

AudioCodes Ltd.

4Q09 Results

Hold

Maintained

Following solid results and guidance, we believe the Company is making steady progress in the revamped spending cycle. In the absence of an alternative OEM partner to replace Nortel, we think it will take some time before the Company retrieves the level it experienced prior to the downturn. Meanwhile, AudioCodes' steady growth and rationalized cost structure suggest a stable outlook with several small-mid sized opportunities. Maintaining HOLD rating and raising our price target to \$3.50 from \$3.00.

Recommendation & Valuation. We standby for developments with MSBG, Microsoft's UC and other verticals addressed by management, as 2010 drivers. We note earlier than expected traction with these verticals could reflect upwards on estimates. Our \$3.50 price target is based on relative valuation and reflects a 2010 EV/EBIT of 12.2x, a premium to peers averaging at 8.2x. AudioCodes trades at 2010 EV/EBIT of 12.4x, an even higher premium.

4Q Results. AudioCodes reported 4Q09 revenues of \$34.2M, above Streets' estimates of \$33.5M and a \$2.1M increase Q/Q. Non-GAAP EPS surpassed our expectations by 1 cent and totaled \$0.06. AUDC maintained gross margin stable at 56.3% supporting a 250 bp increase in operating profit which totaled 7.5%. AUDC generated \$11.9M in operating cash flow, bringing net cash to \$30.7M (or \$0.76 per share).

A "New Normal". Having digested the drawbacks from recession and Nortel's failure, we believe AudioCodes' solid results validate the process of recovery in the Company's business. Management reported customers' restored confidence to pursue previously initiated projects (i.e. DoD and Unified Communications) with higher visibility into the channels. Management's 2010 revenues and Non-GAAP EPS guidance is \$138.0M-\$143.0M/\$0.18-\$0.22. Our 2010 forecast calls for \$143.0M/\$0.21, mirroring the top range of the guidance.

Table 1: Forecasts and Ratios (Non-GAAP)

FY Dec (US\$M)	2008A	2009A	2010E	2011E
Revenues	174.7	125.9	143.0	159.0
Growth YoY (%)	10.4%	(28.0%)	13.6%	11.2%
EBIT	13.1	3.4	9.1	14.4
Net Income	12.3	3.1	8.7	13.5
EPS (US\$)	0.29	0.08	0.21	0.32
Growth YoY (%)	50.8%	NM	NM	NM
P/E (x)	12.2	45.9	16.6	10.9
EV/EBIT (x)	8.5	33.0	12.2	7.7
ROE (%)	8.2%	3.8%	5.6%	21.6%

Source: Company Data and Oscar Gruss Estimates

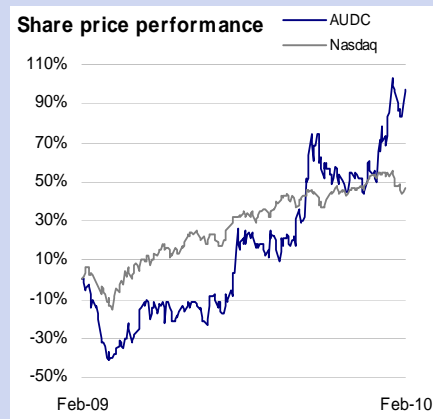
12-mth tgt: **\$3.50** (Previously \$3.00)

Bloomberg: **AUDC US**

Share Data	
Share price	\$3.33
M.Cap	\$135.23M
EV	\$104.50M
S/O	40.61M
Share float	75.31%
3-mth average volume	115,338
52-week range	\$0.92 - \$3.50

Key Ratios	
P/Sales (FY10E)	0.9x
EV/Sales (FY10E)	0.7x
Net cash/Share	\$0.76
TL Liab/TL Assets	0.4x
DSO	52
Net Debt/Equity	0.8x
Dividend Yield	N/A

Quarterly Data	4Q08	4Q09	1Q10E
Revenues (M)	\$38.8	\$34.2	\$34.0
Gross margin	55.5%	56.3%	56.0%
EBIT (M)	\$1.2	\$2.6	\$1.9
Operating margin	3.1%	7.5%	5.7%
Net income (M)	\$0.8	\$2.5	\$1.8
N. GAAP EPS	\$0.02	\$0.06	\$0.04
Operating CF (M)	\$9.4	\$11.9	\$1.9



Source: Bloomberg

New Markets, New Opportunities. Audiocodes seeks to play a meaningful role in the Enterprise market with Multi Service Business Gateway (MSBG) all-in-one solution. Adding to standard media-gateway functionalities, MSBG encompasses numerous enterprise level features such as VoIP transcoding, routing, switching and security. With an entry level and competitive pricing, management looks to gain market share from pricier solutions like Cisco and others.

