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PRESENTATION

Operator

Welcome to the Radware conference call discussing second quarter 2022 results, and thank you all for holding. (Operator Instructions) As a reminder, this conference is being recorded, August 8, 2022. I would now like to turn this call over to Yisca Erez, Director, Investor Relations at Radware. Please go ahead.

Yisca Erez;Radware Ltd.;Director, Investor Relations^ Good morning, everyone, and welcome to Radware's Second Quarter 2022 Earnings Conference Call. Joining me today are Roy Zisapel, President and Chief Executive Officer; and Guy Avidan, Chief Financial Officer. A copy of today's press release and financial statements as well as the investor kit for the second quarter are available in the Investor Relations section of our website.

During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. These forward-looking statements are subject to various risks and uncertainties, and actual results could differ materially from Radware's current forecast and estimates. Factors that could cause or contribute to such differences include, but are not limited to, impact from the COVID-19 pandemic, generalized business conditions and our ability to address changes in our market and our industry, changes in demand for products, the timing in the amount of orders, and other risks detailed from time to time in Radware's filings.

We refer you to the documents of the company files and furnishes from time to time with the SEC, specifically the company's last annual report on Form 20-F as filed on April 11, 2022. We undertake no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date of such statement is made.

I will now turn the call to Roy Zisapel.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Thank you, Yisca, and thanks to all of you for joining us today. In the second quarter, we drove solid results. Our total revenues grew 8% year-over-year. EPS was $0.18, and cash flow from operations was very strong at $31.5 million. Cybersecurity plays a pivotal role in today's business environment. And Radware, as a provider of real-time protection, serves as a fundamental force in defending our customers' most critical applications and data centers from cyberattacks. As the threat landscape continues to evolve with continuous increase in number and size of attacks, our customers must ensure their business continuity, strengthen resilience, and improve the customer experience. Therefore, we have every reason to believe that the demand for our solutions will continue to grow in the long term.

At the same time, we also believe that uncertainties present in the current macro environment might impact the spending behavior of our customers in the short term. Recently, we have seen some delays more than usual and lengthening sales cycles in large deals in Americas enterprise with some customers opting for staged deployments. Looking at the bigger picture, Radware is a healthy company, and we are well positioned for times of recession. We operate in a large and critical market with a growing addressable market. We continue to deliver and forecast sustained growth, high gross margin, and healthy cash from operations. We have best of breed technology, which provides better protection for our customers. We have a large customer base that is diversified across industries and geographies, and we have a strong balance sheet with more than $440 million in cash. Backed by these assets, we remain optimistic about the long term. Therefore, we will continue to make investments in our business and specifically in our strategic cloud security initiatives.

The demand for cybersecurity solution is highly correlated to the level of threats and attacks. The international conflict in Eastern Europe is a clear example for the use of cyberattacks by nation states as part of armed conflicts. A couple of months ago, we announced that that Ukraine State Service of Special Communication and Information Protection is using Radware cloud DDoS protection and cloud application security to protect their infrastructure and applications in the face of daily attacks. Our success in blocking these attacks is a great testament to the capabilities we have.

In the second quarter of 2022, DDoS attacks were relentless. The number of DDoS attacks that we blocked more than tripled compared to the second quarter of 2021. Not only our DDoS attacks mounting, but so our web application attacks, which during the second quarter, their number increased by 24% and bad bot attacks that rose 148%. This very active threat landscape creates a huge challenge to enterprises around the world. The midsized customers have the same cyber threats and security requirements like the large enterprise peers. Yet, they cannot afford the required CapEx investment and personnel needed to deploy and manage by themselves the high-end solutions.

Our Cloud Security as-a-Service allows them to enjoy the high end level of protection with fully managed services and enable us to increase our customer base and increase growth rates. In the second quarter, we continued to expand our cloud service footprint and capacity. We recently opened new points of presence in Taiwan and Chile. We plan to continue our global footprint expansion to penetrate new customers and geographies. We also continue to innovate on the product front. We just released a new set of crypto mitigation algorithms that block sophisticated bots that evade traditional solutions. At the same time, these algorithms enable genuine website visitors to enjoy a frictionless CAPTCHA free user experience. Our cloud application security continued to receive market recognition.

Last quarter, Radware was named the leader and outperformer in the Innovation hemisphere of GigaOm application and API protection radar report. GigaOm awarded Radware the highest possible scores in key criteria categories such as rule bundles, AI enhancement, API discovery, data leak protection, and bot management. In addition, Quadrant Knowledge Solutions named Radware the leader in its Park metrics with DDoS mitigation report. With comprehensive technology and customer experience management, Radware received the highest combined ratings for technology excellence and customer impact, making it the leading vendor overall.

