Company Name: EZchip
Company Ticker: EZCH IT
Date: 2012-02-08
Event Description: Q4 2011 Earnings Call

Market Cap: 3,450.41
Current PX: 12320
YTD Change($): +1460
YTD Change(%): +13.444

Bloomberg Estimates - EPS
Current Quarter: 0.089
Current Year: 0.847
Bloomberg Estimates - Sales
Current Quarter: 9.212
Current Year: 51.017

Q4 2011 Earnings Call

Company Participants

- Ehud Helft
- Eli Fruchter
- Dror Israel

Other Participants

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

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the EZchip Fourth Quarter and Year-end 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 February 8, 2012.

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. 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 the 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 the call over to Mr. Ehud Helft of CCG Investor Relations. Mr. Helft, please go ahead.

Ehud Helft

Thank you, operator and good day to everybody. I would like to welcome you to EZchip's fourth quarter and full-year 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 is included in the earnings

release.

I would now like to hand over the call to EZChip's CEO, Eli Fruchter. Eli?

Eli Fruchter

Thank you, Ehud. Good day everyone and welcome to our fourth quarter and full year 2011 conference call. This has been a transition year for EZchip, a transition from Juniper to Cisco as our largest customer, from NP-2 to NP-3 as our largest revenue generator and to NP-4 becoming our fastest growing product ever. The NP-4, which only entered production at the end of the year, contributed to 21% of 2011 revenues, over 90% from sample shipments.

In 2011 we generated our highest revenues in history despite a 39% decline from our largest customer Juniper reaching $63.5 million, up 2.4% over 2010, with annual gross margin for the year close to 78%, and net income increasing 2% over last year reaching a record $31 million or 49% of revenues.

Our cash position increased by $25.5 million in 2011 to $126.8 million at year end, after making a one-time early royalty payment of close to $10 million to the Israeli Office of Chief Scientist, which represented the full balance of the contingent liability related to the grants we received for NP-4 and NPA.

Upon making this payment, we have eliminated all future royalty obligations related to NP-4 and NPA revenues and saved on the associated future interest payments. We expect this payment will enable us to increase our future gross margins to over 80%. During the fourth quarter, three of our other customers, Huawei, Ericsson and Tellabs, contributed 32% of revenues with Huawei and Ericsson each accounting for more than 10% of our revenues in the fourth quarter even though they are still not in production with their NP-4 based products.

I want to emphasize that most NP-4 customers are not in production yet and are expected to enter production during the first six months of 2012. Once in production, the ramp up phase of their products is still expected to be lumpy and during that time we do not expect them to necessarily represent 10% of our revenues every quarter.

Throughout 2011 we strengthened our position as the vendor of choice for high-speed network processors for many clients, especially in edge routing, ending the year with those world's leading edge routing vendors that selected merchant network processors, being EZchip clients, and developing their next generation products based on our NP-4 processors.

I would like to reiterate that we expect all those products to enter production in the first half of 2012 and we believe all those customers will likely select the NP-5 for their next generation products before the end of 2012.

During the fourth quarter we announced that we have selected Marvell to our ASIC partner for the NP-5 and that the NP-5 is well ahead in its development cycle and we are very pleased that our leading tier-1 customers have selected to continue the EZchip path.

Looking at our fourth quarter and year summary in further detail. Before discussing the results in detail, it is important to reiterate that we experienced lumpiness in quarterly revenues, especially from our large customers, caused mainly by inventory changes and corrections that are done by the contract manufacturers that we are selling to. Annual revenue comparisons are a more accurate measure of our success and we experienced significant growth in 2011 compared with 2010 from all customers other than Juniper which declined, and we expect this trend to continue in 2012.

In the fourth quarter of 2011 we generated revenues of $14.3 million, down 24% from the third quarter and down 17% compared to the fourth quarter last year.

Gross margin for the quarter reached 76.8%, which, paired with our prudent expense management, enabled us to present a healthy non-GAAP net income of $6.3 million, or 44% of revenues for the quarter.

2011 revenues from our specialized NP-3 and NP-4 processors, sold through Marvell to Cisco, grew 34% in 2011 to $16.9 million, reaching 27% of 2011 revenues, up from $12.6 million or 20% of revenues in 2010.

Quarterly revenues from Marvell totaled $3.4 million, reaching 24% of revenues in the fourth quarter, down 5% sequentially and up 53% from the fourth quarter of 2010.

We expect Cisco to grow significantly for us in 2012. There are four major platforms that are using our chips, with three of the four in the process of entering production with NP-4 during the first half of 2012.

2011 revenues from Juniper declined 39% to $15.3 million, reaching 24% of our 2011 revenues, down from $25 million or 40% of revenues in 2010.

Quarterly revenues from Juniper totaled $3.4 million, reaching 24% of revenues in the fourth quarter, down 38% sequentially and down 49% from the fourth quarter of 2010.

