cindy L. Burgdorf
Cindy L. Burgdorf
Chief Financial Officer,
Senior Vice President, Finance and
Administration and Secretary

DATED: March 24, 1999

POWER OF ATTORNEY

KNOW ALL PEOPLE BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Dr. Eli Harari and Cindy L. Burgdorf, jointly and severally, his or her attorneys in fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys in fact, or his or her substitute or substitutes, may do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, this Report has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
By: /s/ Dr. Eli Harari (Dr. Eli Harari)	President, Chief Executive Officer and Director	March 24, 1999
By: /s/ Irwin Federman (Irwin Federman)	Chairman of the Board	March 24, 1999
By: /s/ Cindy L. Burgdorf (Cindy L. Burgdorf)	Chief Financial Officer, Senior Vice President, Finance and Administration and Secretary (Principal Financial and Accounting Officer)	March 24, 1999
By: /s/ William V. Campbell (William V. Campbell)	Director	March 24, 1999
By: /s/ Catherine P. Lego (Catherine P. Lego)	Director	March 24, 1999
By: /s/ Dr. James D. Meindl (Dr. James D. Meindl)	Director	March 24, 1999
By: /s/ Thomas F. Mulvaney (Thomas F. Mulvaney)	Director	March 24, 1999
By: /s/ Alan F. Shugart (Alan F. Shugart)	Director	March 24, 1999

SANDISK CORPORATION

SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	* Deductions	Balance at End of Period
Allowance for doubtful accounts:				
Year ended December 31, 1996	$ 593	$ -	$ -	$ 593
Year ended December 31, 1997	$ 593	$ 204	$ 41	$ 756
Year ended December 31, 1998	$ 756	$ 276	$ 32	$ 1,000

*Write offs

Mission Statement

To be the Global Leader in Flash Data Storage

Corporate Profile

SanDisk Corporation designs, manufactures and markets flash memory products that store data, digital images and digital audio in a rapidly growing number of consumer electronics, telecommunications and electronic commerce applications. These flash memory products include removable CompactFlash(TM), MultiMediaCards, FlashDisk PC cards and embedded FlashDrive and Flash ChipSet devices. Today, CompactFlash cards serve as the digital film in more than 70 ditigal cameras and are replacing tape in digital audio recorders. CompactFlash and MultiMediaCards store data in moblie phones and numerous handheld PCs. SanDisk FlashDrives are replacing magnetic disk drives in industrial and telecommunications applications, while Flash ChipSets store data across a wide range of electronic systems. SanDisk's market leadership position is based on its ability to consitently produce state-of-art, low cost, highly reliable flash technology, based on its leading edge memory and conroller designs and advanced system-level integration, packaginig and low-cost system test.

Corporate Milestones

- Flash memory megabytes shipped increased 124% compared to 1997.

- SanDisk expanded the number of retail outlets carrying its products. More than 7,000 stores now carry SanDisk brand products in the United States, Japan and Europe.

- SanDisk began volume production of flash wafers with its foundry partners, USIC and USC in Taiwan.

- SanDisk introduced high capacity CompactFlash cards (96 megabytes in the Type I form factor) and the world's first flash memory card in the new CompactFlash Type II form factor (160 megabytes).

- SanDisk introduced ImageMate CompactFlash readers (parallel port and USB) for quick and easy transport of images from digital cameras to PCs and printers.

- Canon and Lexmark introduced the world's first printers that directly use CompactFlash cards.

- The MultiMediaCard Association was founded by SanDisk and 13 other companies. Membership grew to 40 in 1998.

- Nokia introduced the world's first mobile smart phone that uses the

MultiMediaCard.

- Pontis introduced the world's first MultiMediaCard based portable MP3 music player.

- SanDisk introduced and shipped the first 2.5" and 3.5" FlashDrives.

- SanDisk introduced its 256Mbit (32 megabyte) Flash ChipSet.

Financial Highlights

(bar graphs w/ the following data)

	1994	1995	1996	1997	1998
		(in thousands)			
Revenues	$35,378	$62,839	$97,599	$125,253	$135,761
Working Capital	$20,971	$68,002	$77,029	$134,298	$138,471
Operating Income (Loss)	($4,781)	$7,777	$12,474	$ 19,680	$ 12,810
Net Income (Loss)	($4,287)	$9,065	$14,485	$ 19,839	$ 11,836

To Our Stockholders:

Fiscal 1998 can be characterized as a year of growth and increased competition. During the year, SanDisk experienced tremendous growth in the number of megabytes shipped. In addition, markets for our CompactFlash and MultiMediaCard products expanded with numerous design wins and the introduction of new and exciting products that utilize our flash solutions to store data, audio or images. Product revenues were down slightly from the previous year due to intense competition and rapidly declining average selling prices. Despite these market conditions, the severe recession in Japan and the Far East, and lower than anticipated product gross margins, SanDisk made great strides and is coming out of 1998 a stronger player and market leader.