I would like to share some of the key wins we had in the quarter. For instance, we signed a large DDoS deal with an IT services and web hosting company. They experienced multiple high volumetric attacks that were not blocked by their incumbent solution alerting them that they needed more comprehensive and robust protection. Our solution is blocking massive attacks in these customers daily, automatically and without any intervention from their staff.

During the quarter, we also expanded our business with one of the world's leading software and SaaS companies. This customer is building a new Internet gateway infrastructure and chose our hybrid cloud DDoS protection to protect it.

We signed another large deal this time for our Bot Manager solution with one of the largest financial services in South America. This customer has been suffering for a long time with outages, occasioned by sophisticated and massive bot attacks. This deal was done with our partner, Azion, a leading edge CDN provider in the region.

To recap, we have been building a leading comprehensive portfolio of data center and application security solutions. We are investing in our strategic cloud initiative to bring our solutions to a broader set of enterprise customers around the world. We are a strong and healthy company in terms of financials and well diversified in terms of customers and geographies, enabling us to overcome macro challenges and deliver sustained revenue growth with profitability.

With that, I would like to thank our customers, shareholders and employees for their confidence and trust they place in Radware. I will now turn the call over to Guy.

Guy Avidan - *Radware Ltd. - CFO*

Thank you, Roy, and good day, everyone. I am pleased to provide the analysis of our financial results and business performance for the second quarter of 2022 as well as our outlook for the third quarter of 2022. Before beginning the financial overview, I would like to remind you that unless otherwise indicated, all financial results are non-GAAP. A full reconciliation of our results on GAAP and non-GAAP basis is available in the earnings press release issued earlier today and on the Investors section of our website.

Second quarter 2022 revenue grew 8% year-over-year to $75.1 million compared to $69.7 million in the same period of last year. On a regional breakdown, revenue of the Americas in the second quarter increased to $29.5 million, representing 6% growth in Q2 2022 compared to Q2 2021. The growth rate is the same, 6%, when we compare the revenue of the Americas over the trailing 12 months.

In the last week of the quarter, we saw lengthening sales cycles in some of our large enterprise customers, which affect our growth in the region.

EMEA had another strong double-digit revenue growth in the second quarter, reaching $29.7 million revenue, representing 24% growth year-over-year, consistent with the longer-term trend represented by the 27% growth in trailing 12 months.

APAC revenue was $15.7 million, a decrease of 10% compared to Q2 2021. The long-term trends in APAC represent a modest 1% increase on a trailing 12 months.

Americas and EMEA account each for nearly 40% of total revenue and APAC accounts for the remainder 21% of total revenue.

I will now discuss expenses and profits.

Gross margin in Q2 2022 was 83.3% compared to 82.3% in the same period in 2021, an expansion of 100 basis points. Our gross margin improvement is mainly the result of the complete integration of SecurityDAM, partially offset by higher costs related to cloud infrastructure and supply chain. Operating expenses in the second quarter of 2022 were $54.1 million, representing an increase of 11% compared to the same period in 2021. The increase is predominantly due to additional R&D headcounts focused on our cloud and Hawks initiatives, the full impact of SecurityDam's integration and the increase in travel cost post COVID. Operating income was $8.5 million compared to $8.8 million in Q2 2021 and was impacted by the increase in operating expenses level.

Last quarter, we shared with you the new structure of Radware, which consist of the core business of application delivery, application and data center security, and cloud security as-a-service, and the Hawks business, which comprise of SkyHawk and EdgeHawk.

Radware's adjusted EBITDA for the second quarter was $10.5 million, which includes a negative $2.1 million impact on adjusted EBITDA of the Hawks Group. Earnings per diluted share for the second quarter 2022 were $0.18 compared to $0.19 last year.

Turning to the balance sheet and cash flow items. Deferred revenue this quarter increased by 18% over Q2 2021 to $187 million and ARR grew by 10% over the second quarter of 2022 to $195 million. We generated strong cash flow from operations in Q2 2022, which totaled $31.5 million compared to $8.8 million in the same period of last year. Cash flow from operation was favorably impacted primarily by strong collection as reflected in decrease in accounts receivable and by increase in deferred revenues. During the second quarter, we repurchased shares in the amount of approximately $18.1 million, and we ended Q2 2022 with approximately $442 million in cash, bank deposit, and marketable securities.

I will conclude my remarks with guidance. As Roy mentioned earlier, while the current global macroeconomic environment posed some uncertainties, we expect cybersecurity spending in our domain to remain resilient in the long term. However, we are witnessing longer sales cycle among large enterprise customers; therefore, we choose to take more prudent approach in the short-term. We expect on revenue for the third quarter to be in the range of $73.5 million to $75 million. Given our long-term positive view on the market and our opportunities, we continue to invest in infrastructure and R&D in order to capitalize on these future opportunities. We expect our operating expenses to be between $54.5 million and $56.5 million. Given all these trends and development reviewed earlier, we anticipate Q3 2022 diluted earnings per share to be between $0.15 and $0.18. As a result of the expected revenue for the third quarter, we are forecasting 6% annual revenue growth for 2022.

