

## MELLANOX TECHNOLOGIES

### 1Q11 net beats, continued strong outlook

**Integration progress drives strong bottom line:** We reiterate our 1-OW and raise our PT to \$34 based on 20x 2012e non-GAAP EPS of \$1.64 (up from \$1.60). Non-GAAP GM reached 68.8% in the quarter; while this is a margin transition year for MLNX we still see GM in the 68% range for the rest of 2011. Revenues of \$55.1mn were above the mid-point of guidance and non-GAAP operating expenses were lower than our estimates and came in at 52.3% of sales.

**Guidance:** 2Q guidance is for revenues of \$61.5-\$62mn, GM of 67%-68%, and non-GAAP operating expenses of 53.5%-54.5% of sales. We have made adjustments to our model and our estimates for 2Q drop to \$0.20 from \$0.24. We view this as mainly the transition in the model from the VOLT acquisition and see room for upside as that integration continues. The upside in 1Q raises our FY11 estimates to \$1.05 from \$1.00.

**Oracle opportunity and beyond:** Our recent upgrade to 1-OW was based in part on potential upside from ORCL (covered by Israel Hernandez), and in 1Q ORCL accounted for 13% of sales. We expect ORCL to remain above 10% for the foreseeable future. Other opportunities for revenue growth and margin expansion should come from continued new product launches like the SwitchX silicon announced on April 25.

**Risks to Thesis and Valuation:** We see the greatest risk to the stock as a macro slow down that reduces IT spending. This would contradict the findings of Barclays Capital's recent CIO survey, and we do not see this outcome as likely. A relatively rich valuation could also be a risk, but given the attractive end market exposure we do not expect to see the stock trade at a dramatically lower multiple in the near term.

#### MLNX: Quarterly and Annual EPS USD

FY Dec	2010		2011		2012		Change y/y		
	Actual	Old	New	Cons	Old	New	Cons	2011	2012
Q1	0.29A	0.13E	0.24A	0.14E	0.34E	0.35E	0.32E	-17%	46%
Q2	0.29A	0.24E	0.20E	0.24E	0.40E	0.41E	0.36E	-31%	105%
Q3	0.22A	0.29E	0.29E	0.29E	0.41E	0.41E	0.39E	32%	41%
Q4	0.21A	0.33E	0.33E	0.34E	0.46E	0.47E	0.42E	57%	42%
Year	1.01A	1.00E	1.05E	1.01E	1.60E	1.64E	1.48E	4%	56%
P/E			27.6			17.7			

Source: Barclays Capital  
Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 6.

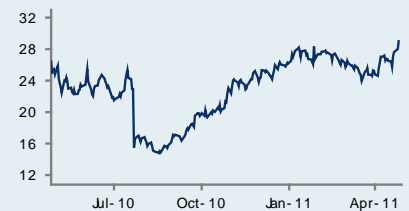
Stock Rating	<b>1-OVERWEIGHT</b> Unchanged
Sector View	<b>2-NEUTRAL</b> Unchanged
Price Target	<b>USD 33.00</b> raised 3% from USD 32.00

Price (26-Apr-2011)	USD 28.99
Potential Upside/Downside	+14%
Tickers	MLNX

Market Cap (USD mn)	1007
Shares Outstanding (mn)	34.75
Free Float (%)	69.75
52 Wk Avg Daily Volume (mn)	0.4
Dividend Yield (%)	N/A
Return on Equity TTM (%)	5.16
Current BVPS (USD)	N/A

Source: FactSet Fundamentals

Price Performance	Exchange-Nasdaq
52 Week range	USD 29.00-14.60



[Link to Barclays Capital Live for interactive charting](#)

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## COMPANY SNAPSHOT

Mellanox

Technology

Income statement (\$m)	2010A	2011E	2012E	2013E	CAGR
Revenue	155	252	319	353	31.6%
EBITDA	44	59	103	116	38.7%
EBIT	23	31	71	81	51.3%
Pre-tax income	23	31	49	81	51.7%
Net income	36	34	66	101	41.1%
EPS (adjusted) (\$)	1.01	1.05	1.64	2.42	34.0%
Diluted shares (m)	37	39	40	42	4.4%
Dividend per share (\$)	-	-	-	-	0.0%

