

(CRNT<sup>5,8</sup> \$8.84 - Intraday) Buy

April 18, 2008

## Solid Results, but GM / Opex Pressures EPS Outlook

### ■ Revenue Beat, EPS In-Line with Expectations

Ceragon reported 1Q08 revenue of \$47.2 million, near the high end of guidance of \$44-48 million, beating the Street of \$46.1 million, and our estimate of \$47.0 million. Non-GAAP EPS (ex-stock comp) of \$0.13 was in-line with consensus and our estimate. Book-to-bill was above 1.0, as bookings were strong and CRNT continues to carry more than one quarter of backlog.

### ■ 2Q08 Revenue Guidance of \$47-51m; OM Goal Pushed Out

Management guided 2Q08 revenue to a range of \$47-51 million versus the Street at \$48.9 million. Management kept the 2008 growth outlook at 25-30% growth, but expects OEM to grow in line with this estimate, ahead of previous expectations for OEM business to be flat versus 2007. Strength in APAC and EMEA is expected to offset softness in North America in 2008. GM is expected to remain in the 35-36% range, while 10% Operating Margin is anticipated to be achieved by 4Q08, rather than for the full year 2008, as was previously expected. Lower OM is due to lower GMs (driven by OEM business), exchange rate, and slightly higher opex.

### ■ CRNT Well-Positioned for Growth

CRNT is well-positioned to benefit from significant growth in APAC driven by cellular expansion, particularly in India where 8.4 million subscribers were added in February alone, significantly higher than net adds of 5.3 million for the full 4Q07 in the U.S. CRNT works with the 4 largest carriers in India. The IP transition is accelerating, and CRNT is among the few competitors with deployed TDM/IP solutions. IP product was 37% of revs in 1Q08, about half from broadband wireless/WiMAX and half from private networks. Cellular operators are in the early stages of testing and choosing IP backhaul, with some RFPs in EMEA to be decided in 2H08, and revenues likely in 2009. We believe CRNT's IP-10 product is in multiple bids, and is among the only products capable of doing both TDM and IP natively in one box, important for carriers to migrate their networks from TDM to IP.

### ■ Lowering EPS on Lower OM Outlook

We are maintaining our 2008 revenue estimate of \$208 million and lowering our EPS estimate to \$0.57 from \$0.62. For 2009, we are raising our revenue estimate to \$256 million from \$244 million, but lowering our non-GAAP EPS estimate to \$0.79 from \$0.85 on lower GM/OM.

### ■ Top Pick; Maintain Buy

We continue to rate CRNT a Buy, noting that the dollar's continued weakness against the Israeli shekel is a risk, but also noting that backhaul trends are very positive longer term. Our \$13 price target is 16x our 2009 EPS estimate of \$0.79. Risks to our outlook include the weak dollar, which could impact expenses later in 2008 and interest income returns on recently raised capital, capex trends, and competition.

#### Key Data

52-Week Range	\$21.89 - \$5.67
Shares Outstanding (MM)	38.8
Float (MM)	32.9
% Held Institutionally	38.7%
Market Capitalization (MM)	\$349
Average Daily Volume (000)	576
Revenues - LTM (MM)	\$175
Total Debt (MM)	\$6.0
Cash per Share	\$3.05
Long Term Growth Rate	25%
12-Month Price Target	\$13

Fiscal Year Ends: Dec.	2007A	2008E	2009E
Revenue (MM)	\$162	\$208	\$256
Previous Revenue	NA	NC	\$244
Earnings per Share			
Q1	\$0.10	\$0.13A	\$0.17
Q2	\$0.11	\$0.13	\$0.18
Q3	\$0.13	\$0.15	\$0.20
Q4	<u>\$0.14</u>	<u>\$0.17</u>	<u>\$0.23</u>
Year	\$0.48	\$0.57	\$0.79
Previous EPS	NA	\$0.62	\$0.85
P/E	18x	15x	11x
Diluted Shares (MM)	32.1	40.0	40.6

*Ceragon was founded in 1996, in Tel Aviv, Israel and completed its IPO in 2000. The company is a leading provider of point-to-point wireless transmission products. Ceragon's systems enable wireless backhaul and BWA for carriers and point-to-point network connectivity for enterprise and private networks, and can be a substitute for wired PDH/SDH/SONET networks.*

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## March Quarter Results

**Customer Breakdown.** Nokia Siemens Network was the only 10% customer in the quarter (we estimate almost 20%). A second OEM accounted for almost 10%. Ceragon is seeing strength with NSN with larger deals in India/APAC and smaller deals in Europe and other regions. CRNT's OEM business was 32% of total revenues, up significantly from 11% in 4Q07. For 2008, management expects a higher contribution from OEM than previously anticipated, as business with all three is reaching all time highs. The OEM mix is expected to pressure GMs, but is expected to be offset by reduced cost products.

