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PRESENTATION

Operator

Good morning. Welcome to the Radware conference call discussing third quarter 2021 results, and thank you all for holding. (Operator Instructions) As a reminder, this conference is being recorded today, November 3, 2021.

I would now like to turn this call over to Yisca Erez, Director of Investor Relations at Radware. Please go ahead.

Yisca Erez - *Radware Ltd. - Director of IR*

Thank you, operator. Good morning, everyone, and welcome to Radware's Third Quarter 2021 Earnings Conference Call. Joining me today are Ron Zisapel, President and Chief Executive Officer; and Michael Goldberger, VP Finance.

A copy of today's press release and financial statements as well as the investor kit for the third 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 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, general business conditions and our ability to address changes in our industry, changes in demand for products, the timing and the amount of orders and other risks detailed from time to time in Radware's filings. We refer you to the documents 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 20, 2021. 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 thank you all for joining us today. We are pleased to report another strong quarter with double-digit growth across our major key financial metrics.

In the third quarter, we set yet another revenue record, hitting $73 million of revenue. This represents 17% year-over-year growth. In addition, earnings per share grew 32% to $0.23 on the same basis. ARR grew sequentially by $7 million and 9% year-over-year. The ARR growth, consistent with previous quarters, was driven by cloud and subscription ARR, which grew 26% year-over-year and is increasing as a percentage of total ARR.

The momentum in our cloud business is being supported by impressive growth in cloud application security, improved retention rates and a steady increase in the number of customers each quarter. We are working diligently on expanding our cloud business. We're opening more points of presence for cloud application security and DDoS so we can be closer to the customer and grow our business faster. We are already opening 1 to 2 new pops each quarter across the world and plan to continue so in the coming quarters.

The strong performance I just outlined is attributed to the combination of strong market fundamentals, our ability to innovate and the breadth of our product offering. One of the market forces that continues to play in our favor is the consistent rise in the number of cyber attacks. In fact, they are at record levels, and they are becoming larger and more complex.

During the third quarter of 2021, we blocked 30% more DDoS attacks, twice as many web application attacks and 3x more bad bot requests compared to the same period last year. The rise in the number and growing complexity of attacks is creating more urgency and driving organizations to strengthen the defenses around the critical assets. They no longer want to compromise protection levels given implications to their brands, business availability, customer privacy and regulatory compliance.

To meet the evolving needs of our customers, we continue to invest in innovation and lead the market with our superior technology. In the third quarter, we rolled out several new capabilities using sophisticated algorithms and automation to detect and mitigate the most advanced attacks.

One example I want to share is our SSL protection. During the last year, attacks using the encrypted HTTPS protocol have soared. As the adoption of encryption increases, attackers are using it to cloak their activities by blending in with legitimate encrypted traffic. Our newest algorithms expose this new generation of attacks without requiring SSL decryption and at the same time, offering mitigation at scale with even greater accuracy.

Another challenge large cloud and service providers are facing, is the ability to detect lower-volume DDoS flood attacks within a high bandwidth network. According to our research, more than 90% of DDoS attacks are less than 1Gbpsand will not be blocked easily by traditional solutions due to the lack of detection sensitivity. While these attacks will bring down specific critical resources, it's hard to pinpoint them in a high bandwidth network.

We are now completely innovating in this space. In a market first, we launched a new Quantiles algorithm that divides incoming traffic into sole segments or quantiles. With this granular level of detection, service providers and carriers automatically intercept phantom floods that historically have gone unnoticed. This new capability eliminates the costly and complex process of extensive manual configuration and ongoing threshold tuning.

Our superior solutions continue to receive recognitions from industry research firms. Recently, Quadrant named Radware as the leader in the STARK Matrix DDoS mitigation report. With the highest ranking across the parameters of technology excellence and customer impact, Radware was positioned as the 2021 technology leader among 14 other vendors in the global DDoS mitigation market.

We also were recognized by Gartner in the Gartner Critical Capabilities for Cloud Web Application and API Protection. We were ranked #2 for API security and for high-security use cases among 11 vendors included in this report.

And we are able to translate the strength of our security offerings into market wins. Let me share with you a few examples of the deals that we signed during the third quarter.

We won a large deal with a U.S. service provider with the DDoS security stack. This new logo experienced major attacks from their infrastructure and realized that their current protection was not sufficient.

We demonstrated an exceptional technical expertise and solution capabilities and won this leading customer.

We also signed an expansion deal with a large U.S. service provider for cloud DDoS. This customer received a ransomware letter from one of the top hacking groups. The letter was followed immediately by a major DDoS attack, which we successfully diverted to our cloud scrubbing center. We won this deal because of customer satisfaction from our solution, proven success in mitigation and the scale of our cloud DDoS solution.

