Company Name: EZchip
Company Ticker: EZCH IT
Date: 2011-08-03
Event Description: Q2 2011 Earnings Call

Market Cap: 3,801.66
Current PX: 13540
YTD Change($): +2680
YTD Change(%): +24.678

Bloomberg Estimates - EPS
Current Quarter: 0.086
Current Year: 0.844
Bloomberg Estimates - Sales
Current Quarter: 9.178
Current Year: 50.967

Q2 2011 Earnings Call

Company Participants

- Kenny Green
- Eli Fruchter
- Dror Israel

Other Participants

- Jeff A. Schreiner
- Daniel A. Berenbaum
- Daniel Meron
- Joseph Wolf
- Jay Srivatsa
- Sandeep Shyamsukha
- Sundeep Bajikar
- Paul McWilliams

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the EZchip Second Quarter 2011 Results Conference Call. All participants are at present in listen-only mode. Following management's formal presentation, instructions will be given for the question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded August 3, 2011.

I would like to remind everyone that forward-looking statements for the respective company's business, financial condition and results of its operations are subject to risks and uncertainties which could cause actual results to differ materially from those contemplated. But such forward-looking statements include, but are not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, and the effect of company's accounting policies, as well as certain other risk factors which are detailed from time-to-time in the company's filings with the various securities authorities.

I would now like to hand over the call over to Mr. Kenny Green of CCG Investor Relations. Mr. Green, please go ahead, sir.

Kenny Green

Thank you, operator, and good day to everybody. I would like to welcome all of you to EZchip's second quarter 2011 conference call, and thank EZchip's management for hosting this call. With us on the line today are Mr. Eli Fruchter, CEO, and Mr. Dror Israel, the CFO.

Before we begin, I would like to point out that during this call certain non-GAAP financial measures will be discussed. These non-GAAP measures are used by management to make strategic decisions and forecast future results, and the company believes that these figures provide a better method of evaluating the company's current performance. A full reconciliation of the company's non-GAAP financial measures to GAAP financial measures are included in the

earnings release found today.

I would now like to hand the call over to EZchip's CEO, Mr. Eli Fruchter. Eli, go ahead please.

Eli Fruchter

Thank you, Kenny. Good day, everyone and welcome to our second quarter 2011 conference call. We are very pleased with our second quarter results. We generated the highest quarterly revenue in our history reaching $17.3 million, up 31% sequentially and up 16% compared to the second quarter last year. Gross margin on a non-GAAP basis for the quarter reached a record 80%, up from 78.5% in the first quarter. This enabled us to present a record non-GAAP net income of $9.4 million for the quarter representing an outstanding 54% non-GAAP net income margin. Furthermore, we increased our cash balance by $12.6 million to $121 million with zero debt at the end of the quarter, further solidifying our already very strong financial position.

Looking at our quarterly revenues in further detail. Revenues from our specialized processors, sold to Cisco through Marvell, grew significantly to $5.3 million, reaching 31% of revenues in the second quarter, up 16% sequentially and up 35% from the second quarter of last year. We are pleased with Cisco's revenue growth and believe that it can accelerate once Cisco moves its NP-4 based systems into production.

Second quarter revenues from Juniper totaled $3.4 million or 20% of the quarter's revenues, up 16% sequentially and down 35% from the second quarter last year. We believe that revenues from Juniper will continue to grow sequentially in the third quarter, but we do expect a full year 2011 sales decline to Juniper versus 2010. It is important, however, to reiterate that while NP-2 revenues from Juniper are expected to decline in 2011 versus 2010, we expect such 2011 NP-2 revenues to be more than offset by 2011 NP-3 and NP-4 revenues from other customers.

Second quarter revenues from ZTE totaled $2.2 million or 12% of revenues, up 518% sequentially and up 48% from the second quarter last year. We believe that all excess inventory that was created by ZTE in the fourth quarter of 2010 was consumed during the first quarter and the second quarter is back to a normal consumption level. We are pleased with ZTE's revenue growth and believe that it can accelerate once ZTE moves its NP-4 based systems to production.

