

Looking to expand presence via acquisition

Possible acquisition of Nortel's app networking unit

According to a news report by Israeli newspaper "Globes," Radware is expected to acquire a division of Nortel Network's, which we believe is the application networking business Radware competes with, for \$30-\$50mn in cash. At these price levels, we value the transaction at about 0.5x to 0.7x 2008 sales (grossing up the services revenue to Infonetics' "annualized" \$55mn revenue estimate for Nortel's business in C2008). However, given the sharp deceleration in Nortel's business recently, we would not be surprised if this figure is actually closer to 1x C2009 sales. We note that Radware itself is trading at ~1x C2009 sales.

What would Radware gain?

Like Nortel, Radware has struggled to grow its revenue out of ~\$80-\$90mn p.a. range due to difficulties gaining traction in the US. Therefore, we believe Radware's main objective is to acquire Nortel's North American installed base and distribution channel. We see an opportunity to rationalize costs, phasing out support for Nortel's product lines, while improving sales coverage. The rationale is reminiscent of BlueCoat's acquisition of Packeteer.

Acquisition raises profitability and execution concerns

Although we see the strategic benefit of a potential transaction, we remain concerned given Radware's existing challenges in attaining profitability and improving its execution. Given an apparently low valuation, the deal could be accretive, although we remain cautious given limited financial detail provided and Radware's track record execution. With a net cash position of \$137.4mn and burning only \$4 - \$5mn / quarter from operations over the past few quarters, Radware does have some room to maneuver.

Quick overview of Nortel's application networking business

Nortel entered the application networking business in 2000 with the acquisition of Alteon Websystems, but has seen a steep revenue decline, particularly in recent years, from \$125mn in 2005 product revenue to \$55mn in "annualized" 2008 revenue, according to Infonetics (mkt share on pg. 2). We believe that Radware could potentially extract sales synergies from this acquisition as the customer profiles both companies are somewhat more carrier oriented than of F5 and others (e.g. Radware derives ~30% of revenue from carriers vs. ~20% for F5).

Maint. Underperform on weak environment and execution

We continue to see risks to estimates given the macro backdrop and weak results at key competitors, such as F5 Networks more recently. With ~\$2.30 of its \$7.10 per share cash balance potentially earmarked for an acquisition, investors may also see less downside protection from Radware's strong balance sheet. Lastly, we remain concerned with the company's sensitivity to swings in exchange rates.

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Stock Data

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Price Objective	US\$6.25
Date Established	3-Nov-2008
Investment Opinion	C-3-9
Volatility Risk	HIGH
ML Symbol / Exchange	RDWR / NAS
Bloomberg / Reuters	RDWR US / RDWR.OQ



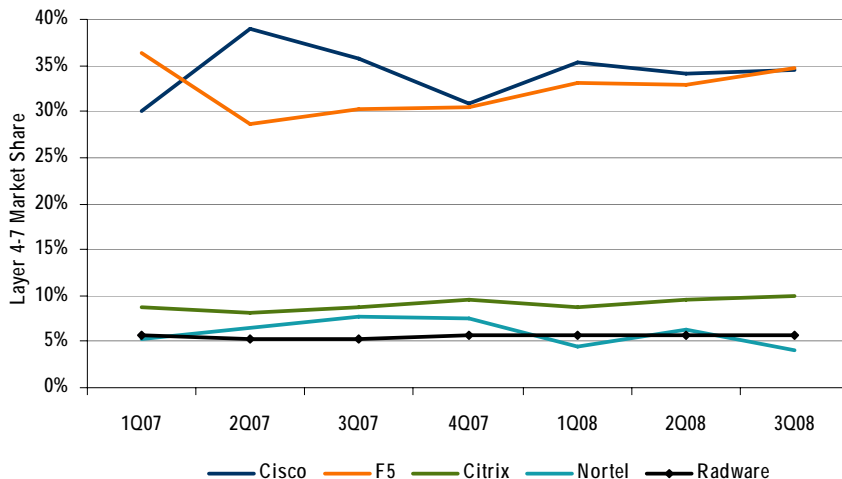
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Refer to important disclosures on page 4 to 6. Analyst Certification on Page 3. Price Objective Basis/Risk on page 2.

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Chart 1: Layer 4 - 7 application networking market share trends – Nortel's and Radware's product revenue have been neck and neck over the past 8 quarters



Source: Infonetics, BAS-ML Research

Investment thesis

Radware Ltd

Radware has been plagued by inconsistent execution, particularly in its Americas business where there has been management and sales force turnover. This has hindered its recovery to its targeted mid to high-teens growth. While we see some signs of a bottom, enterprise spending remains weak in the US, while other risks (eg. rising opex and pressure on financial income) persist. Downside is limited by the company's \$7.10 per share in net cash.

Price objective basis & risk

Radware Ltd (RDWR)

We derive Radware's \$6.25 price objective by applying a 1.1x Price/Sales multiple on our 2009 estimates. These levels represent a substantial discount to the valuation level of other Data Networking companies, reflecting Radware's relatively weak market position and execution track record, as well as challenges to reach profitability. We believe that this multiple is appropriate as it in-line with companies that have similar growth prospects. We highlight the following concerns: (1) Deterioration of the company's business in the US and an inability to turn this division around, (2) Continued increases in operating expenses and unfavorable currency rates that could delay profitability, (3) Stiffer competition from F5 and Cisco, both of which are making a significant push into this market segment of traffic management, and (4) Weakness in enterprise and carrier spending that hinders the company from achieving its mid to high teens growth rate on the top line. Upside to our price objective could result from stronger than expected revenue based on the company's initiatives to expand sales channels and greater than expected demand for Radware's products.

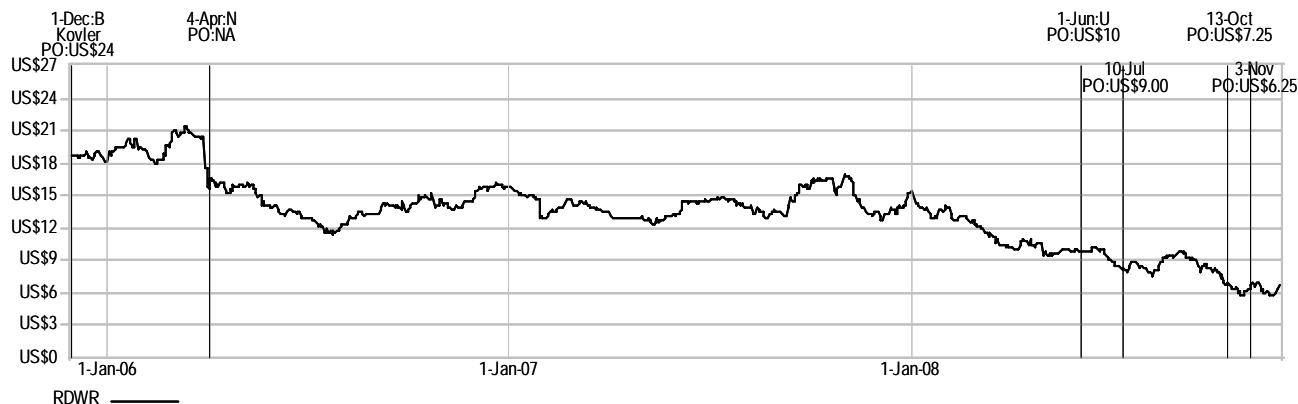
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RDWR Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of September 30, 2008 or such later date as indicated.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
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Neutral	51	28.18%	Neutral	12	30.77%
Sell	48	26.52%	Sell	7	17.50%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

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