

Ceragon Networks

(CRNT^{5,8} \$6.22 - Intraday) Buy

Solid Results/Outlook; Still NOK Uncertainty

Rich Church
212-389-8051
rchurch@unterberg.com

Gina Chen
212-389-8079
gina@unterberg.com

- Revenues and EPS Exceed Expectations.** Revenue of \$32.9 million, was above guidance of \$30-32 million and Street consensus of \$31.2 million. Non-GAAP EPS of \$0.09 was a penny above consensus and in-line with our estimate. Book-to-bill was slightly below 1.0 due to a slowdown in orders from Nokia prior to the closing of its joint venture with Siemens. However, CRNT has significantly more than one quarter's worth of revenue in backlog. The company continued to see significant growth in business with its OEM partners, about 33% of revenue, up 5% sequentially.
- 1Q07 Outlook Similar to 4Q06 Levels; Solid Growth Goals for 2007.** 1Q outlook was for revenues of \$31-33 million range, versus Street consensus of \$31.7 million. Margin profile is expected to be similar to 4Q06. 2007 revenue growth goal is 25%. Longer-term, the company is targeting 10% profit margins.
- Revising Estimates, Reiterate Buy.** For 2007, our revenue estimate goes to \$138.0 million from \$137.0 million and our non-GAAP EPS estimate remains \$0.43. For 2008, we are establishing a revenue estimate of \$160.0 million and EPS estimate of \$0.55. We reiterate our Buy rating and price target of \$8, which is 14x our 2008 EPS estimate of \$0.55. The company has about \$0.96 per share in net cash.
- Risks to our outlook include the Nokia / Siemens Joint Venture.** OEM business was 33% of sales in 4Q06, up 5% sequentially. Management expects revenue from OEM partners to continue to grow. Management still has not seen signs that Nokia would end their relationship post completion of the joint venture. However, CRNT admits that it could come down to a political decision at higher levels that could be out of their control. If this were to happen, CRNT estimated that worst case scenario could be that growth in revenue in 2007 might only be 10% versus the forecasted goal of 25%. Clearly this would have a sharp impact on the stock price if the Nokia business were lost. It is unclear when a decision would be made or how it would be communicated. Other risks include a possible capex slowdown in 2G/3G and delays in carrier decisions.

Key Data

52-Week Range	\$6.33 - \$3.96
Weighted Average Shares (MM)	28.8
Float (MM)	20.3
% Held Institutionally	27.5%
Market Capitalization (MM)	\$176
Average Daily Volume (000)	204
Revenues - LTM (MM)	\$108.4
Total Debt (MM)	\$4.3
Cash per Share	\$0.96
Long-Term Growth Rate	25%
12-Month Price Target	\$8.00

Fiscal Year Ends: Dec.	2006A	2007E	2008E	
Revenue (MM)	\$108.4	\$138.0	\$160.0	
Previous Revenues (MM)	\$106.5	\$137.0	NE	
Earnings per Share				
	Q1	\$0.04	\$0.09	\$0.11
	Q2	\$0.04	\$0.10	\$0.13
	Q3	\$0.07	\$0.11	\$0.15
	Q4	<u>\$0.09A</u>	<u>\$0.13</u>	<u>\$0.16</u>
Year		\$0.24	\$0.43	\$0.55
Previous EPS		\$0.23	NC	NE
P/E		26x	14x	11x
Shares Fully Diluted (MM)		28.3	28.8	28.9

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.

350 Madison Ave.
New York, NY 10017
212-389-8000
Fax: 212-389-8828

456 Montgomery St. 22nd Fl.
San Francisco, CA 94104
415-659-2222
Fax 415-399-1113

4 Shenkar St.
Hertzlia Pituach
Israel, 46120
+972 (9) 961-3000
Fax +972 (9) 961-3003

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Disclaimers regarding the content of this report as well as full disclosure of C.E. Unterberg, Towbin's ratings and information on the firm's position(s) in securities mentioned herein appear on the final page of this report.

December Quarter Results

Revenues and EPS Exceed Expectations. Ceragon reported 4Q06 revenue of \$32.9 million, above guidance of \$30-32 million, the Street consensus of \$31.2 million, and our estimate of \$31.0 million. The company reported non-GAAP EPS of \$0.09, a penny above consensus and in-line with our estimate. The company's book-to-bill was slightly below 1.0 due to a slowdown in orders from Nokia (NOK, NR) prior to the closing of its joint venture with Siemens (SI, NR). However, CRNT has significantly more than one quarter's worth of revenue in backlog. The company continued to see significant growth in business with its OEM partners, about 33% of revenue, up 5% sequentially.