All other customers, as a group, excluding Cisco, Juniper and ZTE, totaled $6.4 million or 37% of the second quarter's revenues, up 20% sequentially and up 50% from the second quarter of last year. Looking ahead, there are three large CESR customers in this group of other customers that are now designing several important platforms based on the NP-4, which we believe are expected to move to production during the fourth quarter. Each of these three customers has the potential of becoming a 10% plus customer once its NP-4 based system ramps and it is in full volume production.

Turning now to our next generation products. NP-4 is making good progress and is on track to move into production during the fourth quarter. It is important to note that customers purchased significant amounts of NP-4 samples during the second quarter and NP-4 already generated meaningful revenues. We expect this trend to continue throughout the third quarter when we expect to complete the testing of the part and move it to production. We expect that NP-4 shipments in the fourth quarter will be production shipments. However it is important to note that since NP-4 is already generating meaningful revenues, the exact time of moving to production is an important milestone but not a revenue event. NP-4 revenues will grow gradually as the NP-4 based systems enter the market and begin ramping up. This ramp up, as always with carrier systems, takes several years.

During the quarter Infonetics Research published its 2010 Carrier Ethernet Equipment Analysis. According to the report, service providers' investment in Carrier Ethernet continues to outpace overall telecom CapEx with CESR and Transport expected to grow to 70% of the total Carrier Ethernet Equipment market by 2015. The result for us is that the market for high speed NPUs, EZchip's main market, is growing much faster than the Carrier Ethernet Equipment space as a whole. In particular, the forecast is for a huge increase in the number of 10 and 100 gigabit Ethernet ports. When drawing from the number of ports, the number of corresponding NPUs, such as the NP-4, we see a significant increase in number of NP-4 like NPUs compared to NP-2 and NP-3 like NPUs combined, which further validates our growth

expectations.

During the second quarter we continued to make good progress with all our other products that are under development. The NP-5 and the new product in our office in Kiryat Gat are in development and expected to become our growth generators when the NP-4 reaches peak revenues several years from now. We believe that the NP-5 is likely to become the NPU of choice for all our NP-4 customers as it protects the huge investment of our customers and enables faster time to market. The NPA-0 has taped out at the end of July with samples expected in September. The NPA-0 provides us with an entry point, low cost, access network processor that integrates all the ingredients that are required in a small Ethernet access box.

As we said on our last earnings call, 2011 is shaping to be a transition year for EZchip, transitioning from Juniper to Cisco and from NP-2 to NP-3 and NP-4. Despite an expected year-over-year revenue decline from Juniper, as compared to 2010, we expect that this decline will be more than offset by our other customers, resulting in a year-over-year growth in 2011 as compared to 2010. Looking further out, the market for high speed NPUs is expected to experience accelerating growth, and with NP-4, the leading merchant high-speed network processor in production, we expect significant revenue growth in the coming years.

With regards to guidance for the upcoming quarter, we believe that revenues in the third quarter of 2011 will be 4% to 8% higher compared to that of the second quarter of 2011. Gross margins in the third quarter are expected to be in the 78% range, down from the 80% gross margins in the second quarter that resulted from significantly lower royalty payments to the Israeli Office of the Chief Scientist, which Dror will shortly explain. We are also expecting annual OpEx to be in the $22 million range, lower than our previous $23 million estimate.

I would like now to turn over the call to our CFO, Dror Israel, for a more detailed financial review. Dror?

Dror Israel

Thank you, Eli. In order to better understand our business we are providing both GAAP and non-GAAP results. While we discuss the non-GAAP results on this call, the GAAP results, and the reconciliation between the figures, are included in our earnings release. The non-GAAP financial measures exclude the effects of stock-based compensation, amortization of intangible assets and changes in deferred tax asset.

Now to the results. Revenues for the second quarter of 2011 totaled $17.3 million, up 16% from the $14.9 million in the second quarter of 2010, and up 31% from the $13.2 million in the prior quarter. Cisco, through Marvell, accounted for $5.3 million or 31% of revenues. Juniper accounted for $3.4 million or 20% of revenues. ZTE accounted for $2.2 million or 12% of revenues. And our other customers, which include, some of the world's other tier 1 networking vendors, as a group, accounted for $6.4 million or 37% of revenues for the quarter.