We anticipate a continued decline in sales to Juniper in 2012, but believe that Juniper could still remain a 10% customer in 2012 and we expect we will continue to see some level of NP-2 revenues from Juniper in the following years as well.

2011 revenues from China's second largest networking and telecom equipment vendor, ZTE, grew 13% in 2011 to $6.8 million, reaching 11% of our 2011 revenues, up from $6 million or 10% of revenues in 2010.

Quarterly revenues from ZTE totaled $294,000, reaching 2% of revenues in the fourth quarter, down 93% sequentially and down 82% from the fourth quarter of 2010.

We believe that excess inventory that was created by ZTE resulted in a significant decline in revenues from ZTE in the fourth quarter. ZTE is selling to large carriers that do not purchase gradually throughout the year but rather make large project purchases. We are pleased with ZTE's overall annual 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, grew 33% in 2011 to $24.5 million, reaching 38% of our 2011 revenues, up from $18.4 million or 30% of revenues in 2010.

Quarterly revenues from all other customers totaled $7.2 million, reaching 50% of revenues in the fourth quarter, up 26% sequentially and up 9% from the fourth quarter of 2010.

We are pleased with the growth of our other customers and especially with Huawei, Ericsson and Tellabs that made up 32% of Q4 and 13% of 2011 revenues. All three customers are in the development phase of their NP-4 based systems and looking ahead, we believe that these customers have strong growth potential once they move their NP-4 based products into production.

Turning now to some of our key achievements in 2011. NP-4 entered production in December after years of intensive development. With more platform wins, higher ASP and expected market growth, NP-4 can potentially quadruple our revenues in the coming years. A strong indication to the potential was demonstrated by the fact that NP-4 contributed 21% to our annual 2011 revenues, mostly consisting of only sample sales.

NP-5 is well along in its development cycle and leading tier-1 customers have already selected to continue then the EZchip path with the NP-5. We believe that substantially all NP-4 customers will select the NP-5 for their next generation platforms. NP-5 is expected to sample towards the end of 2012.

We made good progress with our new product development in Kiryat Gat and we believe that we are building an extremely competitive, strongly differentiated product that will open new markets for EZchip and can more than double our total addressable market. The new product is expected to sample next year.

In 2011 we were able to increase our annual revenue and gross margin even though our largest customer, Juniper, declined sharply, close to 40% year-over-year. It should be noted that EZchip's revenues in 2011, excluding Juniper, grew over 30% year-over-year.

With regard to 2012, we believe that the anticipated strong growth of our NP-4, combined with significant NP-2, NP-3 and NPA revenues, will translate to continued year-over-year growth in 2012, mainly in the second half of the year

when NP-4 based systems are likely to be in production and carriers are expected to resume strong investments in Internet infrastructure. We believe that our gross margins in 2012 will be approximately 81% with annual OpEx at approximately $23 million.

With regards to guidance for the coming quarter, we expect revenues to be flat to slightly down sequentially with a very favorable product and customer mix that will drive gross margins up to approximately 85%.

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 effect of stock-based compensation, amortization of intangible assets, changes in deferred tax assets and one-time charge due to early repayment of Chief Scientist grants.

Now to the results; revenues for the fourth quarter of 2011 totaled $14.3 million, down 17% from the $17.1 million in the fourth quarter of 2010, and down 24% from the $18.7 million in the prior quarter.

Cisco, through Marvell, accounted for $3.4 million or 24% of revenues. Juniper also accounted for $3.4 million or 24% of revenues for the quarter. ZTE accounted for $0.3 million or 2% of revenues for the quarter. Our other customers, which include some of the world's other tier-1 networking vendors, as a group, accounted for $7.2 million or 50% of revenues. Within the other group, Huawei, Ericsson and Tellabs accounted together for $4.6 million or 32% of revenues, all resulting from NP-4 pre-production shipments.

For the year, revenues totaled $63.5 million, up 2.4% from$ 62 million last year. Cisco, through Marvell, accounted for $16.9 million or 27% of revenues. Juniper, accounted for $15.3 million or 24% of annual revenues. ZTE accounted for $6.8 million or 11% of revenues and our other customers as a group accounted for $24.5 million or 38% of revenues. Of the other group, Huawei, Ericsson and Tellabs accounted together for $8.4 million or 13% of annual revenues.

Non-GAAP gross margin for the quarter totaled 76.8%, up from the 74.7% in the fourth quarter of 2010, and above the 76.3% last quarter. Non-GAAP gross margin for the year reached 77.9% compared to 75.2% gross margin last year. As we have mentioned in the past, the special version processors that we sell to Cisco through Marvell bear a royalty model and as Cisco represents a larger share of revenues we see gross margin growing accordingly.