1Q07 Outlook Similar to 4Q06 Levels; Solid Growth Goals for 2007. Management expects revenue for 1Q07 to be in the \$31-33 million range, versus Street consensus of \$31.7 million and our estimate of \$32.0 million. Management expects 1Q07 to be roughly similar to 4Q06 levels in opex and gross margins. The company established a 2007 revenue growth goal of 25%, above the market growth range of 5-25% (depending on source). Longer-term, the company is targeting 10% net profit margins.

Revising Estimates, Reiterate Buy. For the March quarter, we are fine-tuning our estimate to revenue of \$32.5 million from \$32.0 million and maintaining our non-GAAP EPS estimate of \$0.09. For 2007, our revenue estimate goes to \$138.0 million from \$137.0 million and our non-GAAP EPS estimate remains \$0.43. For 2008, we are establishing a revenue estimate of \$160.0 million and EPS estimate of \$0.55. We reiterate our Buy rating and price target of \$8, which is 14x our 2008 EPS estimate of \$0.55. The company has about \$0.96 per share in net cash.

Risks to our outlook include the Nokia / Siemens Joint Venture. OEM business was 33% of sales in 4Q06, up 5% sequentially. Management expects revenue from OEM partners to continue to grow. Management still has not seen signs that Nokia would end their relationship post completion of the joint venture. However, CRNT admits that it could come down to a political decision at higher levels that could be out of their control. If this were to happen, CRNT estimated that worst case scenario could be that growth in revenue in 2007 might only be 10% versus the forecasted goal of 25%. Clearly this would have a sharp impact on the stock price if the Nokia business were lost. It is unclear when a decision would be made or how it would be communicated. Other risks include a possible capex slowdown in 2G/3G and delays in carrier decisions.

Customers and Geographic Breakdown. FiberTower was not a 10% customer this quarter but management notes that it was still an important customer. Management said CRNT has three or four other carriers' carriers as well as FiberTower, as these companies are benefiting from the trend to rent space for wireless backhaul rather than leasing or laying expensive T-1 lines. By geography, EMEA was about 41% of revenues (up 20% sequentially), North America 26% (up about 56% sequentially). Asia Pacific was 28% of revenues (down 20% sequentially) and Latin America 5% (down about \$500,000 sequentially). By market segment, Cellular operators accounted for 42% of revenues in 4Q, down 18% sequentially. Fixed Networks increased by about 13% sequentially to 22% of revenue. Private Networks increased by about 62% sequentially to 36% of revenue. The growth in Private Networks came from growth in government business and a contract with General Dynamics (GD, NR) valued at \$7 million. The remainder of revenue from this contract is expected to be recognized in 2Q07.

Gross Margins Increase Sequentially. The company posted gross margins of 36.3% for the quarter, up from 31.5% sequentially due to product mix and lower COGS of \$1 million resulting from the research grant termination. Excluding the effect of the grant termination, GMs would have improved

C.E. Unterberg, Towbin

by 180 basis points sequentially. In 2007, management expects to improve gross margins from a mix of cost reduction initiatives and outsourcing to counter lower GMs from the higher OEM mix.

Operating Expenses Higher. Operating expenses were \$9.7 million in 4Q06, or 29.6% of revenue, compared to \$8.0 million or 26.3% of revenue in 3Q06. The increase in opex was due to an increase in Sales & Marketing headcount and an increase in R&D, \$500,000 of the increase being due to the termination of the Israel R&D grant program.

Balance Sheet and Cash Flow. On December 31, 2006, the company had \$27.7 million in net cash and securities, or about \$0.96 per share. The company generated \$800,000 in cash in the quarter. Ceragon had 285 employees at the end of the quarter. DSOs were 75 days, down from 79 days sequentially. Inventory turns were 3.6x versus 2.8x sequentially.

