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# EZCHIP SEMICONDUCTOR LTD.

## CONFERENCE CALL SCRIPT

Q2 2010

### CONFERENCE COORDINATOR:

Ladies and gentlemen, thank you for standing by.

Welcome to the EZchip Semiconductor second quarter 2010 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.

The remarks of management during their presentations and in the question and answer session may contain projections or other forward-looking statements regarding future events or the future performance of the Company or the industry. Please note that the safe harbor statement in today's press release also covers the contents of this conference call.

By now you should have all received the company's press release, if you have not received it you may view it in the news section of our company's website [www.EZchip.com](http://www.EZchip.com), or you may call CCG Investor Relations at 1 646 201 9246.

I would now like to hand over the call to Mr. Ehud Helft of CCG Investor Relations.

Mr. Helft, would you like to begin?

### EHUD:

Thank you operator and good day everybody.

I would like to welcome all of you to EZchip's second quarter 2010 conference call and thank EZchip's management for hosting this call.

With us on the line today are:

- Mr. Eli Fruchter, CEO
- Mr. Dror Israel, 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 will now hand over the call to EZchip's CEO, Eli Fruchter ... Eli

## ELI

Thank you Ehud, good day everyone and welcome to our second quarter 2010 conference call.

### [RESULTS]

We are very pleased with our second quarter results. We generated the highest quarterly revenue in our history reaching 14.9 million dollars, up 10% sequentially, better than our guidance for a small sequential increase, and up 123% compared to the second quarter last year. Gross margin on a non-GAAP basis for the quarter reached 75.8%, up from 73.1% in the first quarter, mainly due to a sharp increase of sales to Marvell. This enabled us to present a very healthy non-GAAP net income of 7.1 million dollars for the quarter. Furthermore, this quarter we increased our cash balance by over 8 million dollars to 83.3 million dollars in cash with zero debt at the end of the quarter, improving our already very strong financial position.

Looking at our quarterly revenues in further detail.

### [Marvell]

Revenues from our specialized NP-3 processor, sold through Marvell to the major CESR vendor, grew significantly to 3.9 million dollars, reaching 26% of revenues in the second quarter, up 162% from last quarter and up 262% from the second quarter of last year. We are excited by this very strong ramp in the quarter, as these chips are now beginning to ship in production systems. Even given this substantial acceleration, we believe that we are still early in the ramp phase of our specialized NP-3 processor and believe that Marvell has the potential to become our largest customer.

### [ZTE]

I am happy to announce that this quarter ZTE, China's second largest and a fast growing networking and telecom equipment vendor, became a 10% customer through its successful line of new routers that are based on the NP-3. Second quarter revenues from ZTE totaled 1.5 million dollars, up 38% from the first quarter and up 218% from the second quarter last year. We believe that ZTE is still very early in its ramp of our NP-3 processor and that it will likely become one of our fastest growing customers and its share of total revenues may increase in the near future. We are excited by the addition of ZTE to our large revenue contributing customers and we see the potential for a few more customers in the "others" category to become greater than 10% customers when their NP-4 based products reach volume production. This will have the positive affect of diversifying our customer base.

### [JUNIPER]

Second quarter revenues from our largest customer, Juniper, totaled 5.2 million dollars, or 35% of the quarter's revenues, up 100% from the second quarter last year and down 25% sequentially. We believe that the sequential decline is not at all an indication of a continued sequential decline in the coming quarters, but rather a demonstration that sales to Juniper can be lumpy. It is possible that sales to Juniper will continue to be lumpy in the coming quarters and as we communicated on our last earnings call, we still expect to see a general increase in year over year sales to Juniper in 2010 versus 2009.

Furthermore, based on the huge software development effort that customers make in a new chipset to meet Carrier Ethernet market requirements, and the long qualification process of new products by the carriers, we believe that Juniper's transition to its internally developed processor may take longer than we initially estimated and that the expected year over year decline in sales to Juniper may only start in 2012 and not in 2011 as we have previously estimated. It is important to note however that these are purely our estimates and do not come from Juniper. They may in fact not be accurate and the transition may happen sooner and the decline may in fact start in 2011. Either way, we expect sales to other customers to more than offset any decline from Juniper and we expect revenues from Juniper to continue for several more years regardless of the exact timing of their transition.

### [OTHER CUSTOMERS]

All other customers, as a group, excluding Marvell, Juniper and ZTE, contributed 4.3 million dollars to revenues, up 76% from the second quarter of last year and up 4% sequentially, reaching 29% of our total revenues for the quarter. Looking ahead, there are several large customers in this group that are now moving their NP-3 based products to production and we see significant growth potential once these products ramp up. We also believe, and to stress the point, I am repeating what I have already said, there are additional customers in that group, like ZTE, that have the potential of becoming 10% customers once they move to production with the NP-4, further diversifying our customer base.

## **[NEXT GENERATION]**

Turning now to our next generation products.

The first is our NP-4, for which we received samples last December and have made good progress since. During the quarter, we continued to ship NP-4 samples to customers and continued to add design wins. Overall, we are very pleased with the design win momentum we are experiencing.