Non-GAAP gross margin for the quarter totaled 80.0%, up from the 75.8% in the second quarter of 2010, and above the 78.5% last quarter. The increase in gross margins resulted from significantly lower royalty payments to the Israeli Office of the Chief Scientist. The royalty payments were lower since the company concluded paying royalties related to the NP-3 grants. As NP-4 volumes start to pick up, we expect royalties to the Chief Scientist to be meaningful already in the third quarter and gradually increase. Non-GAAP R&D expenses net for the quarter totaled $2.8 million. This amount included $1.7 million in R&D grants received from the Israeli Office of the Chief Scientist. On a gross basis, our R&D expenses for the quarter totaled $4.5 million.

Non-GAAP operating expenses for the quarter totaled $4.8 million, compared to $4.5 million in the second quarter last year, and compared to $5.3 million in the prior quarter. We expect that our annual OpEx level in 2011 will be around $22 million, lower than our previous $23 million estimate, with the decrease in expenses resulting primarily from higher level of Chief Scientist R&D grants expected this year. Non-GAAP operating income for the quarter was $9.0 million, an increase of 32% from the $6.8 million operating income in the second quarter last year, and up 79% from the $5 million operating income in the prior quarter. Non-GAAP net income for the quarter totaled $9.4 million, an increase of 32% from the $7.1 million net income last year and up 75% from the $5.4 million in the previous quarter.

Fully diluted EPS on non-GAAP basis was $0.33, up from $0.26 in the second quarter last year and from $0.19 in the previous quarter.

Moving over to the balance sheet, cash, cash equivalents and marketable securities totaled $121 million as of June 30, 2011, compared to $108.5 million at the end of the previous quarter. Cash generated from operations during the quarter was $9.2 million, cash used in investing activities was $0.1 million and cash provided by financing activities was $3.4 million, resulting from the exercise of stock options.

And with that I would like to open the call for the Q&A session. Operator?

Q&A

Operator

Thank you. Ladies and gentlemen at this time we will begin the question-and-answer session. [Operator Instructions] Please stand by while we poll for your questions. The first question is from Jeff Schreiner of Capstone Investments. Please go ahead.

<Q - Jeff A. Schreiner>: Good day, gentlemen. Thank you for taking my questions. Eli, can you talk about what contribution you saw in the second quarter from NP-4? And just wondering if there is potentially any push out of maybe expected revenues from NP-4 that might have originally maybe hit in the third quarter, now maybe pushed out in the fourth quarter, because it sounds like you're fairly bullish on the December quarter with regards to some increase of NP-4 contribution. Could you give us some color on that?

<A - Eli Fruchter>: Hi, Jeff. Thank you for the question. So NP-4 was pretty significantly this quarter and we expect it to be significant in the revenue of the third quarter as well. And that is before the part is moving to production. If we move to production in the fourth quarter, but as I said it's a very important milestone, but it's not going to be a revenue event. So the numbers that we see from NP-4 now are just from centers are pretty significant numbers.

<Q - Jeff A. Schreiner>: Okay. And then can you talk a little bit about maybe how the ramp of NP-4 is looking versus kind of what you've seen today with the ramp of NP-3?

<A - Eli Fruchter>: So the ramp really starts when the stuff moves to production, but if we compare the revenue that we see from centers compared to what we have seen with NP-2 and with NP-3 those numbers are much, much higher and that's a good indication for us for the production. So we feel very, very comfortable with the number of chips and the revenue that we already see from NP-4.

<Q - Jeff A. Schreiner>: Okay. And then it sounds like some of your comments in terms of maybe saying it's likely that all NP-4 customers are moving to NP-5. Has the company won any new platforms for NP-4 or maybe any new customers for NP-5?

<A - Eli Fruchter>: We are winning platforms for the NP-4 all the time. So that's an ongoing process that is happening and we win NP-4 on ongoing basis. As for NP-5, when we won the first platform, we said that that was very, very early and was surprising to us, and we felt that it would take about one more year for us to win NP-5 platforms. So those were very early. I believe that until NP-5 sample, that's when we have to win all the NP-4 platforms with NP-5 and that's still down the road. So we have not added additional NP-5 customers but we feel very, very confident that we will.