During December we have made a one-time early repayment of $9.9 million to the Israeli Office of Chief Scientist, representing the full balance of the contingent liability related to the NP-4 and NPA grants received in the past. Upon making this payment, we have eliminated all future royalty obligations related to our anticipated NP-4 and NPA revenues and saved the associated future interest payments related to such obligations. As a result of that we expect gross margin to exceed 80%.

Non-GAAP R&D expenses, net, for the quarter and for the year, totaled $3.3 million and $12.2 million, respectively. This amount included $1.3 million and $5.1 million, for the quarter and year, respectively, in R&D grants received from the Israeli Office of Chief Scientist. On a gross basis, our R&D expenses for the quarter totaled $4.6 million and $17.3 million for the year.

Non-GAAP operating expenses for the quarter totaled $5.2 million, compared to $4.5 million in the fourth quarter last year, and compared to $4.8 million in the prior quarter. Operating expenses for the year totaled $20.1 million, compared to $17.4 million in 2010. We expect that our annual OpEx level in 2012 will be around $23 million.

Non-GAAP operating income for the quarter was $5.7 million, a decrease of 31% from the $8.3 million operating income in the fourth quarter last year, and down 39% compared to the $9.5 million operating income in the prior quarter. Non-GAAP operating income for the year reached $29.3 million, similar to last year.

Non-GAAP net income for the quarter totaled $6.3 million, a decrease of 27% from $8.6 million last year and down 37% compared to $9.9 million in the previous quarter. Non-GAAP net income for the year reached $31 million, up 2% compared to $30 million net income in 2010.

Fully diluted EPS on non-GAAP basis was $0.22 for the quarter, down from $31.0 in the fourth quarter last year and from $35.0 in the previous quarter. Fully diluted EPS for the year was $1.09 compared to $1.14 in 2010.

Moving over to the balance sheet, cash, cash equivalents and marketable securities totaled $126.8 million as of December 31, 2011, compared to $127.6 million at the end of the previous quarter. Cash generated from operations during the quarter was $9 million, cash used in investing activities was $0.6 million, cash provided by financing activities was $0.7 million, resulting from the exercise of stock options. An additional $9.9 million was used for the repayment of Chief Scientist grants.

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] The first question is from Jeff Schreiner of Capstone Investments. Please go ahead.

<Q - Jeff A. Schreiner>: Yes. Thank you for taking my questions, gentlemen. Wanted to just to follow up a little bit, Eli, on the commentary regarding NP-4 and the significant contribution you kind of guided to or expected it could deliver in the coming year, I believe your comments were; and how that relates then to the kind of lower than maybe expectations out there for the March quarter seem kind of a flat to down. What type of ramp should we be thinking about for EZchip? You know you've said it's weighted to the second half but is it going to be fairly linear from Q2, Q3, Q4? Or is there a positive – a potential lumpiness and a big step-up at some point in the second half?

<A - Eli Fruchter>: Hi, Jeff. Thank you for the question. It's really difficult for us to guide beyond Q1. We need to be about a month or five weeks into the quarter to know more or less where the quarter is going. And we're still in a global economy situation where carriers are still not buying as we expect they should buy in the second half of the year. So that's why we provided a general guidance. We feel comfortable that NP-4 will be in production in almost all the platforms that are being now developed around the NP-4 during the first six months of the year. And all those platforms will be in production in the second half of the year where we think that we will see a stronger end. But to be accurate and tell you how it's going to look like quarter-over-quarter, I cannot – I can't tell, I don't know.

<Q - Jeff A. Schreiner>: Okay, fair enough. Could you give us any guidance maybe in terms of, you know, you talked about Cisco having four products, I believe, you made the commentary too possibly I think maybe all are using NP-4, if not, please correct me. But what I'm trying to get at here is how many products are likely to ship this year from your customers using NP-4?

<A - Eli Fruchter>: I don't – we don't count product per customer to all customers but there are, I would say that, with the key customers that are using the NP-4, it is more than one product for each one of them. There are five big customers that are building Edge routers around the NP-4, so that means that there are at least 10 NP-4 based platforms that will be in production during the first six months of this year.

<Q - Jeff A. Schreiner>: Okay. Two quick questions from me and I'll step out. How many customers – how many NP-4 customers have signed an NP-5 agreement at this time and, I guess, what gives you the confidence that you believe by the end of calendar year 2012 that that majority of your NP-4 customers are going to move to NP-5?

<A - Eli Fruchter>: I think that the main reason is the huge investment in software that they – that our customers have with us. They are spending a lot of time and resources to develop software around the NP-4 and we committed to customers that the N-P5 will be softer compared to the NP-4, meaning that they will – the move from – for them from

NP-4 to NP-5 should be very smooth and very quick and accelerate their time to market. That's why we think that it's highly likely for them to move with us. And I can tell you that for all of our customers, this is now the plan of record.

