

Silicom Ltd. (SILC)

Neutral

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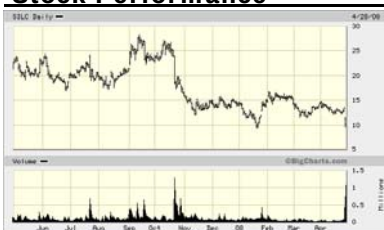
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Please see
**Important
Disclosures** on the
last page of this
report.**In-Line 1Q08 Results But Limited Near-Term Visibility Adds Risk to Story; Downgrading to Neutral****Key Metrics**

Price:	\$10.09
Rating:	Neutral
52-Week Range:	\$9.28-28.24
Cash (M):	\$35.1
Debt (M):	\$0.0
Debt/Capital:	0%
Book Value/Share:	\$6.19

Market Data

Market Cap (M):	\$68.6
Enterprise Value (M):	\$33.5
Shares Out. (M):	6.8
Float (M):	4.5
10-Day Avg. Vol. (M):	0.062
Institutional Ownership:	15.7%

Stock Performance

Source: BigCharts.com

Valuation (FY08E)

EV/Sales:	1.1x
P/E:	12.5x

Company Description

Incorporated in Israel in 1987, Silicom Ltd. currently designs, manufactures and markets connectivity solutions for a broad range of servers and network appliances. The company's product line is composed of bypass and non-bypass high performance multi-port gigabit Ethernet (GBE) network adapters based on either Intel or Broadcom-based chipsets. Prior to providing network adapters, the company produced integrated circuits and broadband Ethernet cards for PCs.

Investment Conclusion

Despite in-line 1Q08 results, we are downgrading SILC shares to Neutral from Buy given the prevailing headwinds that its core customers are experiencing and the related impact to the company's bypass card and adapter sales. While Silicom expects to see continued growth in these business segments, visibility continues to remain weak, which can result in back-end loaded quarters (~50% of sales in month 3—our estimate). We are encouraged by the company's movement into adjacent markets to help diversify its business, but until there is improved visibility with some of its largest customers, we are moving towards a more cautious stance.

Summary

• **Visibility remains the issue, in our view.** While Silicom remains a key supplier to the WAN and appliance markets, we believe the lack of visibility with its core customers, such as Riverbed (RVBD \$13.89, NR) and Cisco (CSCO \$25.35, NR), coupled with a challenging economic environment, adds additional risk to the stock. As a result, we are downgrading to Neutral from Buy and lowering our estimates.

• **In-line 1Q08 results.** Silicom reported in-line 1Q08 results of \$7.7M in sales and \$0.26 in EPS, in-line with our estimates (management does not provide quarterly or annual guidance). Gross margins were better-than-expected at 42.3% vs. our estimate of 39%, driven by a higher mix of fiber products during the quarter, which was outside of management's expected range of 35-40%. Subsequently, we are modeling GM's to return to an approximate 37-38% range going forward.

• **Operating expenses trending higher.** The company reported opex of approximately \$1.8M vs. our estimate of \$1.3M and \$1.3M in 4Q07, with the increase partly due to foreign exchange fluctuations (~\$100K in 1Q08), stock option expenses and \$250K in additional employee expenses. Silicom expects opex to trend between \$1.7-1.8M per quarter for the remainder of the year.

• **Valuation.** SILC shares trade at 1.1x CY08 EV/S and 12.5x CY08 PE vs. the peer group of component suppliers at 1.6x and 14.0x, respectively. We continue to view Silicom as a company with unique technology for its core markets, but believe the shares will continue to trade at a discount to the group until investors can become more confident in the direction of quarterly operating results.

