

PRICE TARGET REVISION | COMMENT

MAY 1, 2007

Ceragon Networks Ltd. (NASDAQ: CRNT)

Raising the Bar

Outperform
Speculative Risk

Price:	6.94	Price Target:	8.50 ↑ 8.00
Shares O/S (MM):	28.8	Implied All-In Return:	22.5%
Dividend:	0.00	Market Cap (MM):	199.9
Float (MM):	21.2	Yield:	0.0%
Institutional Ownership:	20%	Tr. 12 ROE:	16.67%
		3-Yr. Est. EPS Growth:	30.00%

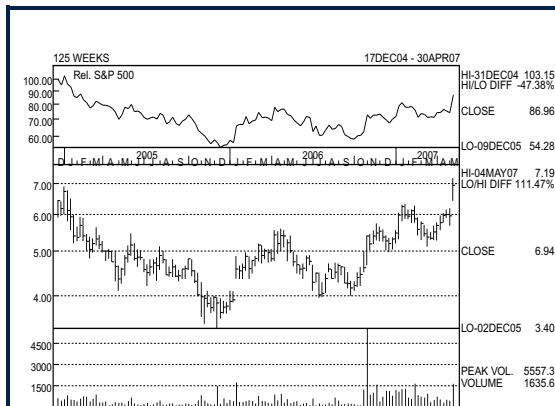
Event

Updates post solid 1q07.

Investment Opinion

We are reiterating Outperform rating, raising our target to \$8.50 and taking estimates higher as Ceragon showed strong start for the year with solid 1Q07 and upped guidance. Furthermore, Nokia OEM business is back, confirming our thesis. We continue to expect booming wireless data to drive Ceragon's growth. We believe shares will edge higher on continued execution.

- **Strong start to the year:** Ceragon reported solid 1Q07 at \$33.9 /\$0.10, ahead of our and street estimates of \$32.5 / \$0.09. Bucking normal industry seasonality, Ceragon posted 3% sequential growth and 59% YoY. Top line upside fueled operating leverage with 11% EPS rise sequentially and 180% YoY.
- **Nokia relationship in full swing** after a few months of uncertainty following the joint venture with Siemens. And while Nokia's revenue were lower this quarter, this major OEM resumed its typical ordering pattern, supporting our thesis that the relationship is solid and should continue fueling growth.
- **Raising the bar:** Management raised 2007 top line growth target to 30% from 25%, emphasizing strong demand from emerging markets, particularly Asia Pacific, and increase in WiMax deployment as the main drivers. For 2qQ07, guidance midpoint was set to \$35M, ahead of our \$33.8m and street \$33.5M.
- **Strong market trends:** Ceragon continues to benefit from growth in wireless data from 3G, WiFi and WiMax with the latter showing particular strength in 1q07. In addition, management noted solid growth in emerging markets, led by Asia-Pacific. We believe we are at the early innings of this growth cycle and with good positioning Ceragon should continue to be a beneficiary.
- **Raising estimates and price target:** We are modeling top line growth tad ahead of guidance bar, projecting 32% revenue rise to \$143m, up from \$137m, with EPS upped to \$0.43 EPS from \$0.39. For 2008 we now project \$176M / \$0.58, up from \$166M / \$0.54. We are raising our price target to \$8.50 based on 20x our higher FY07 EPS and 15x updated FY08E EPS, essentially inline with peers.



RBC Capital Markets Corp.

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FY Dec	2006A	2007E	2008E	
EPS (Op) - FD	0.24	0.43	0.58	
Prev.		0.39	0.54	
P/E	28.92x	16.14x	11.97x	
Revenue (MM)	108.4	143.4	176.0	
Prev.		137.1	166.3	
EPS (Op) - FD	Q1	Q2	Q3	Q4
2006	0.04A	0.04A	0.07A	0.09A
2007	0.10A	0.10E	0.11E	0.11E
Prev.	0.09E	0.09E	0.10E	
2008	0.13E	0.14E	0.15E	0.17E
Prev.	0.11E	0.12E	0.14E	0.16E
Revenue (MM)	Q1	Q2	Q3	Q4
2006	21.3A	23.6A	30.5A	32.9A
2007	33.9A	35.2E	36.1E	38.1E
Prev.	32.5E	33.8E	34.5E	36.3E
2008	39.0E	42.0E	46.0E	49.0E
Prev.	37.1E	40.2E	42.7E	46.3E

All values in USD unless otherwise noted.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Disclosures, please see Page 4.