**Geographic Breakdown.** By geography, Asia Pacific was 50% of revenues (up 4% sequentially). Ceragon sees significant growth opportunities in APAC driven by cellular subscriber growth, as India added about 8.4 million subs in February alone. In addition, GSM licenses were awarded to several major Indian cellular operators as well as licenses to new entrants, which are huge potential opportunities for CRNT. CRNT is a supplier to Bharti Airtel, Vodafone Essar (VOD, \$31.12—intraday, NR), Reliance Communications, IDEA Cellular (IDEA.NS; INR 99.95, NR) and Aircel in India. EMEA was about 37% of revenues (up 18% sequentially), North America 11% (down about 25% sequentially). North America declined as a result of the weak macroeconomic environment, in both Private Networks and across carriers in the U.S. Strength in APAC and other regions is expected to offset NA weakness in 2008. Latin America was 2% (down about 49% sequentially on a small base). By market segment, Service Providers (combined Cellular and Fixed Networks) accounted for 85% of revenues in 1Q08, up 10% sequentially. Private Networks decreased by about 27% sequentially to 15% of revenue (from 21% sequentially) as a majority of the customers are located in the US. IP-based products were about 37% of total revenues in 1Q08, about half from broadband wireless/WiMAX and half from private networks/initial cellular. Ceragon recently introduced the FibeAir IP-10 product line which is targeted for mobile backhaul migration from TDM to IP. The initial reception for the product is positive and CRNT is in bids mainly in Europe and Australia. Management expects decisions in 2H08, followed by revenues in 2009.

**Gross Margins Decrease; Expect to Remain in 35-36% Range.** The company posted gross margins of 35.5% for the quarter, down from 36.2% sequentially. The decrease was mainly due to a change in channel mix as a result of higher OEM offset by cost reduction initiatives. Management expects gross margins to be in the 35-36% range.

**Operating Expenses Increase.** Operating expenses were \$13.4 million in 1Q08, or 24.8% of revenue, compared to \$12.7 million or 27.5% of revenue in 4Q07. Opex was higher due to payments to sub-contractors, spending in R&D, and payment of R&D salaries. Ceragon was hedged against the USD exchange rate fluctuations through 1Q08 so the weak dollar had minimal impact on opex. If the dollar continues to weaken, the impact could be about \$400,000 in 2Q08 and higher in 2H08. However, management expects internal measures such as cost reduction to mitigate the impact of the weakening dollar. The company expects to reach 10% operating margin in 4Q08. Separately, Ceragon expects to start recording taxes on its interest income starting 2Q08 at a tax rate of 27%, consistent with our previous expectations.

**Balance Sheet and Cash Flow.** On March 31, 2007, the company had \$118.4 million in net cash and securities, or about \$3.05 per share. Cash flow from operations was close to break-even during the quarter. CRNT made a payment of \$3 million to the Chief Scientist in 1Q08. DSOs were flat at 79 days, consistent with guidance of 70-90 days. Inventory levels decreased to \$2.6 million from \$36.8 million sequentially. Inventory turns were 3.4x versus 3.1x sequentially. Deferred revenue declined to \$4.6 million from \$6.7 million sequentially.

