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Reason for Report:
Company Update: Q2 Earnings

Changes	From (Previous)	To (Current)
Rating	--	Mkt Perform
Price Tgt	--	\$3.84
FY02E EPS	(\$0.43)	(\$0.40)
FY03E EPS	(\$0.44)	(\$0.37)
FY02E Rev (mil)	\$25.5	\$27.1
FY03E Rev (mil)	\$31.0	\$33.2

Price:	\$1.80
52-Wk Range:	\$6.10-\$1.60
Price Target:	\$3.84 (1x CY02 Revenue + cash)
Shares Out (mil):	39.0
Market Cap (mil):	\$70.2
Avg Daily Vol (000):	139.1
Book Value/Share:	\$3.18
Cash Per Share:	\$3.10
Debt to Total Capital:	NA
Div (ann) - Yield:	Nil
Est LT EPS Growth	15%-20%
P/E to LT Growth (2002):	NM
Est Next Rep Date:	Oct 2002
FY End:	Dec 2002

Rev (mil)	2001	2002E	2003E
Mar	\$13.6	\$5.7A	\$7.2
Jun	\$11.6	\$6.7A	\$8.1
Sep	\$5.0	\$7.1	\$8.4
Dec	\$5.5	\$7.6	\$9.0
FY	\$35.7	\$27.1	\$33.2
CY	\$35.7	\$27.1	\$33.2

FY RM	2.0x	2.6x	2.1x
CY RM	2.0x	2.6x	2.1x

EPS	2001	2002E	2003E
Mar	\$0.05	(\$0.10)A	(\$0.10)
Jun	\$0.01	(\$0.09)A	(\$0.09)
Sep	(\$0.11)	(\$0.10)	(\$0.09)
Dec	(\$0.11)	(\$0.10)	(\$0.09)
FY	(\$0.17)	(\$0.40)	(\$0.37)
CY	(\$0.17)	(\$0.40)	(\$0.37)

FY P/E	NM	NM	NM
CY P/E	NM	NM	NM

Note: EPS are fully diluted.

Disclosures (see last page for details):

- (#) Market Maker
- (^) Beneficial Interest
- (@) Underwriter
- (>) Investment Banking Services
- (~) Employee/Director

AudioCodes Ltd. (AUDC – \$1.80)

Market Perform

Volatility: High

Solid 2Q02; Revising Estimates; Maintaining Market Perform.

KEY POINTS:

- **Maintaining Market Perform.** Based on the continued lack of longer-term visibility, coupled with our view that the near-term demand outlook will continue to be somewhat challenging, we are maintaining our Market Perform rating and our \$3.84 price target. In our opinion, cash plus 1x 2002 revenue equates to \$3.84 and is essentially the valuation floor.
- **Solid 2Q02.** Revenues for the quarter were \$6.7 million, compared with \$11.6 million in the prior year period and \$5.7 million in 1Q02. EPS was (\$0.09), compared with \$0.01 in the second quarter of 2001, and versus (\$0.10) in the first quarter of 2002. We had expected revenues and EPS of \$6.2 million and (\$0.11), respectively.
- **Revising Estimates.** We are revising our estimates. For 2002, we are raising our revenue estimate from \$25.5 million to \$27.1 million and narrowing our EPS from (\$0.43) to (\$0.40). For 2003, we are increasing our revenue estimate from \$31.0 million to \$33.2 million and narrowing our EPS estimate from (\$0.44) to (\$0.37).
- **New Product Development And Traction Continues.** AudioCodes announced on May 31 a higher density addition to its *IPmedia* board family and on April 29, *Mediant*, the Cable Access Gateway product family. AUDC now provides systems-level solutions to the enterprise, access, wireless, and cable markets and commented that it is in advanced discussions with two Tier 1 OEMs for their systems products.