Margin and return data (%)	Average				
Gross margin	73.8	66.9	68.0	75.7	71.1
EBITDA margin	28.2	23.5	32.4	33.0	29.3
EBIT margin	15.2	12.3	22.2	23.0	18.2
Pre-tax margin	15.1	12.4	15.2	23.1	16.5
Net margin	23.2	13.6	20.7	28.5	21.5
ROA	12.1	10.1	17.1	22.4	15.4
ROE	13.7	11.9	20.8	26.6	18.2
ROIC	11.3	10.0	16.9	21.6	15.0

Balance sheet and cash flow (\$m)	CAGR				
Tangible fixed assets	15	18	30	43	40.6%
Intangible fixed assets	0.29	167	167	167	732.4%
Cash and equivalents	108	54	72	128	5.9%
Working capital	268	146	182	243	-3.1%
Inventories	12	17	22	19	17.2%
Accounts receivable	20	40	51	56	41.5%
Accounts payable	7	18	22	19	42.5%
Total assets	316	363	411	485	15.4%
Short and long-term debt	NA	NA	NA	NA	NA
Total liabilities	34	47	52	49	12.7%
Shareholders' equity	282	296	340	416	13.9%
Change in working capital	40	(122)	37	61	14.9%
Cash flow from operations	41	30	43	84	26.7%
Capital expenditure	(11)	(10)	(22)	(25)	NA
Free cash flow	48	(110)	68	124	37.2%
Change in cash	64	(54)	18	57	-4.2%

Valuation and leverage metrics	Average				
EV/sales (x)	6.5	4.2	3.5	3.3	4.4
EV/EBITDA (x)	23.1	18.0	10.8	9.9	15.4
EV/EBIT (x)	42.9	34.3	15.7	14.2	26.8
P/E (adjusted) (x)	28.8	27.6	17.7	12.0	21.5
Price/free cash flow (x)	0.6	NA	0.4	0.2	0.4
FCF yield (%)	1.7	NA	2.4	4.3	2.8
Price/BV (x)	3.8	3.8	3.4	2.9	3.5
Dividend yield (%)	NA	NA	NA	NA	NA

Stock Rating	<b>1-OVERWEIGHT</b>
Sector View	<b>2-NEUTRAL</b>
Price (26-Apr-2011)	USD <b>\$28.99</b>
Price Target	USD <b>\$33</b>
Ticker	<b>MLNX</b>

**Investment case** **\$33**

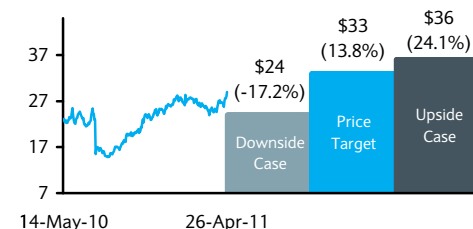
We rate MLNX 1-OW and see the stock trading to 20x 2012e non-GAAP EPS. We believe that the IT spending trends, the near-term/live opportunity with Oracle, and other large opportunities like Web 2.0, make MLNX a winner in the technology environment.

**Upside case** **\$36**

We believe our estimates for MLNX remain conservative given multiple potential growth opportunities. If our 2012e EPS improves to \$1.80, which could be driven by upside at Oracle or another large customer, we could see the stock trade up to \$36.

**Downside case** **\$24**

While we are optimistic regarding MLNX's outlook, challenges in 2011 include the integration of VOLT and the roll-out of at least two new products. Should estimates fall back to our prior \$1.35 we would expect multiple compression to 18x and a stock price of \$24.

**Upside/downside scenarios**

Source: DataStream

## 1Q11 and Model

MLNX had a solid 1Q11 and we see continued room for revenue growth and margin expansion over the course of 2011. We believe that most of the incremental revenues for the remainder of 2011 can be generated from strong growth at ORCL that jumped to 13% of sales in 1Q and from reasonable growth at other customers. HP was 23% of sales in 1Q11 and IBM was 14% as MLNX continues to do well in HPC and across its customer base. With such strong performance at HP, we believe that any lingering concerns from last summer's product transition should no longer be an issue.