They are still busy in bringing the NP-4 to production, so that's why I'm saying until the end of the year where all platforms that use NP-4 are already in production and then they simply start developing the next generation and they think that developing it with NP-5 is their network step forward.

<Q - Jeff A. Schreiner>: Okay. And final one from me, can you help us understand how there would not be a – I think there's a perceived threat by some investors regarding your partner, Marvell, and its acquisition of a former competitor accelerated. Can you tell us why there wouldn't be any need to be concerned that there might be some conflict in the future regarding Marvell wanting to target some of the markets that you're working with them in?

<A - Eli Fruchter>: Yeah, I think that they can understand that – the type of concern and I think that through EZchip, Marvell is actually selling into the platforms that use the NP-4 and later on the NP-5, and that's mainly Edge Routers and I don't think that Marvell is targeting that segment with that acquisition. Based on what they are telling us, they are targeting the switching platforms and targets mainly competing with Broadcom in that space. So, I don't think that they will be competing with us in that main segment. In addition, I can remind the investors that years ago when we developed the NP-1, IBM was the vendor that manufactured the NP-1 for us. And IBM, at that time, was actually the leading network processor vendor. And the – so they did – they cooperated with us on the NP-1 and did their own NPUs at the time.

So, I think that, to summarize, I don't think that Marvell is targeting that – the market segment that we are selling to and we can work with them on the NP-5.

<Q - Jeff A. Schreiner>: Okay. Thank you very much for your time, gentlemen.

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

Operator

The next question is from Gary Mobley of Benchmark. Please go ahead.

<Q - Gary W. Mobley>: Hi, guys. Paying off the OCS grants or the future royalty obligations ahead of time, is that an indication that you're big enough now and profitable enough to where you won't rely on those grants in the future? And does that $23 million in OpEx guidance for 2012 exclude any offset from the OCS grants?

<A - Dror Israel>: Hi, Gary. This is Dror. So, no, it's a – two separate things. On the cost of goods level, we now eliminated all future royalty obligations. And by that, we substantially increased the forecasted gross margin to above the 80%. And of course, we saved a lot of interest payments that we would've paid if we waited for all the NP-4 revenues in the future. And actually, as we became confident in the future revenues that we are going to generate from NP-4, we saw no point in accruing all these interest payments and that was the logic behind this repayment.

At the same time, we continue to get Chief Scientist grants for the more, let's say, risky projects and very complicated projects, NP-5 and the new project in Kiryat Gat. And we got – we get the Chief Scientist helping finance these projects. So, the $23 million operating expenses forecast that we gave actually includes something in the range of $5 million that we expect to receive in Chief Scientist grants.

<Q - Gary W. Mobley>: Okay. And with respect to your first quarter revenue guidance, normally, your first quarter is seasonally weak. How much of that is playing into your – the guidance you're providing today? And then as well, have you seen an improvement in bookings that would indicate that perhaps by the time we get to the second quarter, you'll see fairly substantial sequential revenue growth?

<A - Dror Israel>: So, as Eli mentioned, at that point of time in the quarter, we have pretty good visibility for Q1, but not much beyond that. Actually, even for Q1, customers may still push out or pull in orders until the last month of the quarter. But we definitely can't have a clear vision of how Q2 is going to look like and we don't really have information

of the exact inventory levels of the channels. So, we will have to wait and see.

<Q - Gary W. Mobley>: Okay, last question is really more of a housekeeping question. You've simply mentioned that Tellabs and Ericsson were greater than 10% customers. Could you give us the exact amount?

<A - Dror Israel>: No, at that point we wouldn't like to give the exact amount and as Eli mentioned, it's early production and we don't expect them to be 10% each and every quarter. It will take time for them to ramp up their products into production. Once they will be in volume production we expect them to be 10% each on an annual basis.

At that point we wanted to give this piece of information to show that these customers are serious and to demonstrate the kind of expectations that we have on these customers in the future once they are in volume production with NP-4.

<Q - Gary W. Mobley>: All right, great. Thanks, guys.

Operator

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

<Q - Joseph Wolf>: Hi, thanks. Just a couple of questions that I think are kind of follow-ons. First question is, I know visibility is limited, but can you give us any indication or do you have any indication about the relative geographic strengths in terms of where the products are ending up? Are you feeling better or worse about the U.S., Europe or is everything effectively the same for you guys?

And just in line with that, if we think about annual growth potential, given the opportunities in NP-4, could the growth rate in 2012, if we exclude Juniper, be at the same level that it was in 2011 or even higher? So basically that's the question on the revenue side.

And then now on the expense side, I think the last time you gave OpEx guidance for 2012, it was $25 million to $27 million. I know that that was preliminary. I'm wondering if the new product has changed, whether you've pre-spent a little bit of that, or whether this is just a real, much more accurate indication of when that new product is coming on line?