MCF Estimates

	FY07A		FY08E		FY09E	
			Prev		Prev	
Sales (M)						
1Q	\$6.0		\$7.7	\$7.7A		
2Q	6.6		8.1	6.7		
3Q	6.6		9.2	7.5		
4Q	7.5		10.4	8.4		
FY (Apr)	\$26.8	\$35.4	\$30.2	\$45.3	\$36.2	
EV/S	1.3x			1.1x		0.9x
EPS						
1Q	\$0.22		\$0.26	\$0.26A		
2Q	0.25		0.28	0.15		
3Q	0.25		0.31	0.18		
4Q	0.27		0.36	0.22		
FY (Apr)	\$1.00	\$1.20	\$0.81	\$1.40	\$0.92	
P/E	10.2x			12.5x		11.0x

Silicom Ltd. (SILC)

Neutral

Company Name	Sym.	Rating	Price	Ent Val (m)	Est '08 EPS	Est '09 EPS	Act (m) '07 Rev	Est (m) '08 Rev	Est (m) '09 Rev	'08 Rev Grth	P/E '08	P/E '09	EnVI / '08 Rev	EnVI / '09 Rev
System Component Vendors														
Adaptec, Inc [#]	ADPT	NR	\$ 2.86	\$ 346	\$ (0.05)	\$ (0.04)	\$ 179	\$ 133	\$ 137	-26%	-	-	2.6x	2.5x
Brocade Comm.	BRCD	NR	\$ 7.24	\$ 2,257	\$ 0.61	\$ 0.68	\$ 1,237	\$ 1,423	\$ 1,572	15%	11.9x	10.6x	1.6x	1.4x
Emulex Corp	ELX	NR	\$ 13.40	\$ 820	\$ 1.22	\$ 1.39	\$ 494	\$ 525	\$ 575	6%	11.0x	9.6x	1.6x	1.4x
Mellanox Tech.	MLNX	NR	\$ 15.29	\$ 323	\$ 0.98	\$ 1.28	\$ 84	\$ 113	\$ 144	34%	15.6x	11.9x	2.9x	2.2x
Qlogic Corp [#]	QLGC	NR	\$ 16.69	\$ 1,864	\$ 1.06	\$ 1.11	\$ 585	\$ 618	\$ 655	6%	15.7x	15.0x	3.0x	2.8x
Silicom Ltd.	SILC	Neutral	\$ 10.13	\$ 34	\$ 0.81	\$ 0.92	\$ 27	\$ 30	\$ 36	13%	12.5x	11.0x	1.1x	0.9x
Super Micro [#]	SMCI	NR	\$ 7.37	\$ 177	\$ 0.69	N/A	\$ 472	\$ 603	N/A	28%	10.7x	N/A	0.3x	N/A
Voltaire Ltd.	VOLT	NR	\$ 5.06	\$ 45	\$ 0.21	\$ 0.40	\$ 53	\$ 78	\$ 100	46%	24.1x	12.7x	0.6x	0.5x
Xyratex Ltd.	XRTX	NR	\$ 20.39	\$ 538	\$ 1.32	\$ 1.93	\$ 932	\$ 1,051	\$ 1,204	13%	15.4x	10.6x	0.5x	0.4x
Median											14.0x	11.0x	1.6x	1.4x

Source: Company financial statements, MCF Estimates and Thomson Financial, ^Trailing 4 Quarters FCF - MCF estimates and Revere Data, Pricing may reflect after hours trading, [#] - Estimates represent approx. calendar year