HD VoIP. The company is targeting two additional markets; HD VoIP and VoIP phones. We have recently seen early adaptors like Verizon in N. America and Orange in the UK, trialing HD VoIP. Driven by competition, we expect operators to eventually enhance users' experience and bring higher quality of service. While we expect a more significant build-up towards 2011, we do not exclude earlier traction from Audiocodes as this eco-system escalates into maturity.

In The Bandwagon. We remind that Audiocodes is one of two chosen media gateway providers for Microsoft's Unified Communication (UC). Despite uncovering this account a couple of years back, the company's partnership with Microsoft has yet to yield significant revenues. Management suggested this channel could steer towards improvement as corporate readiness to invest meets Microsoft's revamped efforts to push UC out the door.

Within the underlying opportunities, we highlight company's VoIP transition project with the department of defense (DoD), initiated with Nortel. Our checks indicate this deployment is running smoothly despite the issues surrounding Nortel's bankruptcy. We estimate this channel carries a ~\$10M backlog for 2-3 years. However, we already consider this to be factored-in management's future growth expectations. Following DoD domestic project, we expect a follow-on project outside America, which we believe presents a new opportunity for Audiocodes.

What to watch for:

Event	Implication
Possible capital raise of up to \$15M - resulting in minor stock dilution (most likely through PIPE).	Overall impact: neutral Benefit - slightly strengthen a weak Balance sheet. Disadvantage - stock dilution (minor).
High acceptance of recent initiatives; MSBG, Microsoft's UC, VoIP phones, HD VoIP.	Would likely yield an upside on our current model.
Enhancement of OEM agreement with a major integrator to resell media gateways.	Would help mitigate damage from Nortel's failure, reinstating the company's long time OEM go-to-market strategy.

4Q09 Revenue Mix. Revenue breakdown between TBU (Technology Business Unit - i.e., chips, blades and modules) and NBU (Network Business Unit - i.e. media servers and media gateways) was 27% and 73%, respectively. The N. American market accounted for 54% of total sales, consistent with the previous quarter. Sales in Europe accounted for 21% vs. 23% in 3Q09. APAC and Israel's portions slightly increased, reaching 16% and 9% respectively (15% and 8% in the previous quarter).

Balance Sheet Highlights. The Company generated \$11.9M in cash from operating activities (exceptionally high), bringing net cash to \$30.7M (or \$0.76 per share). DSOs decreased by 12 days sequentially reaching 52 days. Inventory turnover increased from 3.4x to 4.4x, above historical levels of 3.5x. Accounts receivables were \$19.6M, down \$3.0M from the previous quarter, while inventories continued to decline totaling \$13.5M, down ~\$3.0M Q/Q. We note that \$73.1M worth of AUDC' convertible notes were redeemed during the quarter, leaving total cash at \$52.9M.

Risks. (1) Continued decline in Telecom spending (2) Competitive pressures impose lower profitability (3) Low cash position reflects uncertainties over long-term operations. (4) Global VoIP trends are accelerating the penetration of Session Border Controllers (SBC). AUDC is not yet established in the SBC space as its current market share remains negligible at this point. (5) Political and/or terror-related risks connected to AUDC facilities located in Israel.

Rating and Pricing Information of Companies Mentioned in This Report (as of 03/02/2010): Microsoft Corporation (MSFT-Nasdaq-\$28.63). Cisco Systems (CSCO-Nasdaq-\$23.07), Verizon Communications (VZ-NYSE-\$29.19).

