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PRESENTATION

Operator

Welcome to the Radware conference call discussing fourth quarter and full year 2021 results, and thank you all for holding. As a reminder, this conference is being recorded today, February 9, 2022.

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 Fourth Quarter and Full Year 2021 Earnings Conference Call. Joining me today are Roy Zisapel, President and Chief Executive Officer; and Guy Avidan, VP Finance. A copy of today's press release and the financial statements as well as the investor kit for the fourth 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 estimate. 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 the 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 that 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.

Q4 was another record quarter, which closed a record year for Radware. Our strategy to grow our cybersecurity and cloud services has proven very successful. In turn, we've made great progress transitioning from mainly a product-based perpetual license revenue model to revenue model that is based largely on ARR and subscriptions. The evidence of this shift is reflected in our 2021 performance.

Total ARR reached a record of $190 million. Cloud and subscription ARR grew 23% year-over-year. Cloud and subscription revenues grew 44% year-over-year to $93 million, and now they account for 32% of total revenues, up from 26% in 2020. And we exited 2021 with a run rate of more than $100 million of subscription revenue.

Looking forward, we see great momentum and significant potential in continuing to grow our data center and application security offerings. Our customers are advancing their multi-cloud infrastructure and have an elevated need for a strong security strategy. This is a huge market opportunity for us. It is further magnified by an extremely active cyberattack environment, and our recent statistics demonstrate that. Number of denial-of-service attacks that we blocked during 2021 increased by 45% compared to 2020. The web application attacks blocked by us grew by 88%. And both attacks increased by 123% year-over-year.

Based on these market drivers, the resulting need for best-in-class cloud security and our technology leadership, we continue to win many new customers and grow our existing relationships.

In the fourth quarter, we closed several large cloud deals. For example, a Fortune 500 financial services company chose our cloud DDoS solution for a worldwide deployment to better protect and serve their global operations. Our global network footprint and quality, together with our security leadership, were the reasons noted by this new customer.

Our Bot Manager also earned us a 7-digit deal from a Fortune 500 customer and one of the largest e-commerce organizations in the world. After we displaced a competitor solution a year ago, based on last year's success in blocking real-time attacks, this customer extended and expanded the scope of our agreement in our largest Bot Manager sales to date.

Our state-of-the-art technology continues to be a major driver in the purchase decisions of both our new and existing customers. In the fourth quarter, we continued to evolve our solutions, features and capabilities. In our cloud AppSec service, we significantly strengthened our API security with the introduction of the API discovery module. This feature uses an advanced machine learning algorithm to identify undocumented and legacy APIs that are hard to observe and control. Protecting APIs is paramount since hackers and bots can use broken or exposed APIs as an entry point and from there launch a full cyberattack.

We also recently released our integrated content delivery network called CDN, that is now part of our cloud AppSec offering. In the fourth quarter, we closed our first deals with our integrated CDN solution. For example, a multinational conglomerate company in Asia Pacific that spans many industries purchased our complete Cloud WAF, Bot and CDN solutions. The company, which was an existing customer of our ADC and DDoS protection product, was looking to consolidate and centralize control of those services. The customer decided to expand its relationship with Radware due to our superior technical solution and our strong strategic relationships.

The fourth quarter was a strong quarter in carriers and service providers. As a result of infrastructure transformation and the evolving threat landscape, carriers and service providers are facing unprecedented level of attacks on their customers. Having to deal with new cybersecurity demands, they are looking to strengthen their security infrastructure. Following that, we start to witness expansion in their investments. And we closed multiple deals in the fourth quarter with major carriers, existing customers and also new customers that look to replace their incumbent vendor.

One of the largest European carriers needed to increase the security capacity based on the traffic growth within its mobile network. This carrier is a long-term satisfied defense for customer and awarded us a 7-digit expansion deal.

Another example is a new customer to Radware that we won through our Cisco OEM relationships. This Asian carrier was looking for a new DDoS solution. The customer acknowledged our superior technology and decided to replace the incumbent vendor and upgrade to our solution.

In closing, we are very pleased with our performance in 2021. We executed well, achieved double-digit revenue growth each quarter and for the full year, and record revenues for Q4 and 2021. We also grew our subscription business to $93 million and generated healthy operating income, earnings per share and record cash flow from operations.