1Q11 included only 8 weeks of VOLT revenues and expenses but all of the balance sheet items and we believe that the downward adjustment we have made to our model is mainly reflective of the continued integration of VOLT into our model. We expect profitability to improve over the course of 2011 as spending on new product "tape-outs" concludes and as synergies are achieved from the VOLT acquisition. For example, in 1Q GM was 68.8% (non-GAAP). With a full quarter of hardware sales to be included in 2Q, GM will be 67%-68% as per company guidance. This should move closer to 68%-69% over time as software and services become larger portions of the mix and as hardware margins rise with more integrated MLNX silicon included in the designs.

We see the end markets for MLNX as robust in 2011 and expect 2011 to be a strong year for MLNX.

We reiterate our 1-OW. We see MLNX's relatively rich valuation supported by the continued strength of its end markets.

**Figure 1: Results versus expectations**

USDm	Q1-11		Diff Reported vs Expected	% Diff	% Growth	
	Actual	Estimate			Q/Q	Y/Y
Total Revenues	55.1	54.9	0.1	0%	35%	52%
Cost of revenues	19.2	18.7	0.5	3%	67%	112%
Gross Profit	35.9	36.3	-0.4	(1%)	23%	32%
Operating Expenses	37.6	34.9	2.7	8%	47%	89%
Income before taxes	-1.6	1.2	-2.9	(232%)	(148%)	(122%)
Net Income	-1.6	1.1	-2.8	(243%)	214%	(131%)
Non-GAAP Net Income	9.15	5.03	4.1	82%	19%	(12%)
NON GAAP EPS, fully diluted	0.24	0.13	0.1	83%	16%	(18%)

Source: Company report, Barclays Capital

Figure 2: Semiconductor Valuation

Company	Ticker	BarCap Rating	Price	Price Target	Non GAAP EPS		Non-GAAP P/E		5 Yr Avg
			26/04/11		2011E	2012E	2011E	2012E	
nVidia	NVDA	1-OW	\$19.40	\$26	\$1.00	\$1.16	19	16	52
Qualcomm	QCOM	1-OW	\$57.26	\$62	\$3.15	\$3.40	18	17	22
Skyworks	SWKS	1-OW	\$28.22	\$34	\$1.81	\$1.97	15	14	NM
TriQuint	TQNT	1-OW	\$13.31	\$14	\$0.30	NA	44	NA	20
Atheros Communications	ATHR	0-RS	\$44.80	NA	\$2.04	NA	NA	NA	NA
Broadcom	BRCM	1-OW	\$40.51	\$50	\$2.67	\$2.90	15	14	37
Cavium	CAVM	1-OW	\$47.22	\$42	\$1.26	\$1.63	NM	27	NM
Marvell Technology	MRVL	2-EW	\$15.78	\$22	\$1.47	\$1.75	10	9	25
Texas Instruments	TXN	2-EW	\$35.72	\$37	\$2.71	\$2.98	13	12	19
ARM Holdings	ARM.L	2-EW	£6.25	£6.50	£0.11	£0.13	55	44	NA
Ezchip	EZCH	1-OW	\$31.10	\$35	\$1.13	\$1.65	25	17	25
Ceva	CEVA	1-OW	\$30.26	\$34	\$0.82	\$1.13	37	27	NA
Mellanox	MLNX	2-EW	\$28.99	\$25	\$1.15	\$1.35	22	18	27