<A - Dror Israel>: Okay. Joseph, I'll start from the end and let Eli answer on the first part of your question. So regarding operating expenses, we did guide for higher numbers, $25 million to $27 million. And there are a few reasons for us to lower this guidance. First of all, we would now anticipate a much higher Chief Scientist grant in 2012, similar I guess to what we had in 2011 around $5 million.

We also see the U.S. dollar rate compared to the shekel getting much stronger, about 10% stronger, so it's significant because most of our expenses, our label related and nominated in Israeli shekel. And in addition to that, we have the big project in Kiryat Gat that is now a very substantial portion of our R&D expenses. And then with – in the past year, this project became much more defined and clear to us and enabled us to take off some of the buffers that we took for – as a safety measure. And now when it is more defined, we can be more accurate on the forecast that we give.

<A - Eli Fruchter>: On the geography, Joseph, we are seeing – we see weakness, I would say, in Europe and Asia more than in the U.S. Actually, we see stronger signs in the U.S. You can see that we guided Q1 to be 85% gross margins which obviously indicate more royalty-related revenues and that comes from the U.S. So that's on the geography.

Now, you asked about revenues in 2012 including – excluding Juniper and this year it was 30% up excluding Juniper. We don't know exactly what it will be this year. As I said, we cannot see much beyond Q1 right now. But the general feeling is that since NP-4 is expected to be in production with a significant number of platforms in the first six months of the year, we expect to grow significantly this year with those platforms.

<Q - Joseph Wolf>: Great. Just a quick follow-up if I can on the gross margin. With the over 80% for – the 85% for the quarter and over 80% for the year, can you just give us kind of a breakdown of how much of that comes from mix

as you noted in the U.S. and how much of that comes from the Chief Scientist payment?

<A - Dror Israel>: Okay, Joseph, so I can't give you exact numbers. I would say in general that the Chief Scientist royalty that we have now eliminated are contributed let's say average 3%. It's not accurate. It may again vary on – because of customer and product mix each quarter, but in general I think this is the number. If you remember in the past we guided for 78%. Now we are saying 81% for the year. So, this is roughly. Of course we expect Cisco through Marvell to be much more dominant this year compared to the more longer term. I would say that longer-term we expect them to be about 30% of revenues, of course with 100% gross margins. This year it's going to be more in the range of 40% and altogether this provide us with the 81% range for this year.

<Q - Joseph Wolf>: Great, thank you.

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

Operator

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

<Q - Daniel A. Berenbaum>: Yeah, hi guys. Thanks for taking the question. Maybe – I'm not sure if I caught this before, but when you talk about the new product starting to ramp and starting to expand your share of market, can you talk about when and where you think that's going to start to sample next year, or does that actually start to ramp to revenue next year and then how does it affect your served market?

<A - Eli Fruchter>: Daniel, I'm not sure if you are relating to NP-4 or NP-5. So NP-4 sampled last year. It moved to production – you mean the new...

<Q - Daniel A. Berenbaum>: We're talking about the – yes.

<A - Eli Fruchter>: You mean the new product in Kiryat Gat?

<Q - Daniel A. Berenbaum>: Yes.

<A - Eli Fruchter>: Okay. Sorry, so I misunderstood. So that product will only sample next year. So we are not going to see revenues from that product this year and next year. We will see some maybe initial sample-related revenues next year. And then the following year will be the year when – of that product actually moving to production. So development this year, samples next year; 2014, that's when the product moves to production, so we will see more significant revenues; and 2015, the product will be in production. That's...

<Q - Daniel A. Berenbaum>: So we should model it sort of layering on revenue in the out-year. And then for NP-5 though, you talked about NP-5 ramping revenue at some point in 2013?

<A - Eli Fruchter>: Yeah. So NP-5 will sample this year. Again, it takes a year before we can really see production revenues. So next year, we will see some revenues from NP-5 but not significant, and 2014 is when we will start to see more significant revenues from NP-5. So NP-5 is actually a year ahead of the Kiryat Gat product.

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

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

Operator

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

<Q - Daniel Meron>: Hi, Eli and Dror. A quick question first of all on the trends. You guys discussed some of the regional perspective as you see it from your customers. Any discussions that you have with the carriers? You guys mentioned that you're expecting to resume some of the orders that are in the year. But is that based on just commentary

from your own customers, the chip vendors and the networking vendors, or is it also just related to some commentary from carriers that you're hearing?

And related to that, how – I'm trying to understand how they can manage the gap in between, between the growth in data and the infrastructure that's related to that. Is it just merely that they're using some older technologies or just letting it clog a little bit or what?

<A - Eli Fruchter>: So thank you for the question, Daniel. We are not hearing back from the carriers themselves. We don't sell to them. We don't have a direct relationship with them, so it's mainly coming from our customers. Well, they are obviously talking to the carrier directly and – so what will happen between now and then, I think that we have seen it a few times where there is no question that the infrastructure must grow to meet the growing bandwidth demand.