In 2021, we witnessed an increased demand for our security solutions. The total addressable market is large and offers tremendous opportunities in the future. In order to address these opportunities over the coming quarters, we are increasing our investment in field and marketing resources and accelerating investments in our cloud infrastructure and solutions.

I would like to thank all of Radware employees around the world for their dedication, execution and contribution to our 2021 results. I will now turn the call to Guy, who will review the financial results. Guy?

Gil Givoly

Thank you, Roy, and good day, everyone. I'm pleased to provide the analysis of our financial results and business performance for the fourth quarter and full year 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.

We had a strong quarter and a remarkable year with both the top and bottom line growing double digits in 2021 compared to 2020. Revenue for the fourth quarter 2021 was a record $76.6 million, an increase of 11% compared to the same period in 2020. Full year 2021 revenue was also a record, reaching $286.5 million, an increase of 15% compared to 2020.

Looking at geographies, 2021 revenue in the Americas grew 14% in the fourth quarter and 13% during the full year to $31 million and to $129 million, respectively. 2021 revenues in EMEA grew 23% in the fourth quarter and 26% during the full year to $30 million and $98 million, respectively. APAC revenues in the first quarter of 2021 were $16 million compared to $17 million in the same period in 2020. For the full year 2021, APAC revenues increased 4% to $59 million compared to $57 million in 2020.

I will now discuss expenses and profit. Gross margin for the fourth quarter of 2021 was 82.4% compared to 83.1% in the same period in 2020. For the full year 2021, gross margin was 82.4% compared to 82.8% in 2020. Our gross margin does fluctuate from quarter-to-quarter due to product and geographic mix as well as costs related to the supply chain.

Operating expenses in the fourth quarter of 2021 increased 8% to $52.1 million compared to the same period in 2020. Full year 2021 operating expenses also increased by 8% to $197.3 million compared to $182 million during the same period in 2020. The increase in operating expenses is as a result of higher employee count and commission costs, coupled with currency impact, mainly the weakening of the U.S. dollar against the Israeli shekel. Excluding the impact of the weakening of the [U.S. dollar against the Shekel] (corrected by the company after the call), operating expenses would have been approximately $1 million and $5 million lower for the fourth quarter and full year 2021, respectively.

Nevertheless, we were able to increase our operating income and operating margin. Operating income increased to $11 million in the fourth quarter of 2021 compared to $9 million in the fourth quarter of 2020. In addition, operating margin increased to 14.4% in the fourth quarter of 2021 compared to 13.2% during the same period in 2020. For the full year 2021, operating income increased by 55% to $39 million compared to $25 million in 2020, and operating margin increased to 13.6% in 2021 from 10% in 2020.

As discussed in previous earning calls, the declining yields on marketable securities and deposits impacts our financial income, which decreased from $2.2 million in the fourth quarter of 2020 to $1.1 million during the same period in 2021 and from $10.4 million in 2020 to $6.2 million in 2021. Looking ahead, we expect financial income to continue to decrease in the coming quarters.

In the fourth quarter of 2021, we decided to take advantage of a special program initiated by the Israeli Tax Authority that allowed Israeli companies to release trapped profits at a discounted tax rate. Pursuant to this plan and due to the benefit of this program, we elected to participate. The effect of this onetime tax expense related to the release of the trapped profits and fourth quarter GAAP taxes was $8.2 million. Due to the onetime nature of this expense, we excluded it from the non-GAAP results.

The effective tax rate for the fourth quarter of 2021 was 14.9% compared to 13.7% in the fourth quarter of 2020 and 15.1% for full year 2021 compared to 13.1% in 2020. The increase of the effective tax rate is related to multiyear tax settlement that occurred in the fourth quarter. The expected tax rate for 2022 is approximately 14% to 15%.

Despite the decrease in the financial income and the increased tax rate, earnings per diluted share for the fourth quarter of 2021 increased to $0.22 compared to $0.21 in the same period in 2020. And earnings per share for full year 2021 increased by 25% to $0.81 compared to $0.64 in 2020.