Table 1
Ceragon Networks
Annual Earnings Model, 2002-2008E

(in thousands)	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005A</u>	<u>2006E</u>	<u>2007E</u>	<u>2008E</u>
Revenue	\$18,394	\$34,421	\$54,831	\$73,777	\$108,415	\$138,000	\$160,000
Cost of sales	12,791	20,646	32,191	45,013	70,175	88,320	103,645
Gross profit	5,603	13,775	22,640	28,764	38,240	49,680	56,355
Research and development, net	7,273	6,970	7,393	8,949	11,483	13,690	14,050
Sales and marketing	9,130	9,437	11,645	13,613	16,949	19,750	21,700
General and administrative	2,031	2,167	2,429	3,068	4,448	4,800	5,600
Total operating expense	18,434	18,574	21,467	25,630	32,880	38,240	41,350
Amortization of deferred stock comp	2,974	1,354	374	31	-	-	-
Operating income	(12,831)	(4,799)	1,173	3,134	5,360	11,440	15,005
Financial income, net	1,528	1,159	674	607	1,283	1,000	1,000
Other income	-	-	141	64	54	50	-
Income before taxes	(11,303)	(3,640)	1,988	3,805	6,697	12,490	16,005
Income tax (pro forma)	-	-	-	-	-	-	-
Net income	(11,303)	(3,640)	1,988	3,805	6,697	12,490	16,005
Non-GAAP EPS (diluted)	(\$0.51)	(\$0.16)	\$0.07	\$0.14	\$0.24	\$0.43	\$0.55
Avg. shares out. (diluted):	22,376	23,133	27,085	28,062	28,337	28,839	28,864
Yr/Yr % change:							
Revenues	#DIV/0!	87%	59%	35%	47%	27%	16%
Gross profit	(128)	146	64	27	33	30	13
Operating income	(66)	(63)	(124)	167	71	113	31
Pretax income	(70)	(68)	(155)	91	76	87	28
Net income	(70)	(68)	(155)	91	76	87	28
EPS	(88)	(69)	(147)	85	74	83	28
Avg. shares outstanding	145	3	17	4	1	2	0
Gross margin	30.5%	40.0%	41.3%	39.0%	35.3%	36.0%	35.2%
Research and development, net	39.5	20.2	13.5	12.1	10.6	9.9	8.8
Sales and marketing	49.6	27.4	21.2	18.5	15.6	14.3	13.6
General and administrative	11.0	6.3	4.4	4.2	4.1	3.5	3.5
Operating Expense	100.2	54.0	39.2	34.7	30.3	27.7	25.8
Operating margin	(69.8)	(13.9)	2.1	4.2	4.9	8.3	9.4
Pretax margin	(61.4)	(10.6)	3.6	5.2	6.2	9.1	10.0
Net margin	(61.4)	(10.6)	3.6	5.2	6.2	9.1	10.0
Tax rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company data and C.E. Unterberg, Towbin estimates