But right now it's – I would say, that it's on halt for a short period of time which means that the network will be loaded. But obviously, that will change and I think it will have to change quickly.

<Q - Daniel Meron>: Okay, understood. And last question from my end, as you look to the NP-4 ramp up into the NP-5, is there – did you see that NP-5 will naturally be integrated into more products? Maybe it's the same amount of customers that will be using it but do you think that you'll get more into additional product lines and add more features around it? or, is it going to be pretty straightforward and the platforms that are using the NP-4 will be pretty much the same ones using NP-5 going forward and you won't see it spreading out throughout those networking vendors?

<A - Eli Fruchter>: Obviously, we are targeting and expecting it to go into additional platforms. We saw it in – with moving from NP-3 to NP-4 so our NP-3 customers are now using the NP-4 in more platforms than what they used with NP-3. And, we expect the same thing to happen with NP-5. And, like we increased the ASP from NP-3 to NP-4, we are also increasing the ASP, the average selling price, from NP-4 to NP-5. So, additional platforms and higher ASP, that's what we are targeting.

<Q - Daniel Meron>: Okay. And that's embedded in your commentary that you expect your revenue to quadruple over next several years, right?

<A - Eli Fruchter>: That's not including the NP-5. That comment is only based on the NP-4 and the platforms that we have already won with NP-4.

<Q - Daniel Meron>: Right.

<A - Eli Fruchter>: So, just with that, our revenues can quadruple.

<Q - Daniel Meron>: Okay.

<A - Eli Fruchter>: NP-5 then comes on top of it.

<Q - Daniel Meron>: Okay. That's very impressive. Thank you, Eli and Dror. Good luck.

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

Operator

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

<Q - Jay Srivatsa>: Thanks for taking my question. Eli, it looks like a lot of the service providers and carriers seem to be investing a lot more into the wireline side and that seems to be a big priority – wireless side and that seems to be a big priority for them this year versus the wireline. The question is what gives you the confidence that things will pick up in the second half and not that that lumpiness could continue well into later part of this year?

<A - Eli Fruchter>: That's what we're hearing from our customers and they think that it's all combined. They think that wireless and wireline goes together; it's one network. And, if it's an IP – an end-to-end IP network and one part of the network runs fast and the other part runs slow, the network is slow. So, I think that the network needs to develop and

move forward together and we have a strong feeling that that's going to happen.

<Q - Jay Srivatsa>: All right. Competitively, can you give us some sense on how things have changed relative to competition, especially related to what Juniper might be doing or Alcatel-Lucent solution? How do they compare with what you have on the pipeline and what you're hearing from your own direct customers?

<A - Eli Fruchter>: I think that we will only be selected if we can provide customers with time to market advantage over what they can do in-house. This is our main competition. I said it many times before that competition does not come from other merchant silicon providers, especially not in edge routing and that's more than 90% of our revenues. Competition comes from in-house, our own customers, and we have to execute. There's a huge investment in our software, and I believe that as long as we can execute, come out with the new a product, with a new generation every three years, we have a very good chance that they will continue to work with us. That goes for the existing customers. For the ones that are using in-house, I think that it depends on how well they will do in the market with their own solutions, how well they will compete with Cisco and Huawei and others that are using us. We are hearing that Cisco is now gaining market share. I think that they are now in a situation where they have time to market advantage over their competition that they did not have three years ago. And, I think that that's very clear now with NP-4 and I think that it will become even clearer with NP-5. And, if that really happens and our customers really gain market share, then the ones that don't work with us will have to see what they do next. And, I hope that we can be selected maybe in one of our future generations.

<Q - Jay Srivatsa>: All right. Last question; while you haven't really spoken about Q2 much, given that your customers are talking about a second half ramp here, what needs to happen – what are you looking for in terms of a catalyst in the second quarter to really see some material upside in your revenue line? Or, are you expecting this lumpiness to stay well into the first half – at least until the end of the first half?

<A - Eli Fruchter>: We expect all this. So, this – once we see – we get P.O.s, we know that things are looking good and that's too early. We are only in the beginning of the second month of the first quarter. And, as I said before, in a time like that when we are that early in the first quarter, it is very difficult for us to predict the second quarter. We'll have to wait and see.

<Q - Jay Srivatsa>: Thank you, Eli.

<A - Eli Fruchter>: Thanks, Jay.

Operator

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

<Q - Sandeep Shyamsukha>: Thanks for taking my question. Just wanted to get a sense in terms of how big the edge router market is for you as a percentage of revenue in 2011 and how your NPA line is doing right now, if you could provide some color in terms of how big it has been and how do you foresee it going forward?

