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# INVESTOR'S BUSINESS DAILY

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## INTERNET & TECHNOLOGY

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### AudioCodes Heard The Call And Became A VoIP Pioneer

#### Big Potential For A Tiny Outfit

Fast ascent of new service called voice over Internet protocol puts firm on map

BY MIKE ANGELL

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AudioCodes has a three-year money-losing streak, relatively low sales in a brutally competitive field and a stock price that's...soaring. Thanks, VoIP.

The Israeli firm makes components for voice over Internet protocol gear. VoIP transmits phone calls over the Internet or Internet-like networks. It can cut prices dramatically while giving users more types of services, which is why communications firms almost daily herald new VoIP initiatives.

And many VoIP customers are, or will be, using gear from Israel-based AudioCodes<sup>AUDC</sup>, which seems to have the right products at the right time. The VoIP gear field is small, as is AudioCodes, but growing. AudioCodes stands to gain as spending shifts to VoIP, and bigger gear makers need partners to get them in the business.

"The big telecom gear makers are playing the key role in VoIP," said Ben Rabinowitz, vice president of marketing at AudioCodes. "As long as we keep adding value to what we do for the gear makers, we can expect to grow too."

But VoIP is a fast-changing field, which analysts say will force a small company like AudioCodes to scramble to stay ahead.

The company makes chips, circuit boards and other gear for VoIP networks. Its products help provide the bridge between IP and traditional phone networks. Most VoIP calls transmit over both network types.

#### Some Big-Name Customers

AudioCodes sells mostly to larger gear makers, which then use its products in their equipment. Its customers include Nortel Networks<sup>NT</sup>, Siemens<sup>SI</sup>, Avaya<sup>AV</sup> and 3Com<sup>COMS</sup>.

VoIP is still such a new field that even the big players can't provide all the VoIP products, which has opened the door for smaller suppliers. Besides AudioCodes, such firms include Brooktrout<sup>BRKT</sup> and NMS Communications<sup>NMSS</sup>.

"The gear makers don't have time to figure out all the parts that go into VoIP gear," said Carter Driscoll, an analyst with IRG Research. "They're trying to get to market faster and need outside firms to fill in their product portfolios."

Like its customers, AudioCodes' business fell sharply during the telecom downturn. But the types of chips it's specialized in, digital signal processors, are a key to VoIP.

The VoIP surge has lifted AudioCodes back into the black. After losing a combined 92 cents a share in 2001 through 2003, the company recorded a 5 cent per-share profit for its first nine months. Nine analysts polled by Thomson First Call expect a 5 cent fourth-quarter profit vs. a 3-cent loss in fourth-quarter 2003. Its third-quarter revenue rose 93% to \$23 million.

VoIP's promise, though, is attracting strong competition. Cisco Systems<sup>CSCO</sup>, the No. 1 maker of network gear, is among those that offer competing products.

And in VoIP chips, AudioCodes competes with the likes of Texas Instruments<sup>TXN</sup> and Broadcom<sup>BRCM</sup>.

But AudioCodes has at least two legs up on all these rivals, analysts say. One is that its engineers designed a key standard used in VoIP.

#### Many Areas Of Attack

The other is that, instead of just being another commodity maker of chips, AudioCodes makes the higher level VoIP components and full VoIP systems. Components accounted for 60% of its third-quarter sales, with full systems another 30%. Chips made up 10% of sales.

"The barriers to entry are having the expertise in chip design and the ability to integrate a lot of functionalities into the same board," said Merrill Lynch analyst Vivek Arya. AudioCodes is "gradually moving up the food chain."

That's what analysts want to see from AudioCodes. VoIP's newness means products are changing quickly. Arya says AudioCodes has to develop expertise in other areas of VoIP to keep growing.

Even though it developed a key VoIP standard, "that does not provide a company protection against commoditization," Arya said.

Rabinowitz says AudioCodes products can't be commoditized due to the particulars of telecom networks and the many different standards required to make VoIP work.

Observers expect AudioCodes will look for acquisitions to round out its VoIP portfolio. The company recently raised \$100 million in a convertible debt offering. A WR Hambrecht & Co. report says this means the firm is poised for an acquisition.

One target may be the VoIP gear business of a larger company. AudioCodes did a similar deal in 2003 when it bought a piece of Nortel's VoIP business. It also could buy one of the smaller VoIP companies.

IRG's Driscoll says AudioCodes has a history of good investing. "Even when they were losing money, they spent on research and development," Driscoll said.