Details

Emerging markets are booming

Ceragon's first quarter was impacted mostly by the growing emerging market segment, particularly in Asia-Pacific. Countries like India and the Philippines experience a surge in subscriber growth. This increases backhaul requirements and consequently demands for microwave links. Ceragon succeeded in penetrating a few of these markets, either through direct sales and the ever growing OEM partnerships. In Q1 Asia-Pacific sales were 43% of total revenue, vs. only 28% in the previous quarter. We expect the emerging market trend to continue to be a major growth factor in company's growth in the coming months. It must be pointed out that competition in this segment is fierce and price pressure is strong as the SDH product line becomes more generic. This is where the OEM partnerships come in handy as they are able to offer turnkey solutions to end costumers.

IP deployments are getting ground

Ceragon disclosed for the first time the split between IP and SDH related Revenues. In Q1 24% of revenue were from IP solutions, more than \$8M. Most of the Revenue from IP came from the deployment of WiMax networks. Nexlink, part of XO communications, has used Ceragon's services in its WiMax deployment in the US. But also Municipal and community networks are using the WiMax technology or meshed WiFi. One such network is built in Kansas City for the "Operation Green Light" traffic management program. These networks are looking for IP backhaul solutions.

Ceragon is the leader in the all-IP network segment, both in terms of product and market share. The company was the first to offer a native Ethernet-IP product and is the only one offering a combined SDH/Ethernet solution. Competitors in the field are Harris-Stratex (NASDAQ: HSTX) that offers only IP over T1/E1, and DragonWave (TSX: DWI) which does only IP and does not do TDM and therefore cannot offer a combined product that is usually required by an operator. Ceragon is winning most of the current projects but we don't believe that it will last over the long term, as competitors continue to introduce new product lines.

Margins continue to improve

In Q1 Gross margins were higher than expected at 36.4%, demonstrating Ceragon's ability to cut costs. OpEx margin continued to benefit from increase in Revenue and decrease in royalty charges to the Office of the Chief Scientist, bringing operating margin to 8.4%, vs. only 6.7% in 4Q06 and 3% in 1Q06.

One reason for the improved margins in the first quarter was the relatively small OEM sales of just 25%, in comparison with 33% in 4Q06 and 50% long term goal. OEM sales have usually lower margins. We expect OEM sales to grow as a percentage of revenue as the Nokia relationship resumes, and margins should trickle lower.

Cash flow is still Neutral

Cash balance at the end of the first quarter was \$29.5M, about the same as in Q4. One reason for that was the increase in inventory by \$9M. Inventory days were up to 134 days from 99 days in the previous quarter as a result of revenue recognition delays. 70% of inventory was finished goods, mostly already installed in customers' sites but not recognized as revenue. As more projects demand installation services, mainly from Asia and Africa, this trend should continue. Nevertheless, we still expect Ceragon to be cash flow positive for the year, especially as OEM sales continue to grow and support faster revenue recognition.

Valuation

CRNT is currently trading at 16x and 12x our FY07 and FY08 estimates. This is well below peers in wireless networking and communications backhaul that garner P/E of 23x and 18x respectively. We believe that CRNT shares should trade closer to peers, given its high expected growth and market position. Our 12 month target of \$8.50 is based on 20x FY07 EPS and 15x FY08E EPS, essentially inline with peers.

Price Target Impediment

We assign a Speculative Risk qualifier as key investment risks include competition, channel dependency, execution and slowdown in Telecom CapEx and IT spending. In addition, CRNT shares trading volume is fairly low.

We highlight that Ceragon is a fairly small player in the space with competition from larger players; As the high capacity segment becomes mainstream, vendors are introducing new solutions that compete with Ceragon's products. In addition, Ceragon has a high dependency on indirect channels, specifically with Nokia as key OEM. Note that Nokia recently formed a joint venture with Siemens that has an overlapping product line.

Company Description

Ceragon provides communications backhaul systems for various applications, connecting heavy-traffic points of aggregation such as high-capacity wireless base stations and large "out of territory" enterprises to nodes on the fiber-optic core network. Key applications include wireless providers (like CellularOne, FiberTower, Telcel / America Movil, Tele 2, Nextel, Sonofon, Cellcom), broadband wireless and wireline network extensions (AT&T, KPN, Belgacom, Swisscom), and organizations seeking high data transport capacity (General Dynamics, Israeli Air Force). Ceragon Networks was founded in 1996 and is headquartered in Israel with close to 300 employees.