Key Financials

Profit & Loss

\$M GAAP	2007	2008	2009	2010E	2011E
Revenues	158.2	174.7	125.9	143.0	159.0
Gross Profit	92.2	99.7	71.1	79.8	87.6
OPEX	84.8	86.6	67.7	70.7	73.2
Operating Profit	7.3	13.1	3.4	9.1	14.4
Financial Income	2.7	1.2	0.0	0.0	0.1
Tax	0.6	0.5	0.3	0.4	1.0
Net Income	8.3	12.3	3.1	8.7	13.5
Shares O/S	43.7	43.2	40.3	41.2	42.2
EPS (\$)	0.19	0.29	0.08	0.21	0.32

Balance Sheet

\$M	2007	2008	2009	2010E	2011E
Cash & cash equivalents	110.4	115.1	52.9	152.8	20.6
Accounts receivables	32.2	33.9	22.1	28.9	33.1
Other Assets	18.7	20.6	13.5	18.5	21.0
Current Assets	161.3	169.7	88.5	200.2	74.7
PP&E	7.1	6.8	5.0	5.0	8.7
Long-term Assets	184.7	54.0	54.1	52.5	49.7
Total Assets	353.1	230.5	147.5	257.7	133.2
Accounts payables	37.6	41.9	28.2	36.2	41.4
Other current liabilities	0.0	71.4	6.0	0.0	0.0
Long term liabilities	139.0	33.9	29.5	29.1	29.1
Total shareholders equity	176.5	83.3	83.9	192.4	62.7
Total Liabilities	353.1	230.5	147.5	257.7	133.2

Free Cash Flow

\$M	2007	2008	2009	2010E	2011E
Operating Profit	7.3	13.1	3.4	9.1	14.4
D & A	7.8	7.4	5.0	5.3	5.5
Change in Working Capital	0.9	0.6	5.2	(3.7)	(1.5)
Tax Expenses	0.6	0.5	0.3	0.4	1.0
Other Adjustments, Net	0.0	0.0	0.0	0.0	0.0
Capital Expenditure	(2.6)	(3.2)	(0.9)	(1.2)	(2.0)
Free Cash Flow	12.8	17.5	12.4	9.1	15.4

Ratios

	2007	2008	2009	2010E	2011E
FCF Yield	9.5%	12.9%	9.1%	6.7%	11.4%
DSO	52	69	52	55	55
Inventory Days	94	108	81	100	100
Inventory Turns (x)	3.8	3.3	4.4	3.6	3.6
BVPS (\$)	8.70	5.68	3.63	6.35	3.28
P/BV (x)	0.4	0.6	0.9	0.5	1.0
Net Cash Per Share (\$)	0.50	0.55	0.76	3.69	0.39
Total Liabilities / Total Assets (x)	0.5	0.6	0.4	0.3	0.5
P/E (x)	17.5	11.6	43.7	15.8	10.4
PEG (CAGR 2007-2011E) (x)	158.8	105.3	395.9	143.2	94.1

Forward looking estimates

	4Q09	1Q10E	2009	2010E
Actual / Guidance				
Revenue (\$M)	34.2	N/A	125.9	138.0-143.0
Growth YoY	(11.7%)	N/A	(28.0%)	12.2%
EPS (\$)	0.06	N/A	0.08	0.18-0.22
Oscar Gruss estimates				
Revenue (\$M)	33.5	34.0	125.2	143.0
Growth YoY	(13.6%)	16.1%	(28.4%)	14.2%
EPS (\$)	0.05	0.04	0.07	0.21
Consensus estimates				
Revenue (\$M)	33.5	32.7	125.2	139.3
Growth YoY	(13.6%)	11.7%	(28.3%)	11.3%
EPS (\$)	0.06	0.03	0.07	0.19

Source: Company data Thomson Reuters and Oscar Gruss estimates

Company Description

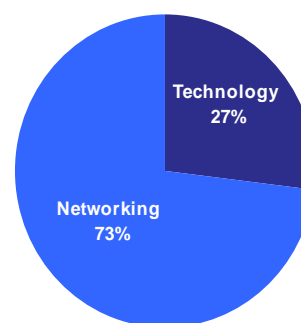
AudioCodes Ltd. designs, manufactures and sells VoIP, converged VoIP and data networking products and applications to service providers and enterprise. Its main products include an IP phone, Media Gateways and VoIP Gateways.