INVESTMENT RECOMMENDATION:

While AudioCodes' 2Q02 results came in above our top line and consensus EPS estimates, we remain cautious given the persistent lackluster demand dynamics. We are maintaining our Market Perform based on the continued challenges in achieving longer-term visibility and the near-term demand outlook for telecommunications equipment, which continues to disappoint. The Company ended the quarter with cash and equivalents of \$120.8 million, or \$3.10 per share, down from the \$125.4 million, or \$3.21 per share, at the end of 1Q02. Approximately \$3.0 million of the decline in cash was due to operations, while AudioCodes expended roughly \$500,000 in capital expenditures and \$1.2 million for share repurchases. We expect cash burn on a quarterly basis going forward to be within the \$4-\$5 million range. Working capital for the quarter was \$126.2 million, while book value per share was \$3.18. DSOs for the quarter were 52 days, compared with 46 days in the first quarter. In our view, based on AudioCodes' technology, product capabilities, and potential from new design wins and, importantly, its new systems design business, the Company appears positioned for strong growth when industry fundamentals improve. We are monitoring for additional signs of favorable activity in AUDC's key markets.

COMPANY DESCRIPTION:

AudioCodes Ltd. (#>) is a leading provider of voice-over-packet enabling technologies for OEMs to build highly efficient, high-capacity gateways and access equipment for connecting circuit-switched telephony networks with emerging packet networks.

Solid Second Quarter 2002 Results

Before the market opened on July 24, AudioCodes announced better than anticipated results for the second quarter of 2002. Revenues for the quarter were \$6.7 million, compared with \$11.6 million in the prior year period and \$5.7 million in 1Q02. EPS was (\$0.09), compared with \$0.01 in the second quarter of 2001, and versus (\$0.10) in the first quarter of 2002. We had expected revenues and EPS of \$6.2 million and (\$0.11), respectively. Systems sales were \$200,000, or 3% of revenue compared to \$172,000, or 3% in 1Q02. Sub-systems sales were \$4.5 million, or 68.0% of revenue during the quarter, compared with \$11.1 million, or 95.5% of sales in the second quarter of 2001 and versus \$2.9 million, or 50.0% in the first quarter of 2002. Chip sales for the quarter were \$1.5 million, or 23.0% of sales compared with \$523,000, or 4.5% of sales in the prior year period and versus \$2.1 million, or 37.0% of sales in the first quarter of 2002. Other revenue accounted for \$399,000, or 6.0% of revenues during the quarter. Other revenue was \$572,600, or 10.0% of sales in the first quarter of 2002.

From a geographic perspective, Asia accounted for 33% of sales, Europe accounted for 9% of sales, Israel accounted for 10% of sales, and the U.S. accounted for 48% of sales. In 1Q02, Asia accounted for 35.5% of sales, Europe accounted for 18.0% of sales, Israel accounted for 11.0% of sales, and the U.S. accounted for 36.0% of sales. As in 1Q02 there were no customers greater than 10.0% during the quarter.

