Sandisk (SNDK)

Raimondas Lencevicius

Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Sandisk - business

Sandisk - business (cont’d)

Sandisk - Misc thoughts

- What can go wrong?

Sandisk - Misc thoughts

- Opportunities:

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Brand? Quality?
  - What does it take to sustain the moats? Increase brand value
  - Bargaining power of suppliers/customers? Not big
- Is it a low risk business? No.
- Is there high uncertainty? Yes
- How capital intensive is the business? yes
- Future growth – Unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Possibly overstated in 2011

Management

- I don't usually do management analysis. Included for template completeness
- Some dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Piotroski Score

Only applicable to Graham Cos – N/A to SNDK

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9

Is it a good business?

- 3 year history of profits
- ROE:
  - 2009: 11 2010:22 2011:14 2012 q1:6
- Margins
  - 2009: 11 2010:27 2011: 17 2012q1:9
- 3 year sales growth 11%, earnings growth 3%
- No dilution
- Strong balance sheet
  - Debt << cash/short term investments
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - ~ ROE

Is it a good business? Cash flow

- 2012 cash flow is weak:
  - 2012 q1 114M earnings, 67M operating cash flow, negative FCF (FCF = OCF - capital expenditures)
  - Free Cash Flow/Share higher than dividends paid

Is business cheap? - Buffettology calculations

- Buffettology calculations do not make much sense since company does not have consistent results
- ROE 13%
- Earnings in 10 years = $ROE*Equity*(1+ROE)^9$ = \$2.7B
- Equity in 10 years = $Equity*(1+ROE)^9$ = \$21B
- Market cap = 2.7B x P/E (15) = \$41B
- Rate of return = 15% after tax (calculations omitted)

- 9 year earnings growth: 19%. Assuming 19% earnings growth: 24% share price growth.

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 800M (FCF ~??)
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $7.8B current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $7B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $9.7B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 457M / (8B+1.7B-2.4B) = 6% (10% assuming 790M earnings)

- What makes up the margin of safety? Valuation, brand??
- Is there a sufficient margin of safety? No.

Is business cheap? - Graham investment considerations

- N/A for SNDK – included for completeness
- 1.2 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)