Table 2
Ceragon Networks
Quarterly Earnings Model, 2006-2008E

	<u>1Q06</u>	<u>2Q06</u>	<u>3Q06</u>	<u>4Q06A</u>	<u>1Q07E</u>	<u>2Q07E</u>	<u>3Q07E</u>	<u>4Q07E</u>	<u>1Q08E</u>	<u>2Q08E</u>	<u>3Q08E</u>	<u>4Q08E</u>
<i>(in thousands)</i>												
Revenue	\$21,322	\$23,640	\$30,508	\$32,945	\$32,500	\$34,000	\$35,000	\$36,500	\$35,500	\$38,000	\$41,500	\$45,000
Cost of sales	13,322	14,971	20,895	20,987	20,800	21,760	22,400	23,360	22,720	24,700	26,975	29,250
Gross profit	8,000	8,669	9,613	11,958	11,700	12,240	12,600	13,140	12,780	13,300	14,525	15,750
Research and development, net	2,674	2,651	2,741	3,417	3,400	3,450	3,420	3,420	3,450	3,450	3,500	3,650
Sales and marketing	3,742	4,068	4,161	4,978	4,900	4,950	4,950	4,950	5,000	5,000	5,500	6,200
General and administrative	939	1,046	1,122	1,341	1,200	1,200	1,200	1,200	1,400	1,400	1,400	1,400
Total operating expense	7,355	7,765	8,024	9,736	9,500	9,600	9,570	9,570	9,850	9,850	10,400	11,250
Operating income	645	904	1,589	2,222	2,200	2,640	3,030	3,570	2,930	3,450	4,125	4,500
Financial income, net	384	191	293	415	250	250	250	250	250	250	250	250
Other income	6	-	-	48	50	-	-	-	-	-	-	-
Income before taxes	1,035	1,095	1,882	2,685	2,500	2,890	3,280	3,820	3,180	3,700	4,375	4,750
Income tax (pro forma)	-	-	-	-	-	-	-	-	-	-	-	-
Net income	1,035	1,095	1,882	2,685	2,500	2,890	3,280	3,820	3,180	3,700	4,375	4,750
Non-GAAP EPS (diluted)	\$0.04	\$0.04	\$0.07	\$0.09	\$0.09	\$0.10	\$0.11	\$0.13	\$0.11	\$0.13	\$0.15	\$0.16
Avg. shares out. (diluted):	28,027	28,426	28,081	28,814	28,824	28,834	28,844	28,854	28,864	28,874	28,884	28,894
Yr/Yr % change:												
Revenue	27%	32%	62%	64%	52%	44%	15%	11%	9%	12%	19%	23%
Gross profit	18	20	34	57	46	41	31	10	9	9	15	20
Operating income	(14)	(0)	146	167	241	192	91	61	33	31	36	26
Pretax income	20	7	112	161	142	164	74	42	27	28	33	24
Net income	20	7	112	161	142	164	74	42	27	28	33	24
EPS	21	6	114	149	135	160	70	42	27	28	33	24
Avg. shares outstanding	(1)	1	(1)	5	3	1	3	0	0	0	0	0
Gross margin	37.5%	36.7%	31.5%	36.3%	36.0%	36.0%	36.0%	36.0%	36.0%	35.0%	35.0%	35.0%
Research and development, net	12.5	11.2	9.0	10.4	10.5	10.1	9.8	9.4	9.7	9.1	8.4	8.1
Sales and marketing	17.5	17.2	13.6	15.1	15.1	14.6	14.1	13.6	14.1	13.2	13.3	13.8
General and administrative	4.4	4.4	3.7	4.1	3.7	3.5	3.4	3.3	3.9	3.7	3.4	3.1
Operating Expense	34.5	32.8	26.3	29.6	29.2	28.2	27.3	26.2	27.7	25.9	25.1	25.0
Operating margin	3.0%	3.8%	5.2%	6.7%	6.8%	7.8%	8.7%	9.8%	8.3%	9.1%	9.9%	10.0%
Pretax margin	4.9	4.6	6.2	8.1	7.7	8.5	9.4	10.5	9.0	9.7	10.5	10.6
Net margin	4.9	4.6	6.2	8.1	7.7	8.5	9.4	10.5	9.0	9.7	10.5	10.6
Tax rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Qtr/Qtr % change:												
Revenue	6%	11%	29%	8%	(1%)	5%	3%	4%	(3%)	7%	9%	8%

Table 3
Ceragon Networks
Quarterly Balance Sheet, 2002-2006

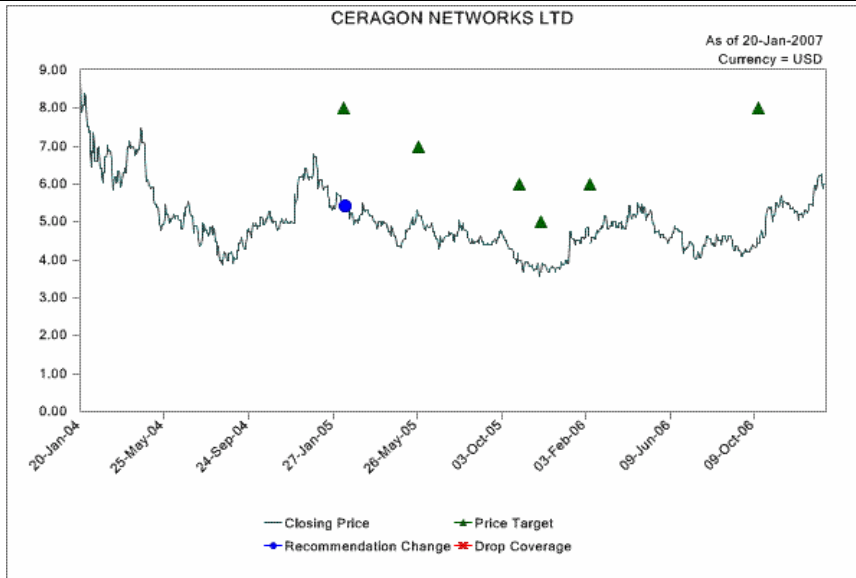
(in thousands)