<Q - Jeff A. Schreiner>: Okay. Last question for me. I appreciate your time guys. In looking at the NPU market and the commentaries about faster than expected growth here in the near term than previously maybe forecasted by Linley, how does that impact longer-term growth rates? Do those need to be sustained, pulled in now, maybe some growth is being pulled forward or should those possibly be looked at maybe being at a higher level as well?

<A - Eli Fruchter>: I think that profit actually, the bottom line of that is that we feel that the markets for high-speed NPUs is going to grow faster than we anticipated until now. And that's simply because we are seeing from the new

report that came from Infonetics Research. What we are seeing, we are seeing that the segment which is the CESR segment will actually double between 2010 and 2015 from about $10 billion to $20 billion. And the CESR is the segment that we are selling on high-speed NPUs to that segment. And in that segment is going faster than the market for high-speed NPUs is larger and actually we have updated our presentation and we will place it on our web after the call, so everyone will be able to see the change in those numbers.

<Q - Jeff A. Schreiner>: Okay. Thank you very much gentlemen.

<A - Eli Fruchter>: Thank you, Jeff.

Operator

The next question is from Daniel Berenbaum of MKM Partners. Please go ahead.

<Q - Daniel A. Berenbaum>: Yes. Hi. Good afternoon. Thanks for taking my question. Just on the revenue growth into next quarter. Can you give us a little bit of color around which customers do you think might grown and then around Juniper, where you expect sequential growth. Do you have an estimate for how much Juniper is going to be down on a full year basis and how should we think about that going forward?

<A - Eli Fruchter>: Okay. So, basically, we believe that other than Juniper, we expect all our other customers to grow on a year-over-year basis. How much Juniper is going to be down compared to last year is something that we really don't know. When we do get their forecast, but it changes on a quarterly basis, sometimes on a monthly basis and overall, we feel comfortable that we are going to grow year-over-year for the entire revenue, but exactly how much, it's not a number that we are providing.

<Q - Daniel A. Berenbaum>: Okay. And then on your R&D expense and on the royalty payments that you paid to the Israeli Chief Scientist, can you – I think you mentioned that, it sounded like there was about $600,000 in that royalty – or in R&D credit that you got in this quarter. Was that sort of an exceptionally large one-time lump sum? And then, how should I think about R&D growing on a normalized basis, on a quarterly basis looking out over the course of the next couple of years?

<A - Eli Fruchter>: So, actually, this quarter we – I said that we gathered the gross R&D expenses worth $4.5 million and we got $1.7 million in grants from the Chief Scientist that we recognized this quarter, so it's much higher than the $0.6 million. And also, we said that we are lowering the operating expenses guidance this year from $23 million to $22 million because we expect that, overall, the support levels of the Chief Scientist this year is going to be higher than what we initially expected. So this is the main reason for reducing the $23 million off of guidance to $22 million. Just to give you a rough understanding, last year the Chief Scientist growth overall was about – just about $3 million altogether. This year it's going to be about $4.5 million and we expect it to be similar next year, although it's not something that we can know for sure. And other than that, R&D expenses are growing mainly because of the new design centers that we started in Kiryat Gat. And the R&D expenses are growing mainly because of head count increase.

<Q - Daniel A. Berenbaum>: Okay, great. Thanks very much.

<A - Eli Fruchter>: Thank you.

Operator

The next question is from Daniel Meron of RBC Capital Markets. Please go ahead.

<Q - Daniel Meron>: Thank you, guys. Congrats on the solid execution here. Can you give us a clear sense of what you're gaining from your end customers? It does seem like – I get some commentaries from some players in the networking space, it's looking a little bit slower than people thought and now, you guys seem to back that. So obviously you're in a niche that is growing very fast. But just, if you can share with us what's your feedback from your customers

right now.