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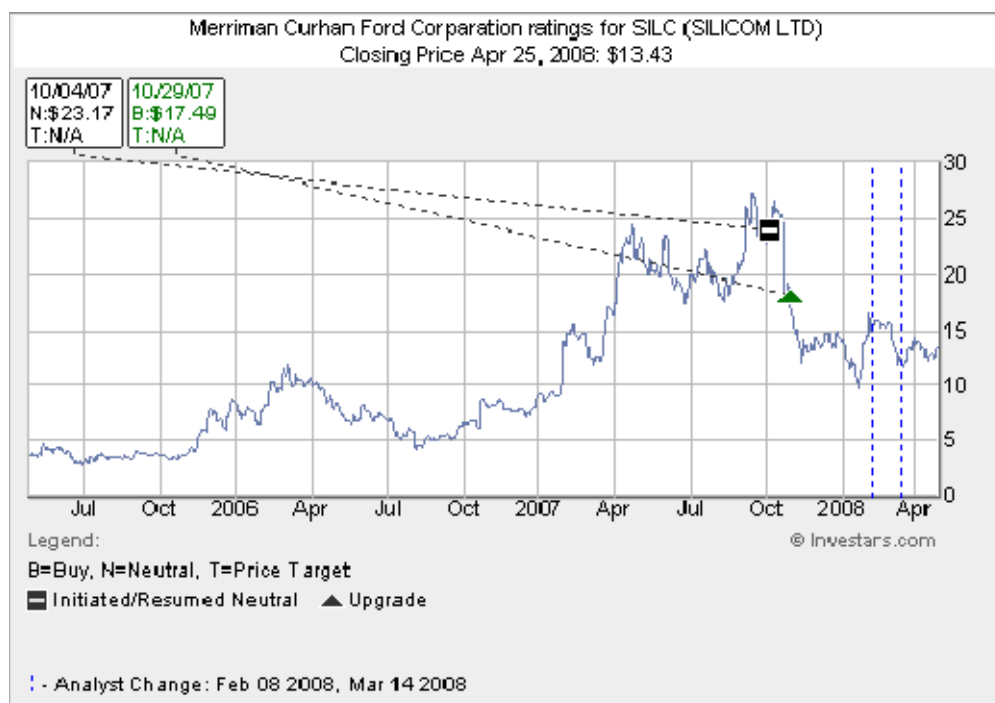
Silicom, Ltd. Income Statement