Top Shareholders

	Shares held	% of o/s
Shabtai Adlersberg	5,565,162	13.85%
Bialik (Leon)	4,079,322	10.15%
Senvest Partners, L.L.C.	2,977,090	7.41%
Renaissance Technologies Corp.	1,248,400	3.11%
Fidelity Management & Research	745,790	1.86%

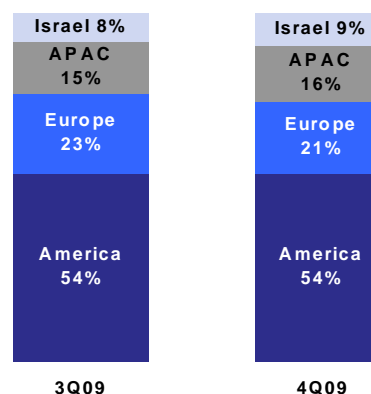
Source: Thomson

Chart 1: Segment Breakdown 4Q09



Source: Company data and Oscar Gruss estimates

Chart 2: Geographical Breakdown



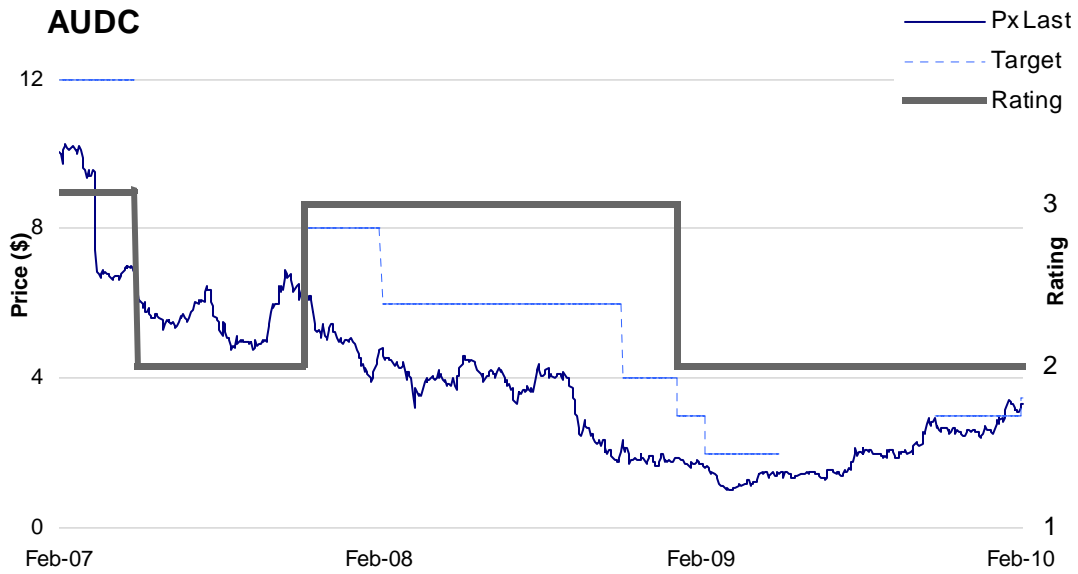
Source: Company data and Oscar Gruss estimates

Income Statement Model (Non-GAAP)