I'd like to spend a few moments talking about the NP-4's vast revenue potential. It is important to note that NP-4 has already accumulated twice as many important design wins as NP-2 and NP-3 combined, garnering design wins from the vast majority of high volume CESR platforms that use high speed merchant NPUs. In addition, NP-4 is expected to be sold at approximately twice the average sales price of NP-2 and NP-3. These NP-4 based platforms are now in various stages of design and we expect ongoing sample-related revenues from the NP-4 during 2010 and the first half of 2011 with some initial production related revenues in the second half of 2011. We expect the NP-4 to become a meaningful contributor to our revenues already during 2012 and will continue to sell for several years thereafter. Looking ahead from our current position at the beginning of the NP-3 ramp and a year away from NP-4 early production revenues, we believe we have established a strong basis for future growth.

The NP-5, now in design, gains strong traction and is likely to be used by most of EZchip's current customers as they will be able to fully reuse the huge software investments that they are now making with NP-3 and NP-4. NP-5 will allow our customers a simple migration of their platforms to feature a multitude of 10G, 40G and 100G ports.

The NPA, our access network processor, is now moving to production and continues to win new designs that will translate into revenues as early as 2011. We also believe that the recently announced NPA-0, now in design, is strengthening our position in the lower cost access market, especially in the fast growing microwave backhaul segment. The NPA-0, combined with the other NPA family chips, provide a solution for all three Carrier Ethernet access segments, copper, fiberoptic and wireless. The access market is highly diversified with many players and platforms, and we believe that our revenues in this space will be highly diversified.

## **[GUIDANCE]**

With regard to guidance for the second half of the year, we believe we will continue to grow and generate year over year revenue and profit growth in 2010 driven by increasing demand from our NP-3 customers. We expect our NP-2 revenues in 2010 to be higher than in 2009 and NP-3 revenues in 2010 to be substantially higher than in 2009, making the NP-3 our main growth driver in 2010. As we progress into 2011 we believe that the anticipated continued strong growth of our NP-3, combined with significant NP-2 revenues and initial NP-4 and NPA revenues, will translate to continued year over year growth in 2011.

From the meetings we have and the ongoing questions we receive from investors, we are aware of the concern some investors have with Juniper's transition from NP-2 to in house chips. As much as we would like to see Juniper selecting our new products, it is important to understand that the NP-3 has accumulated more high volume platform wins than NP-2 and the NP-4 has already accumulated twice as many high volume platform wins as NP-2 and NP-3 combined. We believe that these wins are likely to more than offset Juniper's decline, whenever it may happen, and in addition provide strong revenue and profitability growth and customer diversification.

With regards to guidance for the upcoming quarter, we expect revenues in the third quarter of 2010 to represent sequential growth compared to the second quarter. The customer mix in the third quarter is expected to further increase our gross margins to above 76%. OPEX is expected to continue to grow gradually quarter over quarter and for the full year we expect OPEX to be in the range of 19 million dollars, as we indicated in our last earnings call.

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

Dror?

DROR:

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, changes in deferred tax assets and net loss attributed to non-controlling interest.

And now to the results...

**Revenues** for the second quarter of 2010 totaled 14.9 million, up 123% from the 6.7 million in the second quarter last year, and up 10% from the 13.6 million in the prior quarter.

- **Juniper** accounted for 5.2 million or 35% of revenues for the quarter;
- **Marvell** accounted for 3.9 million or 26% of revenues, representing early production shipments of our leading CESR customer.
- **ZTE** accounted for 1.5 million or 10% of revenues for the quarter;
- Our **other NP-2 and NP-3 customers**, which include some of the world's other tier 1 networking vendors, as a group, continued to grow this quarter with revenues reaching 4.3 million or 29% of revenues, up from 4.1 million last quarter.

**Non-GAAP gross margin** for the quarter totaled 75.8%, up from the 73.3% in the second quarter of 2009, and above the 73.1% last quarter. As we have mentioned in the past, the special version NP-3 processor that we sell through Marvell bears a royalty model and as Marvell becomes more dominant in our revenues we see gross margins growing to the 76% range.

**Non-GAAP R&D expenses**, net, for the quarter totaled 2.9 million. This amount included 0.9 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 3.8 million.

**Non-GAAP operating expenses** for the quarter totaled 4.5 million, compared to 3.9 million in the second quarter last year, and 4.2 million in the prior quarter. We expect that our annual OPEX level in 2010 will be approximately 19 million.

**Non-GAAP operating income** for the quarter was 6.8 million, or 45.8% of revenues, up substantially from the 1.0 million operating income in the second quarter last year, and up 19% compared to 5.7 million in the prior quarter.

**Non-GAAP net income** for the quarter totaled 7.1 million, compared to 1.2 million in the second quarter last year, and 6.0 million in the previous quarter.

**Fully diluted EPS on non GAAP basis** was 26 cents, up from 5 cents in the second quarter last year and from 23 cents in the previous quarter.

Moving over to the **balance sheet**, cash, cash equivalents and marketable securities totaled 83.3 million as of June 30, 2010, compared to 75.0 million at the end of the previous quarter. Cash generated from operations during the quarter was \$7.6 million, and cash provided by financing activities was \$0.7 million.

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

Operator?