Another win in the quarter was a cloud application security deal with a multinational financial technology company that is an existing ADC customer of Radware. The company expanded its relationship with us and purchased our cloud application security. We won this deal based on our long-standing relationship, coupled with the strength of our cloud AppSec offering.

Finally, we closed a large deal with a global European financial services group. This company experienced a volumetric attack when volumes surpassed their ISP mitigation capacity. The ISP was backhauling the traffic and closing outages. They chose Radware to strengthen their security protection coverage. This deal was brought to us by Check Point.

In summary, the third quarter was marked by a solid performance and strong demand for our solution as we continue to witness the impact of an increased level of cyber attacks. We are confident that this demand coupled with our broad security offering will fuel the growth for the coming quarters.

And now to Michael.

Michael Goldberger - *Radware Ltd. - VP of Finance*

Thank you, Roy, and good day, everyone. I'm pleased to provide the analysis of our financial results and business performance for the third quarter of 2021. I would like to remind you that, unless otherwise indicated, all financial results are non-GAAP. Reconciliations between the GAAP and non-GAAP results for the quarter are detailed in our press release.

As Roy outlined, we had a strong quarter with both the top and bottom line results are exceeding our expectations. Revenue for the third quarter of 2021 was a record of $73.4 million, representing an increase of 17% year-over-year and marking the third quarter in a row of double-digit growth. We recorded growth from all revenue types, predominantly subscription. We continue to expand our subscription business as reflected in total ARR, which grew 9% in the third quarter, specifically cloud and subscription ARR, which grew 26% compared to Q3 2020.

Looking in geographies. Americas, our primary region, which represents 49% of total revenue, grew 18% in Q3 2021 compared to the same period of last year. We reported strong growth in EMEA which represents 32% of total revenue and grew 29% in Q3 2021 compared to the same period of last year. APAC revenue increased 1% in Q3 2021 compared to Q3 of 2020 and accounted for the remaining 19% of total revenue in the quarter.

We'll now discuss expenses and profit. Gross margin for the third quarter of 2021 increased to 82.6% compared to 82.2% in the same period of last year. Our gross margin can fluctuate from quarter-to-quarter as a result of products and geographic mix. Operating expenses in Q3 2021 were $49 million, up 10% from Q3 last year. The increase is the result of FX impact as well as marketing and travel expenses that is lower in Q3 2020 due to COVID-19. In Q3, operating income increased 69% to $11.6 million, and operating margin expanded to 15.8% compared to 11% in Q3 2020 due to the strong leverage in the model and despite the headwind from FX. Excluding FX impact, operating income would have been $13.2 million and operating margin would have been 17.9%.

Financial income was $1.4 million compared to $2.8 million in Q3 of last year. As we highlighted in previous quarters, the decrease in the financial income is attributed to the declining yield on marketable securities and deposits. Tax rate for the quarter was 15.2% compared to 13.7% in Q3 2020. The expected tax rate for 2021 is approximately 15% to 16%. Earnings per diluted share for the third quarter 2021 increased 32% and $0.23 compared to the same period last year.

Turning to the balance sheet and cash flow items. Cash flow from operations was $18 million in Q3 2021 compared to $7 million in the third quarter last year. Total cash and financial investments at the end of September 2021 were $456 million.

I'll turn the call back to Roy to discuss the outlook for the first quarter and the full year of 2021.

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

Thank you, Michael. Before opening for Q&A, I will provide our guidance for the fourth quarter.

We expect Q4 total revenue to be in the range of $74 million to $76 million, and full year 2021 total revenue to be in the range of $284 million to $286 million. We expect our fourth quarter 2021 operating expenses to be between $51 million and $52 million, including increased investments in the business, coupled with the continued negative impact from the strengthening of the Israeli shekel. With that, Q4 2021 fully diluted earnings per share is expected to be in the range of $0.21 to $0.22, and full year 2021, fully diluted earnings per share is expected to be in the range of $0.80 to $0.81.

I will now turn the call over to the operator to start the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of George Notter with Jefferies.

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

I guess maybe I would start. You guys have made a push, I think, into hiring more folks in North America on the sales front. I guess I would just check in and kind of see where you guys are in terms of ramping that sales effort. And then also, there was a CFO search underway. I thought I'd ask about that one as well.

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

Yes. So thanks, George. The hiring environment is challenging. We are hiring in the U.S., but we are not yet full versus our plan, so we are doubling our efforts there. We've increased somewhat the level of salespeople, but still far from where we are heading. And going into 2022, we're planning to increase that even further. So we have a lot of work to do in that front. We're progressing, but we would like to accelerate it.