Table 1: Second Quarter Analysis

	2Q02A		2Q01	%	2Q02E	%	<u>Common Size</u>		
	<u>Jun</u>	<u>Jun</u>	<u>Jun</u>	<u>Growth</u>	<u>Jun</u>	<u>Var.</u>	<u>Jun</u>	<u>Jun</u>	<u>Jun</u>
	Systems	200	0		NM	309	-35.48%	3.00%	0.00%
Sub-Systems	4,522	11,105		-59.28%	3,035	49.01%	68.00%	95.50%	48.93%
Chips	1,530	523		192.45%	2,246	-31.89%	23.00%	4.50%	36.21%
Other	399	0		NM	613	-34.88%	6.00%	0.00%	9.88%
Total Sales	6,650	11,628		-42.81%	6,202	7.22%	100.00%	100.00%	100.00%
Total COGS	3,133	4,917		-36.29%	3,288	-4.71%	100.00%	100.00%	100.00%
Gross Profit	3,517	6,711		-47.59%	2,915	20.67%	52.89%	57.71%	46.99%
Operating Expenses:									
R&D	3,230	3,378		-4.38%	3,318	-2.66%	48.57%	29.05%	1073.17%
Sales & Marketing	3,694	3,647		1.29%	3,706	-0.32%	55.55%	31.36%	1198.54%
General & Admin	868	1,183		-26.63%	899	-3.49%	13.05%	10.17%	290.86%
Total Operating Costs	7,792	8,208		-5.07%	7,924	-1.66%	117.17%	70.59%	2562.57%
Operating Income	(4,275)	(1,497)		185.56%	(5,009)	-14.66%	-64.28%	-12.87%	-1619.96%
Interest Income	602	0			850				
Other Income	0	1,803		-100.00%	0	#DIV/0!	0.00%	15.51%	0.00%
Total Other Income	602	1,803		-66.61%	850	-29.18%	9.05%	15.51%	274.90%
Pretax Income	(3,673)	306		-1300.27%	(4,159)	-11.69%	-55.23%	2.63%	-1345.06%
Taxes	0	0		NM	20.79	-100.00%	0.00%	0.00%	-0.50%
Net Income	(3,673)	306		-1300.27%	(4,180)	-12.13%	-55.23%	2.63%	-67.4%
EPS	(0.09)	0.01		-1378.48%	(0.11)	-11.97%	0.00%	0.00%	0.00%

Gross margin increased to 53% compared with 1Q02 of 46.8%. The marked increase in gross margin in 1Q02 was attributed to \$600,000 in product sales booked in the quarter, which had used previously written off inventory from 3Q01. Without the favorable impact of these sales the Company commented that gross margin would have been roughly 48%. Operating expenses accounted for 117.2% of revenue, compared with \$7.8 million, or 133.7% of sales in the first quarter of 2002. AudioCodes generated \$972,000 in interest income during the quarter and generated a tax credit of \$22,000. The bottom-line was EPS of (\$0.09), compared with \$0.01 in the second quarter of 2001 and versus (\$0.10) in the first quarter of 2002. We had expected EPS of (\$0.11).

AudioCodes' balance sheet remains strong

The Company ended the quarter with cash and equivalents of \$120.8 million, or \$3.10 per share, down from the \$125.4 million, or \$3.21 per share, at the end of 1Q02. Approximately \$3.0 million of the decline in cash was due to operations, while AudioCodes expended roughly \$500,00 in capital expenditures and \$1.2 million for share repurchases. We expect cash burn on a quarterly basis going forward to be within the \$4-\$5 million range. The Company also announced today that salaries in aggregate were cut 7% to further lower their cost structure. Working capital for the quarter was \$126.2 million, while book value per share was \$3.18. DSOs for the quarter were 52 days, compared with 46 days in the fourth quarter.

Highlights From the Quarter

Management's optimistic outlook continued following the positive view from 1Q02 highlighting the belief that the Company can show continued growth going forward. Management suggested that sales could increase 5%-10% from the first quarter and that approximately 50% of the quarter was already in backlog. The Company noted that it sees more of a shift in market demand to Enterprise-focused solutions from service providers. In addition, AudioCodes commented that it is in advanced discussions with two Tier 1 OEMs on using AUDC systems solutions with potential design win announcements anticipated shortly. One solution involves a cable access gateway in Europe and the other is with a tier 1 OEM player in the wireless space.

During the quarter, AudioCodes made a couple of significant product announcements as well. On May 31, AudioCodes announced a new product addition, the *IPM-16110 Media Processing* board to its *IPmedia* board family. The IPM-1610 allows OEM developers to quickly bring to market high density voice applications for media servers and enables a smooth migration from TDM based applications to packet-oriented voice applications. On April 29, AudioCodes announced the launch of the *Mediant Cable Access Gateway* Family, which is the Company's first systems offering dedicated to packet cable telephony. With this new product family, AudioCodes continues to mark progress towards being a supplier of systems level products. The Mediant Cable Access Gateway Family is a new family of Access Gateways and packet cable telephony Media Gateways that enable Network Equipment Providers (NEPs) and system integrators to meet the packet voice needs of Multiple Systems Operators (MSOs) and cable operators. With this new cable product, AudioCodes now provides systems-level solutions to the enterprise, access, wireless, and cable markets.