Turning to the balance sheet and cash flow items. We have a very strong balance sheet. We had record cash flows. Cash flows from operations was $29 million compared to $18 million in the fourth quarter of 2020 and cash flow from operations of $72 million in 2021 and compared to $64 million in 2020.

During the fourth quarter, we repurchased shares at approximately $17 million. And during the full year, we repurchased approximately $52 million on share buybacks. We ended 2021 with approximately $466 million in cash, bank deposits and marketable securities.

I will turn the call back to Roy to discuss the outlook for the first quarter and the full year of 2022.

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

Thank you, Gil. I will now provide our guidance for the first quarter of 2022. We expect Q1 revenues to be in the range of $72 million to $74 million, representing 8% to 11% year-over-year growth. As we highlighted, we are increasing investments in the cloud business, and we expect our operating expenses to be between $50.5 million to $52 million. With that and taking into account the decline in financial income, Q1 earnings per share is expected to be between $0.17 and $0.19. For the full year 2022 revenues, we expect to grow slightly above our 3-year CAGR.

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

QUESTIONS AND ANSWERS

Operator

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

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

Roy, maybe just to kind of continue on that. So you're -- in terms of the guidance for the full year. So if I look back, your guidance at one point for the long-term CAGR was 9% to 10%. So I assume you're looking for a slightly better revenue growth this year than that type of number. Is that mid-teens? Is that low-teens, high-teens? Is there some kind of tighter parameters you could put around that?

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

Yes. Unfortunately, our guidance was 7% to 9%, and that's what I'm looking for.

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

Right. Okay. Because I think you -- at one point, the long-term growth rate was 9% to 10%. And then this is at the Analyst Day from 2020. And then I think you took it down at one point subsequent to that. Is that -- so okay, so the bogey is 7% to 9%?

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

Yes. Also in the Analyst Day, that was the figure. I will send you over after the call, the material.

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

Sure. No worries, of course.

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

It's in line with that.

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

Great. Okay. And then OEM bookings is a number you guys have given us in the past. I think you gave it in terms of compares in prior years 2020 and 2019. But how did you guys do in terms of OEM bookings in 2021? Is there a number for that?

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

Yes. So we did -- it depends on the OEM vendors. Some did better than the others. But the growth -- the significant growth in absolute revenues did not come from there. It came from the cloud -- from actually from our other channels, other indirect business. As I've mentioned in the script and in other scripts, along the way, we see the OEMs contributing a lot in bringing new, completely new customers to us. And this continues to be strong. Going into next year, we are trying, obviously, to accelerate with several programs the OEM revenues. Having said that, I think our own go-to-market strategies, also the enterprise and the carriers executed well in 2021.

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

Got it. Okay. And then if I go back earlier in the earnings season, it seems like this was long ago, but one of your competitors, F5, was having issues with component availability. They were seeing a bigger shift towards hardware in their business. It sounds like from the monologue here today that you guys aren't really seeing those issues nor the shift towards hardware. But can you talk about what you're seeing in terms of supply chain impacts?

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

So I think we're exposed to what everyone is seeing. Obviously, component prices are going up. Supply chain, there are some challenges. But we built somewhat more inventory, and we're paying more. We're paying more for the components. We're paying more for the shipment. You see some of the impact in our gross margin, but we ensure continuous supply of our products to our customers.

Operator

And our next question will come from Chris Reimer with Barclays.

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

This is Chris on for Tavy from Barclays. Looking at the revenues across geographies, you delivered strong growth, EMEA, North America. Well, this quarter, APAC was down. Can you comment a little on some of the dynamics you're seeing especially in APAC and then in general just across the different regions?

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

Yes. So at a high level, given we're selling more and more cloud security solutions, obviously, we grow better where the region is more aligned to cloud computing, hybrid cloud and so on. APAC, again, obviously, depends on the country. But in a general statement, it's a bit after Europe and North America in these trends. And we see that in our ability to generate high amount of sales from our cloud security solutions there. So we are working hard to accelerate that and especially in specific markets that we believe there can be a good attainment of cloud security business. But for now, the growth rate there is more challenged versus the more developed market for cloud security.

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

Got it. And just is there any other -- is there any color you can provide on the M&A pipeline? And can you expand a little on the investments you're undertaking to support growth in the business?