Regarding the CFO search, we have nothing to report yet. But obviously, when we have, we will announce it publicly immediately.

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

Got it. Okay. And then how do you think about the environment in terms of the deals? I mean, it sounds like you're still -- there are deals out there in the marketplace that you guys aren't seeing. Any sense for how much opportunity you guys might have as you ramp up the sales force? Or what do you think about your ability to really address the market at this point?

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

The opportunity is immense in cloud security. And obviously, we're just scratching the surface. I think we are represented to a certain degree in the very high end, most prestigious logos, but everything midsize of the market and below, we simply don't have the capacity today to approach. And we are increasing our efforts both organically through increased sales force across the globe, predominantly North America. But now we're hiring also in EMEA and Asia Pacific as well as through our other go-to-market channels.

Operator

Your next question comes from the line of Chris Reimer with Barclays.

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

This is Chris on for Tavy Rosner. Can you provide some color on the traction you're seeing with the OEMs?

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

Yes. So the OEMs continue to perform for us every quarter. Specifically, they are providing us with many new logos as they are marketing our solutions to their existing customers. We are working now on ways to further penetrate the OEMs on more solutions and to grow our business with them even further. I did refer in the call for one large European customer that was brought us by Check Point, there were some that brought to us by Cisco this quarter. So we continue to see activity around the world. But definitely, going into 2022, we believe also there, there's an opportunity to increase it even further.

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

Okay. And just looking across the geographies. You delivered strong growth in EMEA Americas this quarter, APAC was kind of moderate. Can you comment on some of the dynamics you're seeing across the different regions?

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

Yes. At a high level, if I'm looking more on our booking numbers, so overall, all regions performed well. When it translates to revenue, I know that APAC shows flat to slight increase. However, from booking perspective, they were good. I think one comment I want to make on the different regions is obviously, our cloud solutions are stronger in North America and in EMEA. And APAC, depends on the specific market within APAC. It's a bit slower to adopt cloud solutions in general and cloud security in our case, in particular, so we're more in a greenfield early scenario there. And therefore, it might limit the growth rates that we can achieve. However, we believe the potential across the world. And if you look where we are opening data centers, it's in North America. It's in Europe, but it's also in Latin America. It's in Asia Pacific. We think that cloud security is a very large opportunity globally and that all regions should be able to grow nicely as we go forward.

Operator

Your next question comes from the line of Andrew King with Collier Securities.

Andrew King

Congrats on a great quarter. Two questions for me. First off, if you could just parse out the 5G opportunities with the carriers and how that -- how you expect that to start layering into growth? Also how that's been impacted by COVID? And then also, can you just break down a little bit. You called out new -- strong new customers. How much of that was driven by emergency onboarding versus traditional sales processes?

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

Yes. So first, regarding 5G, we see that as a broader opportunity in carrier security, and I referred to some examples in my call. Today, we don't actively have projects in 5G networks that are particular to the 5G deployment versus a next-generation carrier network, disaggregate the network, et cetera. So we don't focus on the 5G specifically for -- as a growth driver for the coming 18 months. However, we do see a broader opportunity. The 5G networks are being built and that are much more application-specific. And with the rise -- potential rise of 5G use cases for IoT, for autonomous cars and so on, that would require to deploy security at the edge. And here, we think the opportunity is massively bigger than what we are seeing today in carrier networks. But for the short term, I would not characterize 5G as a specific growth driver for us outside of the global growth we're seeing in the carrier segment as a whole.

Regarding the emergency onboarding, I think we had several this quarter, but I think we had less than we had in Q2 or Q1 this year. So the growth in Q3 is not triggered by specific emergency onboarding. We did see, however, many customers that had an attack, and I gave some examples in my script, fail to protect. The attacker seems passed, but given that they failed and they went down, they had to search for a solution. So this -- we don't call emergency onboarding as we're not onboarding them under a specific attack, but definitely failure of existing topologies or solutions to protect is a very strong driver to upgrade and to change the incumbent solution. So this, we've seen across the world multiple examples in the third quarter.

Operator

(Operator Instructions) Your next question comes from the line of Alex Henderson with Needham.

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

So I was hoping if you could talk a little bit about the progress you're making with the service provider and other partners that you're signing to resell your technology across various, what I would describe as more narrow verticals. For instance, the transaction in Brazil with Azion or the one in Spain. Those projects obviously have a longer duration to when they start to show up in the revenues, but potentially it could be quite large once they -- those programs ramp. So have you got any more experience with that, that you can share that gives us some sense of the timing of how those will ramp? I think you ended like 16 or 17 of them over the last 18 months.