AudioCodes also announced aggregate share repurchases. AudioCodes' first 2 million share repurchase program was announced in January 2001, and an additional program to repurchase another 2 million shares was announced in 1Q02. The Company purchased 274,000 shares in the first month of July, aggregating to approximately 2.5 million shares purchased already under the two programs that were approved to purchase 4 million shares in total.

Revising Estimates

We are revising our estimates. For 2002, we are raising our revenue estimate from \$25.5 million to \$27.1 million and narrowing our EPS estimate from (\$0.43) to (\$0.40). For 2003, we are increasing our revenue estimate from \$31.0 million to \$33.2 million, and narrowing our EPS estimate from (\$0.44) to (\$0.37). The Company also announced yesterday that salaries in aggregate were cut 7% to further lower its cost structure, which we have taken into consideration in our revised projections. Details of our revisions are included in table 2 below.

Table 2: Revised Projections

Period	Revenue \$Millions				EPS		
	From	To	Chg.	% Chg.	From	To	Change
Q102	\$5.7A	\$5.7A			(\$0.10)A	(\$0.10)A	
Q202	\$6.2E	\$6.7A	0.5	8%	(\$0.11)E	(\$0.09)A	
Q302	\$6.5	\$7.1	0.6	9%	(\$0.11)	(\$0.10)	\$0.01
Q402	\$7.1	\$7.6	0.5	7%	(\$0.11)	(\$0.10)	\$0.01
CY02	\$25.5	\$27.1	1.6	6%	(\$0.43)	(\$0.40)	\$0.03
CY03	\$31.0	\$33.2	2.2	7%	(\$0.44)	(\$0.37)	\$0.07

Potential Risks

We believe that there are several potential risks that investors should be aware of when considering an investment in AUDC. These risk factors include, but are not limited to, the following:

- Continued reductions in capital spending budgets at end customers of AUDC's OEM company customers could provide downward pressure on sales.
- A key growth opportunity for AUDC is the uptake of its Systems solutions. AUDC just began to recognize meaningful revenue from this segment in 1Q02. The Company plans for this business segment to ramp appreciably during 2003. Falling short of this objective could cause AUDC to miss expectations.
- Currently, we are forecasting a modest recovery in enterprise spending during 2003 and a broader recovery in both enterprise and service provider spending during 2004. A protracted delay in these end market recoveries would cause us to reduce our financial projections.

Rating Definitions

Investment Opinion: Investment opinions are based on each stock's return potential relative to the overall market*, not on an absolute return.

- **Strong Buy:** Expected to outperform the relevant broader market index over the next 6 to 12 months. An identifiable catalyst is present to drive appreciation.
- **Outperform:** Expected to outperform the relevant broader market index over the next 12 to 18 months.
- **Market Perform:** Expected to perform in line with the relevant broader market index over the next 6 to 12 months.
- **Underperform:** Expected to underperform the relevant broader market index over the next 6 to 12 months.

* Broader market indices = Russell 2000 and S&P 500

Volatility Rating: Our focus on growth companies implies that the stocks we recommend are typically more volatile than the overall stock market. We are not recommending the "suitability" of a particular stock for an individual investor. Rather, it identifies the volatility of a particular stock.

- **Low:** The stock price has moved up or down by more than 10% in a month in fewer than 8 of the past 24 months.
- **Medium:** The stock price has moved up or down by more than 20% in a month in fewer than 8 of the past 24 months.
- **High:** The stock price has moved up or down by more than 20% in a month in at least 8 of the past 24 months. All IPO stocks automatically get this volatility rating for the first 12 months of trading.

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