Ceragon Networks Ltd. (CRNT)

Income Statement

(\$ 000 except per share, FY Dec)

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	2004A	2005A	1Q06A Mar	2Q06A Jun	3Q06A Sep	4Q06A Dec	2006A	1Q07A Mar	2Q07E Jun	3Q07E Sep	4Q07E Dec	2007E	1Q08E Mar	2Q08E Jun	3Q08E Sep	4Q08E Dec	2008E
Revenue	54,831	73,777	21,322	23,640	30,508	32,945	108,415	33,936	35,200	36,100	38,100	143,400	39,000	42,000	46,000	49,000	176,000
<i>QoQ</i>			6.0%	10.9%	29.1%	8.0%		3%	4%	3%	6%		2.4%	7.7%	9.5%	6.5%	
<i>YoY</i>		35%	27%	32%	62%	64%	47%	59%	49%	18%	16%	32%	15%	19%	27%	29%	23%
Cost of Goods Sold*	32,191	45,013	13,322	14,971	20,895	20,987	70,168	21,598	22,500	23,100	24,400	91,598	25,100	27,100	29,700	31,600	113,500
<i>Margin</i>	58.7%	61.0%		63.3%	68.5%	63.7%	64.7%	63.6%	62.5%	64.0%	64.0%	63.9%	64.4%	64.5%	64.6%	64.5%	64.5%
Gross Income*	22,640	28,764	8,000	8,669	9,613	11,958	38,247	12,338	12,700	13,000	13,700	51,802	13,900	14,900	16,300	17,400	62,500
<i>QoQ</i>			5.3%	8.4%	10.9%	24.4%		3%	3%	2%	5%		1.5%	7.2%	9.4%	6.7%	
<i>YoY</i>		27%	18.0%	20.3%	32.8%	57.4%	33%	5.4%	4.6%	35%	15%	35.4%	12.7%	17.3%	25.4%	27.0%	21%
<i>Margin</i>	41.3%	39.0%	37.5%	36.7%	31.5%	36.3%	35.3%	36.4%	36.1%	36.0%	36.0%	36.1%	35.6%	35.5%	35.4%	35.5%	35.5%
Research and Development, net*	7,393	8,949	2,674	2,651	2,741	3,417	11,483	3,428	3,590	3,646	3,810	14,475	3,822	4,032	4,324	4,557	16,735
<i>Margin</i>	13.5%	12.1%	12.5%	11.2%	9.0%	10.4%	10.6%	10.1%	10.2%	10.1%	10.0%	10.1%	9.8%	9.6%	9.4%	9.3%	9.5%
Sales and Marketing*	11,645	13,613	3,742	4,068	4,161	4,978	16,949	5,102	5,200	5,300	5,600	21,202	5,500	5,900	6,500	6,900	24,800
<i>Margin</i>	21.2%	18.5%	17.5%	17.2%	13.6%	15.1%	15.6%	15.0%	14.8%	14.7%	14.7%	14.8%	14.1%	14.0%	14.1%	14.1%	14.1%
General and Administrative*	2,429	3,068	939	1,046	1,122	1,341	4,450	968	1,200	1,200	1,300	4,668	1,300	1,400	1,500	1,500	5,700
<i>Margin</i>	4.4%	4.2%	4.4%	4.4%	3.7%	4.1%	4.1%	2.9%	3.4%	3.3%	3.4%	3.3%	3.3%	3.3%	3.3%	3.1%	3.2%
Operating Expenses	21,467	25,630	7,355	7,765	8,024	9,736	32,880	9,498	9,990	10,146	10,710	40,345	10,622	11,332	12,324	12,957	47,235
<i>Margin</i>	39.2%	34.7%	34.5%	32.8%	26.3%	29.6%	30.3%	28.0%	28.4%	28.1%	28.1%	28.1%	27.2%	27.0%	26.8%	26.4%	26.8%
Operating Income*	1,173	3,134	645	904	1,589	2,222	5,365	2,840	2,710	2,854	2,990	11,458	3,278	3,568	3,976	4,443	15,265
<i>QoQ</i>			-22.5%	40.2%	75.8%	39.8%		27.8%	-4.6%	5.3%	4.8%		9.6%	8.8%	11.4%	11.7%	
<i>YoY</i>		167%	-14%	0%	129%	167%	71%	340%	200%	80%	35%	114%	15%	32%	39%	49%	33%
<i>Margin</i>	2.1%	4.2%	3.0%	3.8%	5.2%	6.7%	4.9%	8.4%	7.7%	7.9%	7.8%	8.0%	8.4%	8.5%	8.6%	9.1%	8.7%
Financial Income (expense), net	674	607	384	191	293	415	1,284	173	300	400	400	1,273	425	450	475	500	1,850
Other Income (expense)	141	66	6			48	47					-					-
Net Income*	1,988	3,809	1,035	1,095	1,884	2,687	6,697	3,013	3,010	3,254	3,390	12,667	3,703	4,018	4,451	4,943	17,115
<i>QoQ</i>			0.7%	5.9%	72.0%	42.6%		12.1%	-0.1%	8.1%	4.2%		9.2%	8.5%	10.8%	11.1%	
<i>YoY</i>		1	20%	7%	112%	162%	1	191%	175%	73%	26%	89%	23%	34%	37%	46%	35%
<i>Margin</i>	3.6%	5.2%	4.9%	4.6%	6.2%	8.2%	6.2%	8.9%	8.6%	9.0%	8.9%	8.8%	9.5%	9.6%	9.7%	10.1%	9.7%
EPS*	\$ 0.07	\$ 0.14	\$ 0.04	\$ 0.04	\$ 0.07	\$ 0.09	\$ 0.24	\$ 0.10	\$ 0.10	\$ 0.11	\$ 0.11	\$ 0.43	\$ 0.13	\$ 0.14	\$ 0.15	\$ 0.17	\$ 0.58
<i>QoQ</i>			-1.5%	4.4%	74.1%	39.0%		10.8%	-0.6%	7.7%	3.8%		8.9%	8.1%	10.4%	10.7%	
<i>YoY</i>		102%	21%	6%	114%	149%	65%	180%	167%	65%	23%	83%	21%	32%	35%	44%	33%
Wtd. Avg. Diluted Shares Out.*	28,070	26,591	28,027	28,426	28,081	28,814	28,337	29,149	29,300	29,400	29,500	29,337	29,600	29,700	29,800	29,900	29,750