Source: Company report, Barclays Capital

Figure 3: Income Statement

\$ Millions	2009	2010	1Q11	2Q11	3Q11	4Q11	2011E	2012E
Total revenues	116.0	154.6	55.1	61.8	66.2	69.2	252.3	319.0
Cost of revenues	28.7	40.6	19.2	20.4	21.8	22.2	83.6	102.1
<b>Gross profit</b>	<b>87.4</b>	<b>114.1</b>	<b>35.9</b>	<b>41.4</b>	<b>44.3</b>	<b>47.1</b>	<b>168.7</b>	<b>216.9</b>
<i>Operating expenses</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
R&D	42.2	56.8	20.4	19.8	19.9	20.4	80.5	88.0
Sales and marketing	17.0	22.1	8.7	7.7	8.6	8.7	33.7	38.1
G&A	9.4	11.7	8.4	6.2	4.3	4.5	23.4	20.0
Stock based compensation expense	10.7	14.3	4.4	5.3	5.3	5.3	20.1	22.3
<b>Total operating expenses</b>	<b>68.6</b>	<b>90.7</b>	<b>37.6</b>	<b>38.9</b>	<b>38.0</b>	<b>38.8</b>	<b>137.6</b>	<b>146.2</b>
Income from operations	18.7	23.4	-1.7	2.5	6.3	8.3	31.1	70.7
Other income, net	0.5	-0.1	0.0	0.0	0.0	0.0	0.2	0.2
<b>Income before taxes</b>	<b>19.3</b>	<b>23.3</b>	<b>-1.6</b>	<b>2.5</b>	<b>6.4</b>	<b>8.3</b>	<b>31.3</b>	<b>48.6</b>
Income taxes	-6.4	-9.8	0.0	-0.2	-0.5	-0.7	-1.4	-4.9
<b>Net Income</b>	<b>12.9</b>	<b>13.5</b>	<b>-1.6</b>	<b>2.3</b>	<b>5.9</b>	<b>7.6</b>	<b>14.2</b>	<b>43.8</b>
EPS, basic	0.40	0.41	-0.05	0.07	0.17	0.21	0.40	1.20
<b>GAAP EPS, fully diluted</b>	<b>0.39</b>	<b>0.38</b>	<b>-0.05</b>	<b>0.07</b>	<b>0.17</b>	<b>0.21</b>	<b>0.40</b>	<b>1.18</b>
<b>NON GAAP EPS, fully diluted</b>	<b>0.81</b>	<b>1.01</b>	<b>0.24</b>	<b>0.20</b>	<b>0.29</b>	<b>0.33</b>	<b>1.05</b>	<b>1.64</b>

Source: Company report, Barclays Capital

Figure 4: Balance Sheet

\$ Millions	2009	2010	2011E	2012E
<b>Assets</b>				
<i>Current Assets</i>				
Cash and equivalents	43.6	108.0	54.0	71.8
Short-term investments	166.4	142.0	46.2	47.6
Restricted Cash	3.2	3.4	5.1	5.6
AR, net	20.4	19.9	40.4	51.0
Inventories	9.3	11.7	16.7	22.5
Deferred taxes	8.6	0.6	0.6	0.6
Prepaid expenses and other	3.8	3.9	3.2	2.5
<b>Total Current Assets</b>	<b>255.3</b>	<b>289.4</b>	<b>166.2</b>	<b>201.7</b>
PPE	9.7	15.5	17.5	29.6
Severance assets	4.6	5.8	6.8	7.8
Intangible assets, net	0.4	0.3	167.3	167.3
Deferred taxes	0.8	1.4	1.4	1.4
Other long-term assets	4.5	3.4	3.4	3.4
<b>Total Assets</b>	<b>275.4</b>	<b>315.8</b>	<b>362.6</b>	<b>411.2</b>
<b>Liabilities and Shareholders Equity</b>				
<i>Current Liabilities</i>				
Accounts payable	8.8	6.5	18.4	22.5
Other accrued liabilities	14.8	16.9	16.9	16.9
Capital lease obligations, current	0.5	0.3	-0.2	-0.7
<b>Total current liabilities</b>	<b>24.1</b>	<b>23.8</b>	<b>35.1</b>	<b>38.7</b>
Accrued severance	5.8	7.4	8.2	9.0
Capital lease obligations	0.5	0.2	0.2	0.2
Other long-term obligations	2.1	2.8	3.3	3.8
<b>Total liabilities</b>	<b>32.5</b>	<b>34.1</b>	<b>46.7</b>	<b>51.5</b>
Total shareholders equity	242.9	281.7	295.9	339.7
<b>Total liabilities and shareholders equity</b>	<b>275.4</b>	<b>315.8</b>	<b>362.6</b>	<b>411.2</b>