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

Yes, yes. You're right. And Alex, we continue to focus on that. We see carriers, hosting providers, CDN, specialty application, hosting and development providers as a very good source of new customers for us. And the reason is that everyone needs today's security. If you're hosting somewhere, you would expect that environment or that provider to be able to secure your applications. If you are relying on a third party for application hosting or specific part of your business transaction, you would expect them to be able to provide you with security solutions coupled with that application. And what we've seen is that partners can be very, very impactful as part of the relationship and sometimes as part of the transaction, their ability to sell our solutions.

We are ramping them. Not all of them are successful, but we're seeing every quarter more and more customers coming from this trend that we're calling them active, active resellers that are bundling or sometimes leading with our solutions to their customers. So for example, with the Azion relationship you've mentioned, I know we've closed already this quarter, another customer. And last quarter, we did couple. So definitely continuous progress. And I think the more of this we bring in and they don't overlap each other, each one is operating in different markets, different verticals, the more we bring. I think it completely augments and incremental to the channels to market we have now.

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

So I mean, it clearly seems like there's a lot of wind behind the arrowhead here and the arrow is in flight. So when do these partnerships really hit the steep part of the rent? Is it at 6 to 12, 18-month process to get these people to build out their marketing programs? And how do you share revenues or costs or how do they get compensated as part of it?

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

Yes. So it depends on the size of the partner and their operation. But I would say it's around 6 months to get going and to start training their sales force and them being able to pitch and close deals more independently. The business model is simple. It's like a reseller. There's a price list for the service that's competitive in the market, and we agree with them on a certain discount from that price list. It's obviously more than a regular reseller. It's less than a global OEM like Cisco, Check Points, so it's somewhere in the middle, which provides them strong margin and big upsides to serve that critical need that the customers already expect from them in some cases.

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

Well, given the trajectory of those wins, are we in the early phases of the steep ramp part? I mean, are we getting -- going to put to the shin of the S curve over the next year? Is that going to be a big driver?

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

We're still early. It should grow significantly next year. But in the global numbers, it would be still a low component, but it will contribute. It will start contributing to our numbers and growth rates.

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

Okay. Second question. Can you talk a little bit about the rate of subscription and cloud growth that you're expecting in your guide, the 26% in the current period? At this point, what do you think the full year number looks like for that subscription number?

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

I think we said that it's around this area. If you look also on previous quarters, it's pretty consistent the growth rates even as the numbers scale, and I would look for it to continue. I think the growth driver of the cloud portion within it, which is even a, obviously, a much faster growth rate continues, and we're putting more investments into it. So this is what we would be looking for also going forward.

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

And then within the numbers, can you talk about whether you had any supply constraints? I didn't hear. It's the first call. Are the (inaudible) -- comes -- been on that hasn't mentioned supply constraints at all. And I know you do sell -- also some hardware. So can you talk a little bit about whether you had a book-to-bill above 1, or below 1, or at 1, or whether you had supply constraints and whether that's impacting your costs at all?

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

Yes. So we do, like everyone else, I think, have supply constraints. It keeps us mainly on the -- obviously, on the appliance business. There's some minimal impact on the timeline of building new cloud nodes. Sometimes we rely on third parties for switching, routing and so on, but it mainly hits us on our own appliances. And at certain product lines, we do see both significant cost increases as well as delays. But I don't think it's a major impact in the overall. We built some inventory ahead of time. If it would persist, that problem will become, of course, bigger and bigger, if it would persist. But at this point, I think we're managing it relatively well. It hits us somewhat, but definitely less of an impact for our cloud security solutions or public cloud or software subscriptions where it's completely unrelated to it. So overall, I think we're in a good shape definitely relative to the industry, although there is some impact, of course.

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

So your book-to-bill was consistent with around 1 then, it sounds like. No backlog built?

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

Slightly above 1, or -- we've built more backlog through the deferral and so on, we will report it in the end of the year, but you will see that our total backlog is increasing.

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

All right. And then the shekel obviously had an impact in the quarter in the guide. I was surprised how much it spiked in the last 1.5 months or so. So what is the impact of the shekel in your 4Q calculus?

Michael Goldberger - *Radware Ltd. - VP of Finance*

Well, for the next quarter, it will be less impact us year-over-year. It will be around $600 thousands for the fourth quarter.

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

And if it stays at this level, what would it be in the -- for the full year '22?

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

I think per quarter, it hits us now at $0.01 or $0.02 EPS. This quarter, it was a bit more, $1.5 million, so it's more. But going forward, the quarter, at this level, it's $0.01 to $0.02 per quarter.

Operator

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

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

Thank you very much for joining us today, and have a great day. Thank you.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's conference call. You may now disconnect.