In 1998, SanDisk recorded its fourth consecutive year of profitability, with total revenues of $135.8 million and profits of $11.8 million. In the second half of 1998, and in particular in Q498, we began to see a significant improvement in our business, and our investment in the digital film market began to pay off. During the year, SanDisk shipped 25 million megabytes of flash memory, more than double the amount shipped in the previous year.

In fiscal 1998, SanDisk strengthened its market leadership position and

established important beachheads in new and exciting markets. SanDisk's biggest marketing and sales success in 1998 was establishing a strong presence in the retail channel under the SanDisk brand name. In less than 18 months, we went from zero stores to more than 7,000 stores worldwide selling SanDisk branded cards. Very importantly, we did so without alienating our major OEM customers or existing distribution channels. We were helped by SanDisk's reputation for quality, on-time volume delivery and product breadth. We were also able to capitalize on our standing as the inventor of CompactFlash.

Another crucial marketing achievement for SanDisk was our success in establishing CompactFlash as the standard film media for digital cameras. During the year, we saw many new camera models introduced using CompactFlash as the digital film. At year-end, we had 62 cameras and more than 130 total announced design wins for CompactFlash, and the momentum is building for CompactFlash in numerous new applications.

Our MultiMediaCard, jointly developed with Siemens, blossomed in 1998 into a real product family, and has been adopted by Nokia, Ericsson, Motorola, QualComm and others as the standard storage card for future digital smart phones.

Numerous new applications have emerged for the MultiMediaCard, which we believe will accelerate its adoption as a high volume consumer product. One such application is the emerging digital audio market including Internet MP3 music, which we feel will spawn a host of new digital portable music players with our MultiMediaCard as the music recording media. Although this market currently has copyright protection issues, most market observers believe that these will be resolved to the satisfaction of the content providers because this new market is beginning to catch on with Internet users. MP3 or AAC compression requires approximately 60MB to store the content of a 1 hour CD, and this requirement plays to SanDisk's strength in low cost, small form factor, high capacity flash storage products. We are working closely with several of the market leaders and our goal is to become a leading player in this exciting new opportunity for flash storage.

The new wave of digital camcorders provides another potentially large market for our MultiMediaCard and CompactFlash cards. These digital camcorders allow users to capture digital still images on a low capacity flash card. Panasonic and JVC are expected to start volume production of the first of these new camcorder models in the first half of 1999.

Another important market segment for SanDisk is telecommunications and network infrastructure, served by companies such as Lucent, Cisco and Nortel. During 1998, our efforts in this market began to pay off with a number of important design wins. These customers have determined that one of the least reliable components in their remote environment is the mechanical disk drive. With the rapid decline in our flash memory cost, SanDisk is now able to offer a cost effective, highly reliable, solid state plug and play replacement that meets the price threshold of these customers. We believe this business plays to our strengths in high capacity, highly reliable flash storage, and should provide growth opportunities in the years ahead.

In Operations and Technology, the most important accomplishment for SanDisk in 1998 was transferring our flash technology and establishing volume production at both United Semiconductor Corporation and United Silicon Incorporated, our foundry partners in Taiwan. This move allowed us to quickly transition from 32Mbit to 64Mbit technologies for all SanDisk products, and to establish a highly competitive manufacturing source. We also made excellent progress in developing the 128Mbit and 256Mbit flash designs, which will become critically important to leadership products and lower flash costs in 1999 and 2000 respectively. Operations reduced inventories by 43% from the prior year while improving deliveries to customer requests on significantly higher volumes. Our highest priority during 1999 will be making SanDisk the industry's highest volume, most customer responsive flash card
supplier.

Competition is expected to remain fierce as growth in our target markets attracts large technology investments from competitors. The key to retaining our market leadership position is continued execution of our advanced technology development roadmap and continued excellence in high volume manufacturing of our flash storage products.

As we look forward to 1999, we are optimistic that new products based on the 128Mbit and 256Mbit flash will spur growth in product revenues and improved gross margins. Growth will come from an ever more pervasive customer base in all our major markets. According to major independent market reports, SanDisk has several major mega market opportunities ahead of it in 1999 and beyond. These new markets are beginning to respond elastically to the much more favorable pricing for flash cards established over the past several quarters.

I believe SanDisk is well positioned to be the global leader for flash data storage as our target markets enter an accelerated growth phase on their way to becoming mega markets.

We appreciate your continued support of our strategy.