<A - Eli Fruchter>: So what we have seen Daniel, is really no change to what we have seen earlier. We don't talk or we don't work directly with carriers. We work with our customers that are building the products that we sell our chips to mainly developers. We provided guidance for Q3, which is based on what we know right now. And that's the only short term thing that we can do right now. As for the long term, I mentioned the Infonetics report that came out only a few months ago, that's quickly updated. It shows a strong increase. We believe that the build-out of the infrastructure will continue. There will be more smartphones and more video and all of that continues. So the long-term outlook looks very strong.

<Q - Daniel Meron>: Okay. Thank you, Eli. And then just, can you give us a little bit more color on what's going on with the new product line? If there's any update there that you can share – where do you stand with the development plans compared to your original business plan, et cetera?

<A - Eli Fruchter>: It's on track, it's moving as anticipated. We are not yet in a position to provide more information on what product line is. And we'll do it sometime down the road.

<Q - Daniel Meron>: Okay, very good. Thank you, good luck.

<A - Eli Fruchter>: Thank you, Daniel.

Operator

The next question is from Joseph Wolf with Barclays Capital. Please go ahead.

<Q - Joseph Wolf>: Hello?

<A - Eli Fruchter>: Yes, Joseph, we can hear you.

<Q - Joseph Wolf>: Okay, great. Maybe a slight follow-up on the prior question which is, given what some of the commentary on the macro was with some of your larger customers, Juniper in particular, maybe talk about, and maybe this is reflected in the NP-4 traction that you're describing. But there's been a lot of talk about the new Alcatel-Lucent platform and the new ZTE platform and the new Juniper platform, could you talk a little bit about the dynamics in the network and how quickly you're seeing adoption of new maybe 100-gigabit standards and how that's applying into the growth rate for the next 18 months?

<A - Eli Fruchter>: Yes, so – yes, we saw some announcements on new products, especially the 400-gig processor that was announced by Alcatel and we got some questions about that and what – and that's a little bit confusing to investors because measuring gigabits is a little bit difficult and what we are telling our investors is really to measure the product by the port density, meaning the number of ports on the line card.

When you have a chip of 400 gigabit, it could be a single chip, it could be a chipset, it depends on what it requires around it, so it's very hard to really know how good it is. One simple way is really to look at the port density. And if you will look at the announcement that Alcatel made, they spoke about having line cards of 20 ports of 10-gigabit sometime in the second half of next year, where Cisco already announced line cards of 24 ports of 10 gigabit and that's on – that appears on their website, So I think that there is a lead here of about a year from that product.

So, I think that looking at – to maybe to summarize, looking at port density, simply go to the website, go to the platform, look at the line card, look how many ports it can support and that would give you a sense of how integrated is the chipset. Because at the end of the day, the port count or the port density, as you just said, from price per port and on the success of the platform. And you can do the same with all players and you will get a sense of where each one stands.

<Q - Joseph Wolf>: Okay. Jumping to the OpEx, you talked about the contributions from the State – the Chief Scientist. Thinking about 2012 where you did provide some guidance, does that number stay the same or will there be

contributions that reduce that number as well?

<A - Eli Fruchter>: So we did not discuss the number yet but we expect the OpEx number for 2012 to be about $27 million. I mean it's too early to know exactly but this is the range. Again, the main drivers for the OpEx growth is the new design center and the additional employees that we are hiring. We expect them all at the same level of Chief Scientist support in 2012 and it is already included in the $27 million number that I'm talking about. And I think that in the following year after we established our entrance into this new market segment, operating expenses are expected to grow in a more moderate way. I estimate it at about 10% each year following 2012.

<Q - Joseph Wolf>: Okay. And then, I guess with the NPA talk coming online and the comments that you've made, if we think about sampling of production and customers, for 2012 could that be a 5% product line for the company? And if we think about the customers that you're selling to now, are the majority existing customers or will we see any new customers crop up based on the new access product?

<A - Eli Fruchter>: It's a mix. There are new customers and there are existing customers. I would say out of maybe 64 people, 60 are existing customers. I don't know that I can give a number of what NPA percentage will be of the entire revenues. We're winning some significant projects with NPA. It takes time for those to ramp up. We continue to win. We just take out the NPA-0. We got a very significant customer for that one already and we have a few more that are looking at it.