Source: Company report, Barclays Capital

## ANALYST(S) CERTIFICATION(S)

I, Joseph Wolf, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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### Primary Stocks (Ticker, Date, Price)

Mellanox Technologies (MLNX, 26-Apr-2011, USD 28.99), 1-Overweight/2-Neutral

### Materially Mentioned Stocks (Ticker, Date, Price)

ARM Holdings PLC (ARM.L, 26-Apr-2011, GBP 6.25), 2-Equal Weight/2-Neutral

Atheros Communications, Inc. (ATHR, 26-Apr-2011, USD 44.78), RS-Rating Suspended/2-Neutral

Broadcom Corp. (BRCM, 26-Apr-2011, USD 40.41), 1-Overweight/2-Neutral

Cavium Networks Inc. (CAVM, 26-Apr-2011, USD 47.60), 1-Overweight/2-Neutral

CEVA, Inc. (CEVA, 26-Apr-2011, USD 30.26), 1-Overweight/2-Neutral

Elbit Systems Ltd. (ESLT.TA, 26-Apr-2011, USD 56.49), 2-Equal Weight/2-Neutral

EZchip Semiconductor (EZCH, 26-Apr-2011, USD 31.10), 1-Overweight/2-Neutral

Marvell Technology Group, Ltd. (MRVL, 26-Apr-2011, USD 15.81), 2-Equal Weight/2-Neutral

NVIDIA Corp. (NVDA, 26-Apr-2011, USD 19.30), 1-Overweight/2-Neutral

QUALCOMM, Inc. (QCOM, 26-Apr-2011, USD 57.22), 1-Overweight/2-Neutral

Skyworks Solutions, Inc. (SWKS, 26-Apr-2011, USD 28.29), 1-Overweight/2-Neutral

Texas Instruments, Inc. (TXN, 26-Apr-2011, USD 35.74), 2-Equal Weight/2-Neutral

Triquint Semiconductor (TQNT, 26-Apr-2011, USD 13.40), 1-Overweight/2-Neutral

### Other Material Conflicts

QCOM: Barclays Capital is serving as financial advisor and rendered a fairness opinion to Qualcomm in the potential sale of its spectrum licenses to AT&T.

Barclays Capital is acting as a financial advisor to Qualcomm in their potential acquisition of Atheros. The rating and price target on Atheros have been temporarily suspended due to Barclays Capital's role in this potential transaction. The estimates on Atheros do not incorporate this potential transaction. The rating, price target and estimates on Qualcomm do not incorporate this potential transaction.

ATHR: Barclays Capital is acting as a financial advisor to Qualcomm in their potential acquisition of Atheros. The rating and price target on Atheros have been temporarily suspended due to Barclays Capital's role in this potential transaction. The estimates on Atheros do not incorporate this potential transaction. The rating, price target and estimates on Qualcomm do not incorporate this potential transaction.

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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

### Stock Rating

**IMPORTANT DISCLOSURES CONTINUED**

**1-Overweight** - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**2-Equal Weight** - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**3-Underweight** - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**RS-Rating Suspended** - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including when Barclays Capital is acting in an advisory capacity in a merger or strategic transaction involving the company.

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**2-Neutral** - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

**3-Negative** - sector coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "sector coverage universe":

## European Technology Hardware

Aixtron AG (AIXGn.DE)	Alcatel-Lucent (ALUA.PA)	ARM Holdings PLC (ARM.L)
ASML Holding NV (ASML.AS)	CSR plc (CSR.L)	Ericsson (ERICB.ST)
Infineon Technologies AG (IFXGn.DE)	Kudelski S.A. (KUD.S)	Logitech International SA (LOGN.VX)
Nokia (NOK1V.HE)	Pace plc (PIC.L)	STMicroelectronics NV (STM.PA)
Technicolor S.A. (TCH.PA)	TomTom NV (TOM2.AS)	
Israel Technology		
CEVA, Inc. (CEVA)	Elbit Systems Ltd. (ESLT.TA)	EZchip Semiconductor (EZCH)
Mellanox Technologies (MLNX)	Nice Systems (NICE)	