I will now turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Alexander Henderson with Needham.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

I was hoping you could talk about a couple of issues. The first one was in the quarter; it looks to me like you would have had earnings about $0.04 higher had it been not for the currency translation hit in the quarter. First off, is that right? And then second, as we look forward, can you remind us how you are hedged and what is your approach to the shekel at this point? Obviously, has seen a very significant move in the exchange rates over the last pretty much since the war started in Ukraine.

Guy Avidan - *Radware Ltd. - CFO*

So Alex, I will start actually with the second part of the question that we already hedged from the first half, let us say, middle of the first half of the year. So the FX new Israeli shekel versus U.S. dollar did not impact us a lot when you look at the non-GAAP reporting, but you can compare financial income from GAAP and non-GAAP. And then you can see the impact of the new Israeli shekel. We already hedged for the beginning of 2023. What was the first part of the question?

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

To mid-'22 to when mid-'23?

Guy Avidan - *Radware Ltd. - CFO*

Mid '23, but this is partially, it is not 100% hedged.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Partially. Okay. If the exchange rate stays where it is, how would that impact your OpEx costs? How much would you save on a full year of '23 if the exchange rate stays at the current levels?

Guy Avidan - *Radware Ltd. - CFO*

It is supposed to go more than 100 basis points.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

So you would have 100 basis both in OpEx?

Guy Avidan - *Radware Ltd. - CFO*

Again, if the FX stays as it is today, we expect to reduce let us say, OpEx based on the same headcount as of today, more than 100 basis points in 2023.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

That's what I was looking for. Going back to the operational aspect of your business, Roy, you guys have been making a pretty aggressive play to sign up a lot of partnerships. And a lot of those partnerships are in the early phases of ramp. And generally speaking, take a long time for them to go from concept, signing a contract to impacting your revenues. In this environment, does that process gets stretched out because those companies are looking at the macro and thinking, do I really need to drive this business forward? Or can I slow that down a little bit? How do we think about all of these programs because it has been a big piece of the investment thesis that all of these partnerships would ramp into a meaningful contribution over time?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I think it varies. I would say, partnerships that were more of the natural reselling type of partnership, you might be right. They would look to minimize future investments to be more conservative, etcetera. At the same time, what we see from partnerships that are more towards the MSSP side or the SOC or even the CDN is that they actually see an opportunity to increase their footprint and market share in the customer. So some of those partners, I have mentioned, for example, Azion with the bot management win, and we have many others, especially in the MSSP domain, we are actually seeing a lot of activity from them as they can increase their share of wallet in their customers. They can actually play very strongly on the fact that security now is a fully managed service at the very high level versus the need for dedicated OpEx and CapEx.

So I would say it depends on the partnership. But definitely, some of them are acting very well, and we plan to continue to invest in them. They brought us very nice logos in Q2. Yes, it is ramping. Yes, it is still early, but we see promise them.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Similar, Dam, obviously, the Cisco relationship is an important piece of the puzzle. And you have had Cisco unable to get the parts necessary to ship systems, but sitting on essentially 40% of full quarter revenues, product revenues and backlog, does that impede the timing of when they ship your product. So with those products, how do we think about their backlog and your realization of revenues into that account because it is a non-material piece of your business at this point?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Obviously, the pieces of Radware software that reside on top of Cisco hardware; let us say, the firepower firewall. If the firewall cannot ship, then obviously, we do not get our part. However, I think in every bad there is also good, this environment of supply chain challenges on the appliances is actually pushing Cisco and other partners of ours to strengthen our sizing actually in the cloud environment. So I do expect Cisco to be more active with our cloud DDoS offering, Cloud WAF offering, as a result of the lack of ability on their end to ship maybe firewalls in the quantities that were used to. So, I think we can actually, time would tell, it is still early, and we will update you in the future calls. But we do have some new programs together with both Cisco and Checkpoint that are centered around the cloud solutions.

Operator

Your next question comes from Tavy Rosner with Barclays.

Chris Reimer - *Barclays Bank PLC, Research Division - Analyst*

This is Chris Reimer on for Tavy. I was wondering if you could give any further color on gross margins and what is contributing to the expansion we are seeing there?

Guy Avidan - *Radware Ltd. - CFO*

So we mentioned that we grew around 100 basis points to a point of 83.3%. Let say, most of the growth is attributed to the acquisition of SecurityDAM. And having more scrubbing center and PoPs spread over the globe allow us to get higher gross margin.

