
EZCHIP SEMICONDUCTOR LTD.

CONFERENCE CALL SCRIPT

Q3 2011

CONFERENCE COORDINATOR:

Ladies and gentlemen, thank you for standing by.

Welcome to the EZchip Semiconductor third quarter 2011 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.

As a reminder, this conference is being recorded November 2, 2011.

I'd like to remind everyone that forward-looking statements made 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 over the call to Mr. Kenny Green of CCG Investor Relations.

Mr. Green, would you like to begin?

KENNY GREEN, INVESTOR RELATIONS:

Thank you operator and good day everybody.

I would like to welcome all of you to EZchip's third quarter 2011 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 FRUCHTER, CEO

Thank you Kenny, good day everyone and welcome to our third quarter 2011 conference call.

We are very pleased with our third quarter results. We generated the highest quarterly revenue in our history reaching 18.7 million dollars, up 8% sequentially and up 14% compared to the third quarter last year. Gross margin on a non-GAAP basis for the quarter reached 76.3%. This enabled us to present a record non-GAAP net income of 9.9 million dollars for the quarter representing an outstanding 53% non-GAAP net income margin. Furthermore, we increased our cash balance by 6.6 million dollars to 128 million dollars with zero debt as at the end of the quarter, further solidifying our already very strong financial position.

Looking at our quarterly revenues in further detail.

Before discussing each customer in detail, it is important to note that we do experience lumpiness in quarterly revenues, especially from our large customers. Our quarterly revenue changes shouldn't be used to draw conclusions on our customer's success in the market. We believe that the revenue lumpiness is typically a result of inventory changes and corrections that are done by the contract manufactures that we are selling to. Annual revenue comparisons are a more accurate measure of our success and we are seeing significant growth in 2011 compared with 2010 from all customers and a decline from Juniper, a trend that is expected to continue in 2012.

[Cisco]

Revenues from our specialized processors, sold to Cisco through Marvell, totaled 3.6 million dollars, reaching 19% of revenues in the third quarter. As I explained, there is lumpiness in quarterly revenues especially at the early stage in the ramp, and Cisco revenues were down 32% sequentially and down 27% from the third quarter of last year. However, we feel very comfortable about Cisco's success, especially with the ASR 9000, and believe that we are very early in Cisco's ramp as a customer and believe that it can accelerate once Cisco moves its NP-4 based systems into production.

[JUNIPER]

Third quarter revenues from Juniper totaled 5.5 million dollars or 29% of the quarter's revenues, up 62% sequentially and down 10% from the third quarter last year. Despite the strong sequential growth in the third quarter we expect a considerable decline in full year 2011 sales to Juniper versus 2010. It is important however to reiterate that while revenues from Juniper are expected to decline in 2011 vs. 2010, we expect 2011 revenues from all other customers to increase vs. 2010.

[ZTE]

Third quarter revenues from ZTE totaled 3.9 million dollars or 21% of revenues, up 81% sequentially and up 116% from the third quarter last year. We believe that the sharp increase in the quarter does not necessarily represent a normal consumption level. 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 revenue growth and believe that it can accelerate once ZTE moves its NP-4 based systems to production.

[OTHER CUSTOMERS]

All other customers, as a group, excluding Cisco, Juniper and ZTE, totaled 5.7 million dollars or 31% of the third quarter's revenues, down 12% sequentially and up 62% from the third quarter of last year. Looking ahead, there are three large CESR customers in this group of other customers that are now close to production with important NP-4 based platforms, and have the potential of becoming 10%-plus customers and lowering our customer concentration once their NP-4 based systems ramp and are in full volume production.

Turning now to our next generation products.

NP-4 is making good progress and is on track to move to production this month. It is important to note that customers continued to purchase significant amounts of NP-4 samples during the third quarter resulting in the NP-4 already generating meaningful revenues. We expect this trend to continue into the fourth quarter and NP-4 shipments commencing December 2011 will be production shipments. During the first three quarters of 2011 we shipped a large number of NP-4 samples to our customers – several times the number of NP-3 samples shipped in the comparable NP-3 sampling time period, and double the number of NP-3 chips shipped in the first full production year of NP-3. NP-4 revenues in 2011, mostly sample related, could be as high as 20% of 2011 revenues, a strong indication to the potential that NP-4 represents.