The contribution of the NPA is not just the fact that it provides more revenues but it provides us with a complete solution from 1-gig to 200-gig with the same architecture and the same software. And NPA is helping to win NP deals and vice versa. And what more I can say about it is that the access market, we really draw the line between low speed which is NPA and high speed which is NP at 20-gig. But all the time, that line will rise, it will go up, and maybe the 20-gig will soon become 40-gig. And we are already seeing our NP for that winning access platform. So, I think that the mix between high speed and low speed over time will really change. So, we will see more high speed going into that segment.

<Q - Joseph Wolf>: All right. Thank you.

<A - Eli Fruchter>: You're welcome.

Operator

the next question is from Jay Srivatsa of Chardan Capital Markets. Please go ahead.

<Q - Jay Srivatsa>: Yes, thanks for taking my question. Eli, competitively outside of Juniper's internal solution in the merchant market, what are you seeing? Are you seeing any solutions out there that are potential challengers as you look ahead to NP-4 ramp-up?

<A - Eli Fruchter>: Thank you, Jay. No, actually we don't. We feel that NP-1 – NP-4 sorry, won almost all the high speed platforms that can use merchant silicon. I would say that it's very, very clear in routers, in Edge Router. We are not aware of an Edge Router that we lost with NP-4 to another merchant silicon chip.

<Q - Jay Srivatsa>: All right. In terms of your new products that you have planned from Kiryat Gat, you seemed to have suggested you are pretty happy with the progress. Could you give us a little bit update on where things are and when do you expect to be able to speak more on that?

<A - Eli Fruchter>: I don't see that I'm in a position today to give – to put more color on it. I believe that we will be able to do so either towards the end of this year or early next year but not today.

<Q - Jay Srivatsa>: Okay. Thank you very much.

<A - Eli Fruchter>: You are welcome, Jay.

Operator

The next question from Sandeep Shyamsukha from Auriga USA. Please go ahead.

<Q - Sandeep Shyamsukha>: Thanks for taking my question. First thing, I just wanted to get was regarding NP-5, can you provide us a number in terms of what percentage of existing design wins for NP-4 have been converted into design wins at NP-5. And also what's – what sort of dollar increase do you expect from NP-5 versus NP-4 in terms of having newer features and probably better in division?

<A - Eli Fruchter>: >: I'll start with the second part of the question. We expect the ASP to be about 50% higher for NP-5 versus the NP-4 and the throughput two times higher. As I've said before about design wins, we got a couple from Tier 1 customers that are using the NP-4, but I can say that the plan of record for all of our customers is really to use NP-5, although those design wins are not official, it's – this is I believe the plan of record for all of them and that's mainly as I said already because of the huge investments in software that those customers have already made with us. So I'll be very surprised if NP-4 customers will not move to NP-5. And that will happen between now and middle of next year.

<Q - Sandeep Shyamsukha>: And also from a competitive landscape standpoint, compared to NP-4, are you expecting maybe more competition for NP-5 maybe from some newcomers like Broadcom or do you think that the competitive landscape remains fairly benign just like NP-4s?

<A - Eli Fruchter>: I think it remains mainly like NP-4 because the investment in moving to another network processor is huge. And I believe that, a Tier 1 customer that invested onwards of many years in working with NP-4 will not move to another network processor unless we do something very, very wrong. And we don't want to do something very wrong. So I don't believe that that's highly likely. If someone will move to another processor, it will be in-house. It will be the same type of investment but I cannot see someone doing it with another merchant silicon.

<Q - Sandeep Shyamsukha>: Sounds good. Thank you.

<A - Eli Fruchter>: Thank you, Sandeep.

Operator

The next question is from Sundeep Bajikar of Jefferies & Co. Please go ahead.

<A - Eli Fruchter>: Yes, Sundeep, we can't hear you. Okay, so it seems that Sundeep's got -

Operator

Sundeep, are you on the line?

<Q - Sundeep Bajikar>: I'm on the line. Can you hear me?

Operator

Yes. Thank you.

<A - Dror Israel>: Yes.

<Q - Sundeep Bajikar>: Can you hear me?

<A - Dror Israel>: Yes.

<A - Eli Fruchter>: We can hear you, Sundeep. Go on.