(\$ millions, except per share data)	2008A	1Q09A	2Q09A	3Q09A	4Q09A	2009A	1Q10E	2Q10E	3Q10E	4Q10E	2010E	2011E
Revenues	174.7	29.3	30.4	32.1	34.2	125.9	34.0	35.3	36.2	37.5	143.0	159.0
Cost of revenues	75.0	12.6	13.3	14.0	14.9	54.8	15.0	15.6	16.0	16.7	63.2	71.4
Gross profit (loss)	99.7	16.7	17.0	18.1	19.2	71.1	19.0	19.7	20.2	20.9	79.8	87.6
Operating Expenses												
R&D, net	36.4	8.0	7.1	7.1	7.1	29.3	7.3	7.4	7.6	7.8	30.1	31.8
Sales and marketing	41.6	8.3	7.4	7.4	7.8	30.9	7.9	8.0	8.2	8.3	32.4	32.4
General and administrative	8.7	2.0	1.8	1.9	1.8	7.5	1.9	2.0	2.1	2.2	8.2	9.0
Total operating expenses	86.6	18.3	16.3	16.5	16.6	67.7	17.1	17.4	17.9	18.3	70.7	73.2
Operating income (loss)	13.1	(1.6)	0.7	1.6	2.6	3.4	1.9	2.3	2.3	2.6	9.1	14.4
Other expenses	1.5	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial income, net	1.2	0.0	(0.0)	0.1	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Income before income taxes	12.8	(1.6)	0.7	1.7	2.6	3.4	1.9	2.3	2.3	2.5	9.1	14.5
Income taxes	0.5	0.1	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.4	1.0
Non-GAAP net income	12.3	(1.6)	0.6	1.6	2.5	3.1	1.8	2.2	2.2	2.4	8.7	13.5
FAS123 expenses	4.3	0.5	0.5	0.4	0.5	2.0	0.5	0.5	0.6	0.7	2.3	2.8
One-time charges	90.2	1.0	1.0	1.0	0.7	3.7	0.7	0.7	0.7	0.7	2.8	4.0
GAAP net income	(82.3)	(3.1)	(0.9)	0.1	1.3	(2.6)	0.9	0.9	0.9	0.9	3.6	6.7
Wtg Average number of shares (MM fully diluted)	43.2	40.2	40.2	40.3	40.6	40.3	40.9	41.1	41.2	41.4	41.2	42.2
Non GAAP EPS (ex. Option Expenses)	\$0.29	(\$0.04)	\$0.02	\$0.04	\$0.06	\$0.08	\$0.04	\$0.05	\$0.05	\$0.06	\$0.21	\$0.32
GAAP EPS	(\$2.05)	(\$0.07)	(\$0.02)	\$0.00	\$0.03	(\$0.06)	\$0.02	\$0.02	\$0.02	\$0.02	\$0.09	\$0.16
Margin Analysis												
Gross	57.1%	57.1%	56.2%	56.3%	56.3%	56.4%	56.0%	55.9%	55.8%	55.6%	55.8%	55.1%
Net R&D as % of revenues	20.8%	27.4%	23.3%	22.2%	20.7%	23.3%	21.5%	21.0%	21.0%	20.8%	21.0%	20.0%
S&M as % of revenues	23.8%	28.2%	24.4%	23.2%	22.7%	24.5%	23.2%	22.7%	22.7%	22.1%	22.7%	20.4%
G&A as % of	5.0%	6.8%	6.0%	5.9%	5.3%	6.0%	5.6%	5.7%	5.8%	5.9%	5.7%	5.7%
Operating	7.5%	(5.3%)	2.5%	5.0%	7.5%	2.7%	5.7%	6.6%	6.4%	6.8%	6.4%	9.1%
Tax percentage	4.0%	(3.3%)	11.3%	6.4%	2.1%	8.6%	5.2%	4.3%	4.4%	3.9%	4.4%	7.0%
Net (non-GAAP)	7.0%	(5.5%)	2.0%	4.9%	7.4%	2.5%	5.4%	6.3%	6.0%	6.5%	6.1%	8.5%
Sales growth Q/Q		(24.4%)	3.6%	5.7%	6.5%		(0.5%)	3.8%	2.5%	3.6%		
Sales growth Y/Y	10.4%	(33.0%)	(33.5%)	(31.2%)	(11.9%)	(28.0%)	16.1%	16.3%	12.8%	9.8%	13.6%	11.2%

Source : Company's data and Oscar Gruss estimates

Historical Price Chart



Ratings Scale: 1 - Reduce, 2 - Hold, 3 - Buy

Note: Price chart adjusted for dividends and splits. Past ratings have been recalibrated to reflect the current ratings scale.

<u>TECHNOLOGY & TELECOM</u>		<u>RISK ARBITRAGE & SPECIAL SITUATIONS</u>	
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Marcel Tschan		Michael O'Brien	
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Rating (as of 3/2/10)	# of securities in OG universe with this rating:	% of securities in OG universe with this rating:	# of companies for which Investment Banking ser- vices have been provided:	% of companies for which Investment Banking ser- vices have been provided:
Buy	33	56.90%	0	0%
Hold	23	39.66%	0	0%
Sell / Reduce	2	3.45%	0	0%

More information available on request.

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