* Pro forma results exclude stock-based comp, amortization of intangibles and one-time charges.
Source: Company Reports and RBC estimates.

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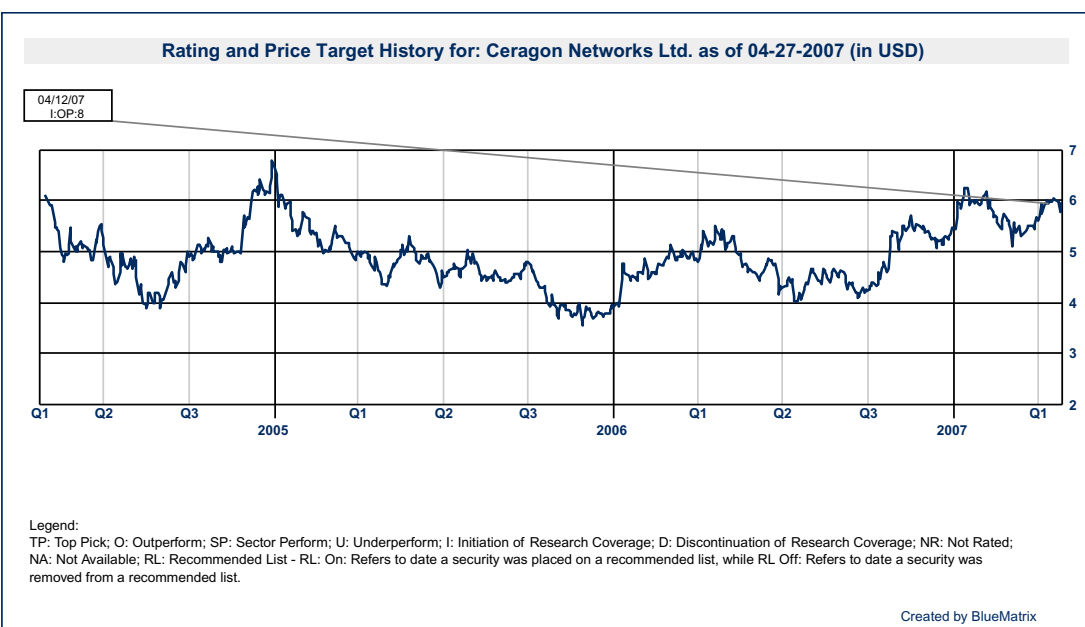
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			Count	Percent
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