**Table 1**  
**Ceragon Networks**  
**Annual Earnings Model, 2005-2009E**

(in thousands)	<u>2005</u>	<u>2006</u>	<u>2007A</u>	<u>2008E</u>	<u>2009E</u>
<b>Revenue</b>	<b>\$73,777</b>	<b>\$108,415</b>	<b>\$161,888</b>	<b>\$208,176</b>	<b>\$256,000</b>
Cost of sales	45,013	70,175	103,280	134,119	164,575
Gross profit	28,764	38,240	58,608	74,057	91,425
Research and development, net	8,949	11,483	15,164	19,360	22,200
Sales and marketing	13,613	16,949	24,596	28,847	32,400
General and administrative	3,068	4,448	4,686	6,325	7,250
Total operating expense	25,630	32,880	44,446	54,532	61,850
Amortization of deferred stock comp	31	-	-	-	-
Operating income	3,134	5,360	14,162	19,525	29,575
Financial income, net	607	1,283	1,182	3,178	3,450
Other income	64	54	-	-	-
Income before taxes	3,805	6,697	15,344	22,703	33,025
Income tax (pro forma)	-	-	-	637	932
Net income	3,805	6,697	15,344	22,066	32,094
<b>Non-GAAP EPS (diluted)</b>	<b>\$0.14</b>	<b>\$0.24</b>	<b>\$0.48</b>	<b>\$0.57</b>	<b>\$0.79</b>
Avg. shares out. (diluted):	28,062	28,337	32,073	38,981	40,550
<b>Yr/Yr % change:</b>					
<b>Revenues</b>	<b>35%</b>	<b>47%</b>	<b>49%</b>	<b>29%</b>	<b>23%</b>
Gross profit	27	33	53	26	23
Operating income	167	71	164	38	51
Pretax income	91	76	129	48	45
Net income	91	76	129	44	45
EPS	85	74	102	18	40
Avg. shares outstanding	4	1	13	22	4
<b>Gross margin</b>	<b>39.0%</b>	<b>35.3%</b>	<b>36.2%</b>	<b>35.6%</b>	<b>35.7%</b>
Research and development, net	12.1	10.6	9.4	9.3	8.7
Sales and marketing	18.5	15.6	15.2	13.9	12.7
General and administrative	4.2	4.1	2.9	3.0	2.8
Operating Expense	34.7	30.3	27.5	26.2	24.2
<b>Operating margin</b>	<b>4.2</b>	<b>4.9</b>	<b>8.7</b>	<b>9.4</b>	<b>11.6</b>
Pretax margin	5.2	6.2	9.5	10.9	12.9
Net margin	5.2	6.2	9.5	10.6	12.5
Tax rate	0.0	0.0	0.0	2.8	2.8