	<u>4Q02</u>	<u>4Q03</u>	<u>4Q04</u>	<u>4Q05</u>	<u>1Q06</u>	<u>2Q06</u>	<u>3Q06</u>	<u>4Q06</u>
Cash and cash equivalents	\$4,688	\$7,307	\$11,234	\$10,315	\$9,900	\$8,336	\$9,976	\$10,170
Short term bank deposits	10,853	10,556	3,973	3,917	3,486	2,780	3,838	5,364
Marketable securities	11,743	4,861	11,101	5,654	6,902	7,454	6,357	6,578
Trade receivables, net	4,329	5,056	6,939	15,079	19,482	17,599	26,744	27,433
Other A/R and prepaid expenses	1,268	2,892	4,435	5,141	7,159	5,950	7,366	11,092
Inventories, net	8,054	11,103	19,083	16,144	19,918	17,011	21,321	23,144
Total current assets	40,935	41,775	56,765	56,250	66,847	59,130	75,602	83,781
Long-term bank deposits	4,214	1,473	4,451	5,322	4,367	4,949	3,356	2,873
Long-term marketable securities	11,675	14,849	7,042	7,814	5,643	6,496	5,134	4,500
Long-term receivables	0	0	390	0	0	0	0	0
Severance pay funds	1,200	1,664	1,947	2,142	2,445	2,290	2,564	2,537
Property and equipment, net	3,616	2,667	2,516	2,464	2,435	2,495	2,409	2,660
Total assets	\$61,640	\$62,428	\$73,111	\$73,992	\$81,737	\$75,360	\$89,065	\$96,351
Trade payables	\$5,744	\$5,662	\$9,348	\$12,382	\$15,237	\$13,029	\$19,257	\$22,147
Deferred revenues	-	1,188	3,114	3,456	4,012	3,251	4,945	3,739
Other payables and accrued expenses	4,805	4,444	5,479	5,541	6,575	4,939	6,633	10,627
Total current liabilities	10,549	11,294	17,941	21,379	25,824	21,219	30,835	36,513
Accrued severance pay	1,825	2,451	2,986	3,424	4,014	3,693	4,278	4,352
Other payables								7,925
Total liabilities	12,374	13,745	20,927	24,803	29,838	24,912	35,113	48,790
Total shareholders' equity	49,266	48,683	52,187	49,189	51,899	50,448	53,952	47,561
Total liabilities and stockholders' equity	\$61,640	\$62,428	\$73,114	\$73,992	\$81,737	\$75,360	\$89,065	\$96,351

Balance Sheet Metrics

Net cash	42,548	38,259	36,762	31,740	28,729	28,612	26,947	27,670
Net cash per share	1.89	1.59	1.31	1.16	1.03	1.01	0.96	0.96
Change in net cash		(4,289)	(449)	312	(3,011)	(117)	(1,665)	723
Change in accounts receivable		727	(2,414)	3,536	4,403	(1,883)	9,145	689
Change in net inventory		3,049	2,117	(4,924)	3,774	(2,907)	4,310	1,823
LT debt to capital (%)	3.6	4.8	5.4	6.5	7.2	6.8	7.3	8.4
Working capital	30,386	30,481	38,824	34,871	41,023	37,911	44,767	47,268
DSO	64	42	39	67	74	67	79	75
Turns	2.0	1.9	1.8	2.9	2.5	3.1	2.8	3.6

Source: Company data and C.E. Unterberg, Towbin estimates



CERAGON NETWORKS LTD
Currency = USD

Date	Closing Price	Recommendation Change	Date	Closing Price	Price Target
10-Feb-2005	5.42	BUY	12-Oct-2006	4.60	8.00
10-Feb-2005	5.42	BUY/BUY	06-Feb-2006	4.63	6.00
			29-Nov-2005	3.68	5.00
			27-Oct-2005	3.95	6.00
			27-May-2005	5.15	7.00
			10-Feb-2005	5.42	8.00

C.E. Unterberg, Towbin Ratings

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- Buy: 12 months, estimated 20% or more appreciation
- Market Perform: Performance in line with the market averages anticipated.
- Under Perform: 12 months, estimated underperformance of 20% or more

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	% of CEUT Universe with this rating	% of rating tier for which CEUT provided IB services
Buy	59%	81%
Market Perform	40%	19%
Under Perform	1%	0%

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- 7 - CEUT has received compensation for investment banking services from this company in the past 12 months.
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