It is interesting to note that in previous NP generations, we did not see samples being such a significant portion of revenues. We expect 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 third quarter NPA-0 samples have arrived and are now being tested. The NPA-0 provides us with an entry point, low cost access NPU that integrates all the ingredients that are required in a small Ethernet access box. During the quarter a leading semiconductor company, EZchip's partner, received samples of its highly integrated microwave chip with a special version of NPA-0 embedded as IP in that chip. Once in production, the chip will be sold by that partner and EZchip will collect royalties. It is important to note however that the royalty potential is a few million dollars at full production.

The NP-5 and the new product in Kiryat Gat are in development and continue to make good progress. Both are expected to become our growth generators when the NP-4 reaches its peak revenues several years from now.

[GUIDANCE]

In terms of our outlook, 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. We now expect a stronger YoY revenue decline from Juniper while all our other customers are expected to grow significantly in 2011 as compared to 2010.

Looking further out, and based on the Infonetics research report from last quarter, the market for high speed NPUs is expected to experience further accelerated growth. NP-4 is positioned extremely well in that market and has already won the important platforms that are now generating significant revenues from NP-4 samples and are expected to generate very significant production revenues in the coming years.

With regards to guidance for the upcoming quarter, the sharp decline that is expected from Juniper and the lumpiness in revenues that is expected from our other large NP-3 customers will likely result in a significant sequential decline in the fourth quarter. We therefore expect to see a considerable decline in revenues in the fourth quarter of 2011, in the range of 25% to 30% sequentially with gross margins in the 75% range, resulting in 2011 revenues that are in the 2010 range. We are also expecting annual 2011 OPEX to be in the 20 million dollars range, which is lower than our previous 22 million dollar estimate. We continue to believe that our 2012 gross margin will be in the 78% range.

With regards to the expected Q4 revenues decline, we believe it is driven by the global economic uncertainty and mixed signals from the market, which for us presently translates to a reduction in inventory levels at our customer's contract manufacturers. Nevertheless it is important to stress that the fundamentals underlying our business and driving our growth have not changed. We are well positioned to see growth as economic confidence is restored and spending resumes to previous patterns.

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

DROR ISRAEL, CFO:

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 and amortization of intangible assets.

And now to the results...

Revenues for the third quarter of 2011 totaled \$18.7 million, up 14% from the \$16.4 million in the third quarter of 2010, and up 8% from the \$17.3 million in the prior quarter.

- **Cisco, through Marvell**, accounted for 3.6 million or 19% of revenues;
- **Juniper** accounted for \$5.5 million or 29% of revenues;
- **ZTE** accounted for \$3.9 million or 21% of revenues;
- Our **other customers**, which include some of the world's other tier 1 networking vendors, as a group, accounted for \$5.7 million or 31% of revenues for the quarter.

Non-GAAP gross margin for the quarter totaled 76.3%, down from the 76.9% in the third quarter of 2010, and the 80% last quarter. The decrease in gross margins resulted from a different customer and product mix, with lower than expected royalty revenues from Cisco combined with higher than expected direct product selling, mainly to ZTE.

Non-GAAP R&D expenses net, for the quarter totaled \$2.9 million. This amount included \$1.1 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 \$4.0 million.

Non-GAAP operating expenses for the quarter totaled \$4.8 million, compared to \$4.2 million in the third quarter last year, and similar to the prior quarter. We expect that our annual OPEX level in 2011 will be around \$20 million, lower than our previous estimate of \$22 million. The decrease in expenses is expected to result mainly from the combination of a stronger US\$, lower than projected increase in headcount and NRE expenses shifting to 2012.

Non-GAAP operating income for the quarter was \$9.5 million, an increase of 13% from the \$8.4 million operating income in the third quarter last year, and up 5% from the \$9.0 million operating income in the prior quarter.

Non-GAAP net income for the quarter totaled \$9.9 million, an increase of 14% from the \$8.7 million net income last year and up 6% from the \$9.4 million in the previous quarter.

Fully diluted EPS on non GAAP basis was 35 cents, up from 32 cents in the third quarter last year and from 33 cents in the previous quarter.

Moving over to the **balance sheet**, cash, cash equivalents and marketable securities totaled \$127.6 million as of September 30, 2011, compared to \$121 million at the end of the previous quarter. Cash generated from operations during the quarter was \$5.8 million, Cash used in investing activities was \$0.2 million, cash provided by financing activities was \$1.5 million, resulting from the exercise of stock options and an additional \$0.5 million decrease resulted from unrealized loss in marketable securities.

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