<A - Eli Fruchter>: Okay. Thank you for the question, Sandeep. So, regarding edge routing, based on reports we see from Infonetics, the market is expected to grow pretty significantly. We included a slide in our investor presentation. It's on our website. It shows the change in edge routing from 2010 to [inaudible] (52:50) shows the increase in number of ports. It shows a huge increase in number of ports and as a result a huge increase in number of chips. And, we actually see that that increase combined with the higher ASP and combined with the fact that we have more platforms and higher market share than we had [inaudible] (53:26) we anticipate to quadruple our revenues. And that's based just on edge routing. Regarding the NPA, the NPA goes to the access market. It's more competitive. We do not expect NPA to become a very significant portion of our revenues. We don't see it going beyond 10%. [Inaudible] (53:54) I would say will become – is more dominant and will continue to be more dominant. And, with the new product line that is now being developed in Kiryat Gat, it's also high-speed and that will increase the high-speed portion in our revenues in the long-term.

<Q - Sandeep Shyamsukha>: Okay. And, you talked about carrier spending returning in the second half based on at least what your customers are saying. Would you like to share some comments in terms of what you're hearing about 2013 in terms of how carrier spending might trend for that year?

<A - Eli Fruchter>: I don't think that they'd go far with comments. So, we are – we want to see now when spending will resume and hopefully if it resumes in the second half of this year, it continues into 2013 but I'm not going that far.

<Q - Sandeep Shyamsukha>: Okay. And, do you think – do you see any difference in different geographies in terms of how service provider spending comes back in different parts of the world? Do you see more strength in China versus Europe or anything of that nature?

<A - Eli Fruchter>: I would say that I don't hear any different things. I think that we are hearing a consistent message about returning in the second half from the different parts of the world.

<Q - Sandeep Shyamsukha>: Okay. Thank you.

Operator

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

<Q - Paul McWilliams>: Hi, guys. Congratulations on a great year, and I really appreciate the OCS decision and I think that will pay off well. When did the NP-4 start shipping? Was that December or November?

<A - Eli Fruchter>: Hi, Paul. I think it was the second part of November, if I remember correctly.

<Q - Paul McWilliams>: Okay. Now, in your press release you say that the Kiryat Gat products will more than double your TAM. What is your TAM perceived to be today?

<A - Eli Fruchter>: Our TAM today about $800 million. That's actually not the TAM; that's the SAM. The TAM is higher than that. And, you can – again, it appears on our investors' presentation in one of the slides that show TAM. So, as we said, the product in Kiryat Gat is targeting more or less the same-sized market.

<Q - Paul McWilliams>: Okay. So, it's whatever that TAM is shown on the investor presentation?

<A - Eli Fruchter>: Yes.

<Q - Paul McWilliams>: 2X that?

<A - Eli Fruchter>: Yes.

<Q - Paul McWilliams>: Or, an equal size coming from Kiryat Gat?

<A - Eli Fruchter>: Yeah, 2X combined.

<Q - Paul McWilliams>: Got you. Now in Q3, I believe, you described those products as being a paradigm shift and I realized you aren't giving the detail here. But, if I divided the world into infrastructure and CPE, which side of that equation would the product sit on? Would it be an infrastructure or a CPE product?

<A - Eli Fruchter>: We don't really want to give too much details on that product right now. We'll come out with a detailed announcement when time – when we think the time is right and we'll say exactly what it is and what markets it is targeting.

<Q - Paul McWilliams>: Okay. I appreciate that. My job to ask. Just a quick housekeeper here as I'm going down on my list, what is your stock-based compensation outlook for 2012?

<A - Dror Israel>: So, it will be around – about $9 million for the year.

<Q - Paul McWilliams>: Okay. And the $23 million OpEx target, that is non-GAAP as you report non-GAAP, correct?

<A - Dror Israel>: The $23 million you mean?

<Q - Paul McWilliams>: Yes.

<A - Dror Israel>: Yes, non-GAAP.

<Q - Paul McWilliams>: Okay. And then, Eli, in your presentation, when I was taking notes very quickly here, I wrote down that you're forecasting full year growth, inclusive of Juniper, for 2012. Is that correct?

<A - Eli Fruchter>: Yes.

<Q - Paul McWilliams>: Okay. And, on the NP-5 price relative to the NP-4, you're very helpful in giving some picture that the NP-4 was essentially 2X NP-3, what's the ratio comparison betweenst the NP-5 and the NP-4?

<A - Eli Fruchter>: As I said, on the ASP, it's about 50% higher, NP-5 versus NP-4. And as for the number of platforms, that's too early to say. So once we get all the design wins that we can get with the NP-5, we will be able to provide similar guidance of NP-5 versus NP-4 as we did with NP-4 versus NP-3.