/s/ Eli Harari
Eli Harari
President and Chief Executive Officer

SanDisk Sales Offices

SanDisk Corporate Headquarters
140 Caspian Court
Sunnyvale, CA 94089
Tel: 408-542-0500
Fax: 408-542-0503
http://www.sandisk.com

SanDisk Sales Offices

Northwestern Region USA
140 Caspian Court
Sunnyvale, CA 94089
Tel: 408-542-0730
Fax: 408-542-0403

Western Region
8 Corporate Park, Suite 300
Irvine, CA 92606
Tel: 949-442-8370
Fax: 949-442-8371

Central Region
One MetroPlace
MetroPlace South, Suite 100
Dublin, OH 43017
Tel: 614-760-3700
Fax: 614-760-3701

Mid-Atlantic Region
620 Herndon Pkwy, Ste. 200
Herndon, VA 22070
Tel: 703-481-9828
Fax: 703-437-9215

New England & Canada
175 N. Main Street
Branford, CT 06405
Tel: 203-483-4390
Fax: 203-483-4399

Southern & Latin America
101 Southhall Ln, Suite 400
Maitland, FL 32751
Tel: 407-667-4880
Fax: 407-667-4834

European Sales
Karlsruher Str. 2C
D-30519 Hannover
Germany
Tel: 49-511-875-9185
Fax: 49-511-875-9187

4, rue de l'abreuvoir
92415 Courbevoie Cedex
France

Tel: 33-1-4717-6510
Fax: 33-1-4717-6531

Japan
8F Nisso Bldg. 15
2-17-19 Shin-Yokohama
Kohoku-ku
Yokohama 222-0033
Japan
Tel: 81-45-474-0181
Fax: 81-45-474-0371

Asia/Pacific Rim
89 Queensway, Lippo Center
Tower II, Suite 2207-9
Admiralty
Hong Kong
Tel: 852-2712-0501
Fax: 852-2712-9385

US Retail Sales

21842 Las Nubes Dr.
Prabuco Canyon, CA 92679
Tel: 949-589-8351
Fax: 949-589-8364

32555 Mills Rd.
Avon, OH 44011
Tel: 440-327-0490
Fax: 440-327-0295

European Retail Sales
9 Prinsengracht
1015 DF Amsterdam
The Netherlands
Tel: 31-20-4289740
Fax: 31-20-4289743

Japan Retail Sales
Umeda-Shinmichi Bldg. 10F
1-1-5 Dojima, Kita-ku, Osaka 530-0003
Tel: 81-6-6343-6480
Fax: 81-6-6343-6481

CORPORATE INFORMATION

REGISTRAR AND TRANSFER AGENT
Harris Trust and Savings Bank, Chicago, Illinois

INDEPENDENT PUBLIC AUDITORS
Ernst & Young LLP, San Jose, California

INVESTOR/SHAREHOLDER RELATIONS
Cindy Burgdorf, Chief Financial Officer,
Senior Vice President, Finance and Administration
Sharon Spehar, Shareholder Relations

LEGAL COUNSEL
Brobeck, Phleger & Harrison LLP, Palo Alto, California

BOARD OF DIRECTORS
William V. Campbell(2)
Intuit, President and Chief Executive Officer

Irwin Federman(1)
Chairman of the Board, U.S. Venture Partners, General Partner

Dr. Eli Harari
SanDisk Corporation, President and Chief Executive Officer

Catherine P. Lego(1)
Lego Ventures

Dr. James D. Meindl
Georgia Institute of Technology

Thomas F. Mulvaney(1)
Seagate Technology, Senior Vice President, General Counsel and Secretary

Alan F. Shugart(2)
Al Shugart International, President and Chief Executive Officer

(1)Audit Committee
(2)Compensation Committee

EXECUTIVE OFFICERS

Daniel Auclair
Senior Vice President, Business Development
and Intellectual Property

Cindy Burgdorf
Chief Financial Officer,
Senior Vice President,
Finance and Administration and Secretary

Dr. Eli Harari, President
and Chief Executive Officer

Ralph Hudson
Senior Vice President, Operations

Leon Malmed
Senior Vice President, Marketing and Sales

Jocelyn Scarborough
Vice President, Human Resources

SUBSIDIARIES OF THE REGISTRANT

1) SanDisk KK

2) SanDisk GMBH

3) SanDisk Israel

4) SanDisk Hong Kong

5) SanDisk International Sales, Inc.

6) SanDisk Foreign Sales Corporation

Consent of Ernst & Young LLP, Independent Auditors

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 33-96298 and No. 333-32039) pertaining to the SanDisk Corporation 1995 Stock Option Plan, 1995 Non-Employee Directors Stock Option Plan and Employee Stock Purchase Plan of SanDisk Corporation of our report dated January 22, 1999, with respect to the consolidated financial statements and schedule of SanDisk Corporation included in this Annual Report (Form 10-K) for the year ended December 31, 1998.

/s/ Ernst & Young LLP

San Jose, California
March 24, 1999

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