Chris Reimer - *Barclays Bank PLC, Research Division - Analyst*

And how confident are you in the pipeline through next year, especially considering the macro headwinds if they persist and considering if the customer behavior changes longer than you expect.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I think in my comments, I have mentioned that we took that into account in our forecast as much as we can at this point. I would like to draw the attention to the growth in our ARR. So the annual recurring revenue is now getting close to $200 million. And with that also the increase in the deferred revenue, obviously, give us confidence, as early, I would say, sign of future growth. So at this point, we were quite consistent in previous quarters around 8%, 9% this quarter, even 10%, but let us call it the 7% to 9% CAGR that we were alluding to as the growth rate of the company. I think it's well backed by the ARR and by the deferred revenues that is, I would say, future looking.

And together with that, our pipelines today are at record level, some of it because of the delays in closing, but some of it because we continue to enhance pipeline. So looking on everything together, I think the forecast that we gave is well balanced. We have the ARR and deferred even giving us some tailwind for that. So we feel confident about it.

Operator

Your next question comes from George Notter with Jefferies.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

I guess I was looking at the Americas revenue generation. It seems like it is sort of topped out a bit last handful of quarters. I guess I am just wondering how you guys were doing there. I know hiring has been an issue in general. Any thoughts on sort of North American contribution growth, hiring, that would be great.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

So definitely, we are looking for North America to grow faster. It is clear. We were able actually to bring hiring to where we want it to be. So we closed on the hiring. But obviously, those people are relatively new in the organization. Most of them are 3 months, maybe even less, 6 months and so on. So they will be ramping. Together with this ramp of personnel and sharper focus on cloud security solutions, we believe that we will be able to get North America to faster growth. So it is definitely in our focus.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

And then is there a headcount number for the company? And can you remind me how many of those new heads were from SecurityDAM?

Guy Avidan - *Radware Ltd. - CFO*

So for June 30, we ended with 1,282 employees, close to 70, Actually, 69 employees came from are the SecurityDAM side.

Operator

Your next question comes from Timothy Horan with Oppenheimer.

Timothy Kelly Horan - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Maybe just a little more color on the slowdown. Do you think it is more macro driven or customers maybe just trying to figure out how to re-engineer their whole IT as they move to the cloud? Or is it supply chain driven. I guess those are the 3 buckets unless there is something else going on.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I do not want to say macro because our exposure to all of that is not that high. But if I look specifically like 3 large deals that we had in North America, each one of them in the millions of dollar range that I can think of as the prime examples of those delays. So we show budget freezes towards the end of the quarter that I think is more macro than anything because we are talking on a very large successful profitable growing company.

By now, that was actually released and went on.. In financial services, we saw a delay in pushing of investments towards even Q4. In the last case, of carrier infrastructure, it is more scrutiny and more look on architecture, on budgets, et cetera. By now, I think we have a variable for forecasting this quarter, but that is what we have seen in June, beginning of July. So definitely, some of it is heavily impacted by the macro, but those companies that we work with are the large enterprise, the carriers. It is not a risk for their business. It is those delays, recession, budgets, and scrutiny of the budget that comes into place in those times.

Timothy Kelly Horan - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

And do you think the supply chain is having any impact on their decisions or your decisions or your revenue? And are you seeing any other real supply chain?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I think the supply chain is not only from last quarter, we have seen it. And on our end, I think we were able to navigate it pretty well. We increased inventory. Guy mentioned also in his remarks, we were paying more for components. We were suffering in gross margin, but we were able to supply. However, in some cases, we do see that they are building a new data center; the switching equipment is not ready to ship in the next 6 months. They are not taking also our deliverables because they have nothing to do with it without the underlying infrastructure. So there is some, I would say, overall delay because of supply chain globally, but that is already built into our guidance, forecast, etcetera, we are seeing that.

I would say that is another good reason to focusing other end on cloud security services. It reasons from all those delays and supply chain issues.

Timothy Kelly Horan - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Got it. And just lastly, I know you are kind of talking about the revenue growth, 7%-9%. Will you kind of be willing to sacrifice margin expansion for a few years to make sure that you are well positioned longer term if we are in a weaker environment in the next 18 months, should we expect margins to be down?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

We might do that at least in the short term, that is our decision to continue to invest. Over the long run, I must tell you that with the resumption of sales growth towards the 7% to 9%, I believe you would see the leverage in the model. So I am not worried about that. We want to bring back the growth is back to our 7 to 9 CAGR. I think the leverage would be seen.

Operator

There are no further questions at this time. Mr. Roy Zisapel, I will turn the call back to you.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Thank you, everyone, for attending, and have a great day.

Operator

This concludes today's conference. You may now disconnect.