<Q - Paul McWilliams>: I appreciate that. Now for Cisco, you had mentioned that 2012, you anticipate them being about 40% of revenue, their royalty being about 40% of total revenue, is that correct?

<A - Dror Israel>: Yes. That's correct.

<Q - Paul McWilliams>: Okay. It seems as though you're being – you're hedging towards the conservative side than in your 81% GP forecast with them going up as a percentage and OCS disappearing from the COGS line. Fair statement?

<A - Dror Israel>: Yeah. I mean, you can take, of course, 100% margin for Cisco for modeling purposes and for the other product, let's say, between 65% and 70%. So it's possible that we'll do better than 81%, but it will depend on product and customer mix.

<Q - Paul McWilliams>: I always appreciate your understatement. Now, the last question here, on the roadmap for growth as I took it down and you had confirmed I was correct in my statement that full-year growth including Juniper is expected. And then you had said earlier something about 30% of the growth coming in during the first half and 70% during the second half. Is that due in year-over-year comparisons first half to first half and second half to second half?

<A - Eli Fruchter>: We didn't say something like that with 30% and 70%, so that's probably something that we said wrong and caused you to misunderstand, but I don't know where those numbers come from.

<Q - Paul McWilliams>: Did you say something about 30% and 70% like – I was taking some pretty fast notes when you were presenting...?

<A - Dror Israel>: I'll say what I – what I said about 30% was that if you exclude Juniper from 2011 revenues, we grew 30% in 2011 versus 2010 with all other customers except – excluding Juniper.

<Q - Paul McWilliams>: Got you. It must have been my fault.

<A - Eli Fruchter>: That's where we mentioned 30%, that – if I remember correctly that's the only 30% we mentioned.

<Q - Paul McWilliams>: Okay, fair enough. Thank you very much. One last thing here, with – you've got four platforms at Juniper that you discussed, three entered production during the first half. Is one of those the Nexus upgrade card?

<A - Eli Fruchter>: You mean Cisco, but we don't...

<Q - Paul McWilliams>: Yes.

<A - Eli Fruchter>: ...we don't really give the names of those platforms, so.

<Q - Paul McWilliams>: I understand. Thank you and congratulations again on a good year. I'm looking forward to 2012.

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

Operator

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

<Q - Sundeep Bajikar>: Hi, guys. Thanks for squeezing me in and nice job on the gross margins. Just a clarification, you said NP-5 sample shipments would potentially start towards the end of 2012. Should we – how should we think of the level of those shipments compared to what you had with NP-4 in 2011? Would they be about the same level or less?

<A - Eli Fruchter>: So in 2012, Sundeep, it's going to be neglectable. In 2012, because it will only sample towards the end of the year. It will be more meaningful in next year, in 2013, but it's still too early to say what we expect it to be. We'll need to get closer to be able to provide some guidance on that.

<Q - Sundeep Bajikar>: Okay, thanks for that. And a question on lead-times and order visibility. Perhaps if you could just help us understand how much of the quarter you've booked already compared to sort of a similar point last quarter to give us some sense of how much your visibility might have improved?

<A - Dror Israel>: So, as I said, we get pretty good visibility once we are one month into the quarter. In general, lead-times from customers will be about 12 weeks. So, the two months, that will provide us with pretty good visibility. Again, we still can expect pull-ins or push-outs until one month into the – one month before the end of the quarter. So things may change and even change it significantly. But this is the kind of visibility that we have.

<Q - Sundeep Bajikar>: Okay. I appreciate the color. Now in terms of these new 10% customers that you've added, is there any way for us to think about the relative size of your design wins that you already have at these customers? Is there any distinction that can be made on that basis or that's not something you would want to share?

<A - Eli Fruchter>: We said in the past that we have a group of other customers and that group includes all other customers probably close to 50. But among them, there are a few that make like between 5% and 10% and we said that Ericsson, Tellabs and Huawei can become 10% each. And what we said now is that two of them, Ericsson and Huawei became 10% this quarter, this Q4.

But each one of them can become a 10% customer once they are in production and once their product ramps up.

<Q - Sundeep Bajikar>: Okay. Thanks for that update. And just final question from me on OpEx. How should we think about the shape of OpEx through 2012 on a quarterly basis coming off of 2011 Q4?

<A - Dror Israel>: You can assume a gradual growth from Q4 and grow quarter-by-quarter until you get to the $23 million.

<Q - Sundeep Bajikar>: Okay. Thanks very much, guys.

<A - Eli Fruchter>: 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's website at www.ezchip.com. Mr. Fruchter would you like to make your concluding statement?

Eli Fruchter

Sure. Thank you, everyone for joining us today. I would also like to take this opportunity we are now at the end of the year reporting the year. I want to thank our employees. Many of them are with the company for many, many years. And many of them close to 20 years, so thanks to everyone. You have been great and hopefully continue to succeed.

Thank you, operator.

Operator

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