<Q - Sundeep Bajikar>: Okay, great. Sorry about that. On the gross margins, can you give us your puts and takes in terms of – both in terms of the royalty payments to the Israeli Office of Chief Scientist as well as your non-fiscal revenue mix which looks like it might have improved last quarter? Just perhaps provide us with relative impact of each factor?

<A - Dror Israel>: Okay, so in the second quarter we had gross margins of 80% and we said it was – as compared to the 78% guidance mainly because we concluded paying royalties on the NP-3 related grants that we received from the Chief Scientist. Now we expect NP-4 to start kicking in and this will, of course, have an effect again on the gross margins and we are guiding 78% going forward. In terms of the breakdown between fiscal and non-fiscal gross margins, so I think that the 78% is derived from taking above 90 plus percent for the fiscal related revenues, royalty revenues and above 70% for the direct product sale. And this will give us the average 78%.

<Q - Sundeep Bajikar>: Okay. That's helpful. And in terms of your end markets particularly on the metro side, can you give us your big picture views on CESR trends in a rate – adoption of IPv6? And what do you think specifically is driving growth for EZchip in the near term?

<A - Eli Fruchter>: So I mentioned already the Infonetics' Research report that came out that shows the strong increase in CESR especially looking at 10 and 100-gigabit Ethernet ports and specifically in Edge Router, it show a very sharp increase between now and 2015. And if we translate that to the number of chips, there is potentially very big increase in the number of chips between now and 2015, and before we've just entered in production it will be in production in the fourth quarter for the first time. And our growth in the coming years will be based on that and we have said many times already that NP-4 has won two times the number of platforms compared to NP-2 and NP-3 combined. And the ASP is also close to the other. And the reason that we have won twice the number of platforms is also supported by the number of ports from the Infonetics report. So when we take into account all those numbers, it seems that it is supporting our long-term view of quadrupling the NP-4 revenues compared to NP-2 and NP-3 combined.

<Q - Sundeep Bajikar>: Okay. And one last question from me, if I may. Can you give us an update on the access market? Tell us if anything has changed with the way the industry is progressing on LTE infrastructure rollouts. Are you seeing a faster adoption of your products in access? Any color you can provide on the underlying technology transition from TDM to packet would be great.

<A - Eli Fruchter>: So we always believe that there is a transition from TDM to packet. And we actually are not supporting TDM directly on our chips. We work with partners. So for TDM our integration, that's not where we are focused on. We focused on pure IT and we see the market going there. Obviously there will be a lot of legacy sold in that space in the coming years. But looking five years down the road, I think that all the new products that will sell there are going to be IT packet-based and that's where we are focusing. So we will continue to do that and develop more products for the access space, like the one that we have just phased out, the NPA-0 that integrates all the elements that you need on a board, including the half CPU, so we integrated that as well. And it's a real system on a chip that costs in the range $30 and you don't need much more than that on an access box.

<Q - Sundeep Bajikar>: Thank you very much.

<A - Eli Fruchter>: You're welcome, Sundeep.

Operator

The next question is from Paul McWilliams of Next Technologies Research. Please go ahead.

<Q - Paul McWilliams>: Hi, guys. Thank you for taking my call. Can you hear me?

<A - Eli Fruchter>: Sure. Thank you, Paul.

<Q - Paul McWilliams>: Okay. I like the arrangement – the agreement that you guys struck with NetLogic. During their conference call, they mentioned that they had 24 design wins for the NL-11k and the IPv6 platforms. Would you

have a similar number of design wins for your NP-4 since you're tied with that part from NetLogic?

<A - Eli Fruchter>: I don't know if they have other – what I can tell you is that on every design win that we have for NP-4 at high end box especially edge router, there is a NetLogic device there. So we work very closely together. We win all those designs together. I don't know if they have designs that maybe work with ASICs that are not NP-4s, that's possible. So I cannot tell you that all of their design wins are ours.

<Q - Paul McWilliams>: Okay, I understand. I'm curious, is Juniper taking a serious look at the NP-5?

<A - Eli Fruchter>: We cannot comment to that but I think that every networking vendor that is not taking a serious look at NP-5 might end up not being competitive, so I think that every player should look at NP-5.