		FY2005A	FY2006A	Mar 1QA	Jun 2QA	Sep 3QA	Dec 4QA	FY2007A	Mar 1QA	Jun 2QE	Sep 3QE	Dec 4QE	FY2008E	FY2009E
(\$000) - GAAP Presentation														
Fiscal Year End: December														
Net Sales		\$ 10,876	\$ 16,118	\$ 6,049	\$ 6,617	\$ 6,640	\$ 7,478	\$ 26,784	\$ 7,703	\$ 6,652	\$ 7,483	\$ 8,356	\$ 30,193	\$ 36,215
Y/Y Growth		138.6%	48.2%	84.0%	82.0%	58.9%	49.1%	66.2%	27.3%	0.5%	12.7%	11.7%	12.7%	19.9%
Q/Q Growth		-	-	20.6%	9.4%	0.4%	12.6%	-	3.0%	-13.6%	12.5%	11.7%	-	-
% of Annual Revenues		-	-	20.6%	24.7%	24.8%	27.9%	-	25.5%	22.0%	24.8%	27.7%	-	-
Cost of sales		\$ 6,507	\$ 9,828	\$ 3,651	\$ 3,983	\$ 3,991	\$ 4,470	\$ 16,094	\$ 4,445	\$ 4,124	\$ 4,677	\$ 5,225	\$ 18,471	\$ 22,885
Gross Profit		\$ 4,369	\$ 6,290	\$ 2,398	\$ 2,634	\$ 2,650	\$ 3,008	\$ 10,690	\$ 3,258	\$ 2,528	\$ 2,806	\$ 3,130	\$ 11,721	\$ 13,330
Gross Margin		40.2%	39.0%	39.6%	39.8%	39.9%	40.2%	39.9%	42.3%	38.0%	37.5%	37.5%	38.8%	36.8%
Research & development		\$ 1,463	\$ 1,820	\$ 539	\$ 524	\$ 524	\$ 621	\$ 2,208	\$ 857	\$ 800	\$ 800	\$ 800	\$ 3,257	\$ 3,200
% of total revenue		13.5%	11.3%	8.9%	7.9%	7.9%	8.3%	8.2%	11.1%	12.0%	10.7%	9.6%	10.8%	8.8%
Sales & marketing		\$ 903	\$ 1,105	\$ 400	\$ 382	\$ 365	\$ 390	\$ 1,537	\$ 544	\$ 514	\$ 537	\$ 540	\$ 2,135	\$ 2,100
% of total revenue		8.3%	6.9%	6.6%	5.8%	5.5%	5.2%	5.7%	7.1%	7.7%	7.2%	6.5%	7.1%	5.8%
General & administrative		\$ 695	\$ 980	\$ 253	\$ 289	\$ 316	\$ 331	\$ 1,189	\$ 409	\$ 412	\$ 419	\$ 418	\$ 1,658	\$ 1,660
% of total revenue		6.4%	6.1%	4.2%	4.4%	4.8%	4.4%	4.4%	5.3%	6.2%	5.6%	5.0%	5.5%	4.6%
Total operating expenses		\$ 3,061	\$ 3,905	\$ 1,192	\$ 1,195	\$ 1,205	\$ 1,342	\$ 4,934	\$ 1,810	\$ 1,727	\$ 1,756	\$ 1,758	\$ 7,050	\$ 6,960
% of total revenue		28.1%	24.2%	19.7%	18.1%	18.1%	17.9%	18.4%	23.5%	26.0%	23.5%	21.0%	23.4%	19.2%
Operating Income		\$ 1,308	\$ 2,385	\$ 1,206	\$ 1,439	\$ 1,445	\$ 1,666	\$ 5,756	\$ 1,448	\$ 801	\$ 1,050	\$ 1,372	\$ 4,671	\$ 6,370
% of total revenue		12.0%	14.8%	19.9%	21.7%	21.8%	22.3%	21.5%	18.8%	12.0%	14.0%	16.4%	15.5%	17.6%
Interest expense, net		\$ 14	\$ 167	\$ 69	\$ 283	\$ 297	\$ 307	\$ 956	\$ 247	\$ 300	\$ 300	\$ 300	\$ 1,147	\$ 1,200
% of total revenue		0.1%	1.0%	1.1%	4.3%	4.5%	4.1%	3.6%	3.2%	4.5%	4.0%	3.6%	3.8%	3.3%
Income (loss) pre-tax		\$ 1,322	\$ 2,552	\$ 1,275	\$ 1,722	\$ 1,742	\$ 1,973	\$ 6,712	\$ 1,695	\$ 1,101	\$ 1,350	\$ 1,672	\$ 5,818	\$ 7,570
% of total revenue		12.2%	15.8%	21.1%	26.0%	26.2%	26.4%	25.1%	22.0%	16.6%	18.0%	20.0%	19.3%	20.9%
Provision for income taxes		\$ -	\$ (46)	\$ 30	\$ 153	\$ 96	\$ 153	\$ 432	\$ (41)	\$ 88	\$ 108	\$ 134	\$ 289	\$ 1,135
% of total revenue		0.0%	-0.3%	0.5%	2.3%	1.4%	2.0%	1.6%	-0.5%	1.3%	1.4%	1.6%	1.0%	3.1%
Tax Rate		0.0%	-1.8%	2.4%	8.9%	5.5%	7.8%	6.4%	-	8.0%	8.0%	8.0%	5.0%	15.0%
Net Income(Loss)		\$ 1,322	\$ 2,598	\$ 1,245	\$ 1,569	\$ 1,646	\$ 1,820	\$ 6,280	\$ 1,736	\$ 1,013	\$ 1,242	\$ 1,539	\$ 5,529	\$ 6,434
% of total revenue		12.16%	16.12%	20.58%	23.71%	24.78%	24.34%	23.45%	22.53%	15.23%	16.60%	18.41%	18.31%	17.77%
Shares outstanding		4,301	5,347	5,653	6,328	6,707	6,760	6,309	6,800	6,834	6,868	6,903	6,851	6,989
EPS after stock split		\$ 0.31	\$ 0.49	\$ 0.22	\$ 0.25	\$ 0.25	\$ 0.27	\$ 1.00	\$ 0.26	\$ 0.15	\$ 0.18	\$ 0.22	\$ 0.81	\$ 0.92
Net Income w/o one-time charges		1,322	2,598	1,245	1,569	1,646	1,820	6,280	1,736	1,013	1,242	1,539	5,529	6,434
EPS w/o one-time charges		\$ 0.31	\$ 0.49	\$ 0.22	\$ 0.25	\$ 0.25	\$ 0.27	\$ 1.00	\$ 0.26	\$ 0.15	\$ 0.18	\$ 0.22	\$ 0.81	\$ 0.92

Source: Silicom Ltd. and MCF Co. estimates FY08 and FY09 results and estimates include stock based comp

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Neutral



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