## U.S. Semiconductors

Advanced Micro Devices (AMD)	Altera Corp. (ALTR)	Analog Devices (ADI)
Atheros Communications, Inc. (ATHR)	Avago Technologies Ltd. (AVGO)	Broadcom Corp. (BRCM)
Cavium Networks Inc. (CAVM)	Cypress Semiconductor Corp. (CY)	Entropic Communications Inc. (ENTR)
Integrated Device Technology, Inc. (IDTI)	Intel Corp. (INTC)	Linear Technology (LLTC)
Marvell Technology Group, Ltd. (MRVL)	Maxim Integrated Products (MXIM)	Microchip Technology (MCHP)
Micron Technology, Inc. (MU)	NVIDIA Corp. (NVDA)	NXP Semiconductors NV (NXPI)
QUALCOMM, Inc. (QCOM)	RF Micro Devices (RFMD)	Skyworks Solutions, Inc. (SWKS)
Smart Modular Technologies (SMOD)	Spansion Inc. (CODE)	Texas Instruments, Inc. (TXN)
Triquint Semiconductor (TQNT)	Xilinx, Inc. (XLNX)	

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43% have been assigned a 1-Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 53% of companies with this rating are investment banking clients of the Firm.

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Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

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Absa Capital, a division of Absa Bank Limited (Absa Capital, Johannesburg)



IMPORTANT DISCLOSURES CONTINUED

**Mellanox Technologies (MLNX)**

USD 28.99 (26-Apr-2011)

Stock Rating

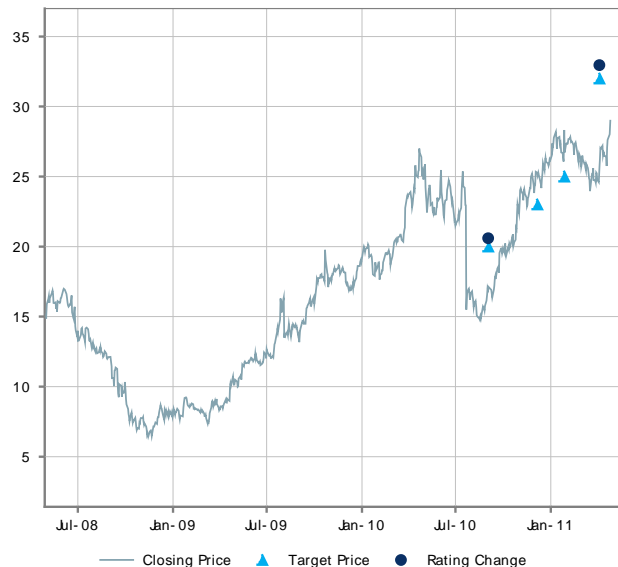
**1-OVERWEIGHT**

Sector View

**2-NEUTRAL**

Rating and Price Target Chart - USD (as of 26-Apr-2011)

Currency=USD



Date	Closing Price	Rating	Price Target
05-Apr-2011	25.62	1-Overweight	32.00
27-Jan-2011	28.32		25.00
06-Dec-2010	25.27		23.00
02-Sep-2010	16.93	2-Equal Weight	20.00

[Link to Barclays Capital Live for interactive charting](#)

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**Valuation Methodology:** Our \$33 price target is based on a DCF valuation that uses a WACC of 9.6%, incremental ROCE of 15% and a terminal growth rate of 4%. Our PT also equates to 20x 2012e EPS.

**Risks which May Impede the Achievement of the Price Target:** Given MLNX's exposure to the storage and cloud computing segments, the positive sentiment towards these end markets could cause the stock to appreciate more than we expect. Continued transition to LOM designs and mix of business that is reducing margins could provide downside pressure on the stock. The acquisition and integration of Voltaire is another risk to consider.

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