Source: Company data and Collins Stewart LLC estimates

**Table 2**  
**Ceragon Networks**  
**Quarterly Earnings Model, 2007-2009E**  
(in thousands)

	<b>1Q07</b>	<b>2Q07</b>	<b>3Q07</b>	<b>4Q07</b>	<b>1Q08A</b>	<b>2Q08E</b>	<b>3Q08E</b>	<b>4Q08E</b>	<b>1Q09E</b>	<b>2Q09E</b>	<b>3Q09E</b>	<b>4Q09E</b>
<b>Revenue</b>	<b>\$33,936</b>	<b>\$37,337</b>	<b>\$44,470</b>	<b>\$46,145</b>	<b>\$47,176</b>	<b>\$50,000</b>	<b>\$54,000</b>	<b>\$57,000</b>	<b>\$59,000</b>	<b>\$62,000</b>	<b>\$65,000</b>	<b>\$70,000</b>
Cost of sales	21,598	23,802	28,461	29,419	30,445	32,250	34,830	36,594	38,055	39,990	41,730	44,800
Gross profit	12,338	13,535	16,009	16,726	16,731	17,750	19,170	20,406	20,945	22,010	23,270	25,200
Research and development, net	3,428	3,393	4,059	4,284	4,660	4,700	4,900	5,100	5,200	5,400	5,600	6,000
Sales and marketing	5,102	6,060	6,438	6,996	6,747	7,100	7,400	7,600	7,700	8,000	8,200	8,500
General and administrative	968	838	1,486	1,394	1,225	1,600	1,700	1,800	1,700	1,800	1,850	1,900
Total operating expense	9,498	10,291	11,983	12,674	12,632	13,400	14,000	14,500	14,600	15,200	15,650	16,400
Operating income	2,840	3,244	4,026	4,052	4,099	4,350	5,170	5,906	6,345	6,810	7,620	8,800
Financial income, net	173	49	104	856	818	800	780	780	850	850	850	900
Other income	-	-	-	-	-	-	-	-	-	-	-	-
Income before taxes	3,013	3,293	4,130	4,908	4,917	5,150	5,950	6,686	7,195	7,660	8,470	9,700
Income tax (pro forma)	-	-	-	-	-	216	211	211	230	230	230	243
Net income	3,013	3,293	4,130	4,908	4,917	4,934	5,739	6,475	6,966	7,431	8,241	9,457
<b>Non-GAAP EPS (diluted)</b>	<b>\$0.10</b>	<b>\$0.11</b>	<b>\$0.13</b>	<b>\$0.14</b>	<b>\$0.13</b>	<b>\$0.13</b>	<b>\$0.15</b>	<b>\$0.17</b>	<b>\$0.17</b>	<b>\$0.18</b>	<b>\$0.20</b>	<b>\$0.23</b>
Avg. shares out. (diluted):	29,149	30,715	32,536	35,890	38,831	38,931	39,031	39,131	40,400	40,500	40,600	40,700
<b>Yr/Yr % change:</b>												
<b>Revenue</b>	<b>59%</b>	<b>58%</b>	<b>46%</b>	<b>40%</b>	<b>39%</b>	<b>34%</b>	<b>21%</b>	<b>24%</b>	<b>25%</b>	<b>24%</b>	<b>20%</b>	<b>23%</b>
Gross profit	54	56	67	40	36	31	20	22	25	24	21	23
Operating income	340	259	153	82	44	34	28	46	55	57	47	49
Pretax income	191	201	119	83	63	56	44	36	46	49	42	45
Net income	191	201	119	83	63	50	39	32	42	51	44	46
EPS	180	178	89	47	23	18	16	21	36	45	38	40
Avg. shares outstanding	4	8	16	25	33	27	20	9	4	4	4	4
<b>Gross margin</b>	<b>36.4%</b>	<b>36.3%</b>	<b>36.0%</b>	<b>36.2%</b>	<b>35.5%</b>	<b>35.5%</b>	<b>35.5%</b>	<b>35.8%</b>	<b>35.5%</b>	<b>35.5%</b>	<b>35.8%</b>	<b>36.0%</b>
Research and development, net	10.1	9.1	9.1	9.3	9.9	9.4	9.1	8.9	8.8	8.7	8.6	8.6
Sales and marketing	15.0	16.2	14.5	15.2	14.3	14.2	13.7	13.3	13.1	12.9	12.6	12.1
General and administrative	2.9	2.2	3.3	3.0	2.6	3.2	3.1	3.2	2.9	2.9	2.8	2.7
Operating Expense	28.0	27.6	26.9	27.5	26.8	26.8	25.9	25.4	24.7	24.5	24.1	23.4
<b>Operating margin</b>	<b>8.4%</b>	<b>8.7%</b>	<b>9.1%</b>	<b>8.8%</b>	<b>8.7%</b>	<b>8.7%</b>	<b>9.6%</b>	<b>10.4%</b>	<b>10.8%</b>	<b>11.0%</b>	<b>11.7%</b>	<b>12.6%</b>
Pretax margin	8.9	8.8	9.3	10.6	10.4	10.3	11.0	11.7	12.2	12.4	13.0	13.9
Net margin	8.9	8.8	9.3	10.6	10.4	9.9	10.6	11.4	11.8	12.0	12.7	13.5
Tax rate (on Interest Income)	0.0	0.0	0.0	0.0	0.0	27.0	27.0	27.0	27.0	27.0	27.0	27.0
<b>Qtr/Qtr % change:</b>												
<b>Revenue</b>	<b>3%</b>	<b>10%</b>	<b>19%</b>	<b>4%</b>	<b>2%</b>	<b>6%</b>	<b>8%</b>	<b>6%</b>	<b>4%</b>	<b>5%</b>	<b>5%</b>	<b>8%</b>