<Q - Paul McWilliams>: Very good. A housekeeping question here, what was the OCS royalty for Q2?

<A - Dror Israel>: It was less than $200,000. And in Q1, it was close to $600,000.

<Q - Paul McWilliams>: Okay. What do you estimate for full year royalty this year?

<A - Dror Israel>: We don't provide this one number. We are just saying – we are just providing the gross margin guidance of 78% for the coming quarter and for Q4 at this point. So you can add up the numbers, 78.5% in Q1, 80% in Q2, and then 78% for the remainder of the year.

<Q - Paul McWilliams>: Okay. Now your full year estimate on the OCS grant that was $4.5 million?

<A - Dror Israel>: Yes.

<Q - Paul McWilliams>: Okay. And just to make sure here. That's all I've got for now. Thank you.

<A - Eli Fruchter>: Thank you, Paul.

Operator

[Operator Instructions] The next question is a follow-up question from Jeff Schreiner of Capstone Investments. Please go ahead.

<Q - Jeff A. Schreiner>: Yes. Dror, I just had one quick question for you on a follow-up. Looking at the numbers it seems like in the quarter the cash flow yield was somewhere around 53% in Q2. Just wondered what should we think about in terms of maybe cash – free cash flow expectations on a longer term basis and what are potential uses for this cash or that you guys are developing maybe over the next 12 months?

<A - Dror Israel>: Okay. So, operating cash flows are pretty much driving directly from the net income that we are generating. We are not paying taxes. Actually this quarter we concluded utilizing our NOLs and from now on we are going to benefit for 10 years of a tax-free period. So, I think the general expectation should be that our operating income will translate pretty directly to cash flows. And in addition to that we are generating cash flows from option exercise. As you saw it was above the $3 million this quarter. And so I think that's it. I hope it answered your question.

<Q - Jeff A. Schreiner>: Yes. And any uses of cash? You're getting a pretty strong cash balance, I think it is well over $4 per share on a dilutive basis per our calculation, any thoughts for the use of cash for the next 12 months?

<A - Dror Israel>: So you know the high cash levels are very important for our customers. As you know when they pick us up it's a very strategic decision and they want to be sure that they are dealing with a very stable company. And of course we like to be in a position that we can take advantage of biggest opportunities, M&A and stuff like that, but nothing that we can report right now.

<Q - Jeff A. Schreiner>: Thank you.

<A - Dror Israel>: Thank you, Jeff.

Operator

The next question is a follow-up question from Paul McWilliams of Next Technologies Research. Please go ahead.

<Q - Paul McWilliams>: Thank you. I wanted to ask on the NP-5, do you anticipate continuing the Marvell partnership similar to what it was on the NP-4?

<A - Eli Fruchter>: That's an option, Paul. This is something that we will have to realize, but I would say that that could be a good option for us.

<Q - Paul McWilliams>: Okay. Based on what we discussed during the last conference call, I estimate that Marvell is essentially doubling the price of the NP-3c to Cisco, is that – based on the royalty that you get, is that a reasonably good rough estimate?

<A - Eli Fruchter>: Do you mean if that's a good estimate for NP-4?

<Q - Paul McWilliams>: Is that a good estimate for NP-3c and will it be a good estimate for NP-4? Yes.

<A - Eli Fruchter>: Yes, it's a good estimate.

<Q - Paul McWilliams>: Okay. Well, thank you very much. And I'm sorry I forgot to mention last time, congratulations. Great execution.

<A - Eli Fruchter>: Thank you, Paul. Thank you.

Operator

There are no further questions at this time. Before I turn the call over to Mr. Fruchter, for the concluding statement, I would like to remind participants that a replay of this call will be available on the company website, www.ezchip.com.

Mr. Fruchter, would you like to make your concluding statement?

Eli Fruchter

So, I'll just thank everyone for joining us today. I was really pleased to provide good results. I hope that I would be always able to do it and I'm looking forward to speak to you all on our next earnings call. Thank you. Bye-bye.

Operator

Thank you. This concludes the EZchip second quarter 2011 results conference call. Thank you for your participation. You may go ahead and disconnect.