Source: Company data and Collins Stewart LLC estimates

**Table 3**  
**Ceragon Networks**  
**Quarterly Balance Sheet, 2005-2008**

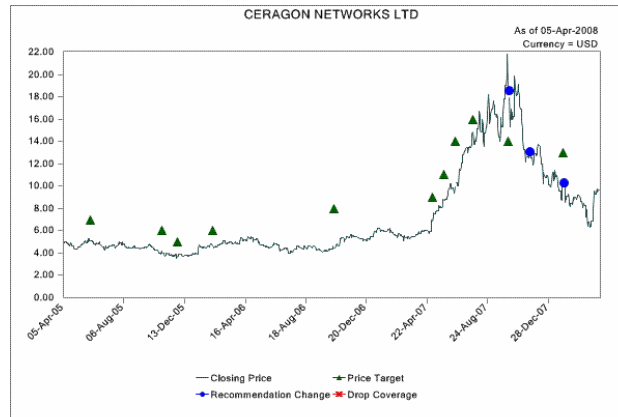
(in thousands)

	<u>4Q05</u>	<u>4Q06</u>	<u>4Q07</u>	<u>1Q08A</u>
Cash and cash equivalents	\$10,315	\$10,170	\$58,650	\$48,298
Short term bank deposits	3,917	5,364	25,997	23,151
Marketable securities	5,654	6,578	6,399	8,809
Trade receivables, net	15,079	27,433	40,533	41,520
Other A/R and prepaid expenses	5,141	11,092	10,888	8,947
Inventories, net	16,144	23,144	36,763	34,168
<b>Total current assets</b>	<b>56,250</b>	<b>83,781</b>	<b>179,230</b>	<b>164,893</b>
Long-term bank deposits	5,322	2,873	12,030	12,154
Long-term marketable securities	7,814	4,500	18,665	28,196
Long-term receivables	0	0	0	0
Severance pay funds	2,142	2,537	3,268	3,788
Property and equipment, net	2,464	2,660	4,447	5,309
<b>Total assets</b>	<b>\$73,992</b>	<b>\$96,351</b>	<b>\$217,640</b>	<b>\$214,340</b>
Trade payables	\$12,382	\$22,147	\$25,173	\$22,707
Deferred revenues	3,456	3,739	6,702	4,628
Other payables and accrued expenses	5,541	10,627	14,935	12,825
<b>Total current liabilities</b>	<b>21,379</b>	<b>36,513</b>	<b>46,810</b>	<b>40,160</b>
Accrued severance pay	3,424	4,352	5,286	5,954
Other payables		7,925	4,650	2,232
<b>Total liabilities</b>	<b>24,803</b>	<b>48,790</b>	<b>56,746</b>	<b>48,346</b>
<b>Total shareholders' equity</b>	<b>49,189</b>	<b>47,561</b>	<b>160,894</b>	<b>165,994</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$73,992</b>	<b>\$96,351</b>	<b>\$217,640</b>	<b>\$214,340</b>

**Balance Sheet Metrics**

Net cash	31,740	27,670	119,723	118,442
Net cash per share	1.16	0.96	3.34	3.05
Change in net cash	312	723	84,445	(1,281)
Change in accounts receivable	3,536	689	6,301	987
Change in net inventory	(4,924)	1,823	(2,306)	(2,595)
LT debt to capital (%)	6.5	8.4	3.2	3.5
Working capital	34,871	47,268	132,420	124,733
DSO	67	75	79	79
Turns	2.9	3.6	3.1	3.4

Source: Company data and Collins Stewart LLC estimates



CERAGON NETWORKS LTD					
Currency = USD					
Date	Closing Price	Recommendation Change	Date	Closing Price	Price Target
25-Jan-2008	10.33	BUY	25-Jan-2008	10.33	13.00
21-Nov-2007	13.07	MARKET PERFORM	03-Oct-2007	18.60	14.00
03-Oct-2007	18.60	UNDER PERFORM	24-Jul-2007	14.79	16.00
			14-Jun-2007	9.90	14.00
			23-May-2007	8.71	11.00
			30-Apr-2007	6.94	9.00
			12-Oct-2006	4.60	8.00
			06-Feb-2006	4.63	6.00
			23-Nov-2005	3.68	5.00
			27-Oct-2005	3.25	6.00
			27-May-2005	5.15	7.00

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- Sell: 12 months, estimated underperformance of 20% or more

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	% of CSTI Universe with this rating	% of rating tier for which CSTI provided IB services
Buy	54%	63%
Hold	45%	38%
Sell	1%	0%

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