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

Yes, absolutely. So we continue to be active in the market to search for M&A candidates. However, I must tell you that some of the pricing we're seeing on private companies are making it hard for Radware to act upon at this time. However, we have the time and the patience to find the right candidate and the right opportunity to do an M&A.

Regarding the investments we're making, as I've mentioned in my notes, we're focusing on growing our security business and specifically the cloud security. So we're making investment in dedicated sales, headcount, in marketing investments towards that as well as significant investment in the cloud infrastructure and the R&D to support future growth.

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

So really just all around. Yes. Okay.

Operator

And our next question will come from Alex Henderson with Needham.

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

Great. So I was wondering if you could give us a sense of your target on headcount increases in 2022.

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

We're targeting, give or take, 100 to 120 people adds during the year.

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

Okay. And do you have any guide towards your expected growth rate in ARR in 2022, which I know is one of the key drivers of the business. Are we looking at, say, 25% type growth again?

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

Yes. So we're not giving specific guide for the ARR. But if you see the total ARR in the recent quarters was 9% and that's also by the way, driving the figure for the whole revenue growth. For cloud and subscription, we were in the -- as you've mentioned, we were in the mid-20s, and we would like to keep it. Again, it requires more work from us, but that's the direction we're taking.

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

Got you. And this is a little bit more of a longer-term question. But you signed, I don't know, 18, 20 pretty significant wins with companies that are going to be reselling your product as a service into their local economies, whether it be the deal in Poland or whether it be the one in Spain or a couple in Latin America. I mean you had a bunch of these. My sense is that those programs take a long time to roll out from the time they're announced. And so there's somewhat of a pent-up incremental revenue growth that's coming down the pipe. Can you talk about how those major wins will translate into revenues? I'm assuming that that's not much of an impact in '22, but probably '23, '24, it starts to be a considerable driver of growth.

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

Yes. So like you've mentioned, we think those local partners, dedicated partners are key ways for us to grow our footprint. It does require a lot of training, product management work, joint marketing with them, white labeling and so on. We started to see the first fruits with some of them. Obviously, not all of them won't be successful. But we do see very good progress in this, what we call, active channels, cloud resellers. And we started to gain the first wins, I would say, in the second half of the year. It's still not in a big number, but the signs are very good. And we are ramping our investments also in those channel sales, marketing programs towards this go-to-market, which we believe is a unique opportunity for us.

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

So is it a '23, '24 ramp of that business? Is that right?

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

I think it would also contribute to 2022. I would not push it as far as 2023. But there is a ramp, and we plan to sign more. So we think this type of dedicated channel is very suitable for our cloud sales.

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

All right. Cisco has implemented, I think, 4 price hikes over the last year, including 1 effective February 1st, which I understand to be 10%. How does that -- how are the price increases at Cisco impact you? And what are you doing on price relative to the increase in supply chain costs and inflation in semiconductors and the like?

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

Yes. So Cisco price lift increases obviously apply to all products, including products that they carry from us. They can implement the price hikes by themselves based on their view of the market. Regarding us, we did not increase our price list. So far, we were absorbing the costs on one end. Of course, we were looking at discount structures, et cetera, but we did not implement a price increase. We're looking into that. For now, we are staying as is.

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

Okay. And so the price hikes from Cisco, does that impact your growth with Cisco? I mean are you expecting that to -- I'm struggling with the disconnect here between 20%-plus price hikes and big backlogs at these companies and the fact that most enterprises are increasing their IT spend in single digits. How do we think about the give and take between price hikes and decreased volume of production or orders going forward?

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

Yes. So I think price list is one component. There's also a question about what discounts and whether some of those customers maybe with Cisco, in this case, have agreement, not with price list discount but actually price figures. So far, I did not see the 20% price hike on Cisco on our end. I know there are some plans for certain percentage points. And we will see if they maintain the same discount levels. We will see an increase from that, absolutely. But it's too soon to tell.

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

Just to be clear, so when Cisco takes up prices in your product, that's not passing through your prices, therefore, do they capture that price?

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

No, no, no. If assuming they sell it the same discount as before, we would see a bigger portion of that on our end. So there are certain discounts and certain thresholds and transfer price. There's multiple parameters. But in general, Alex, to make it simple, if Cisco will sell in higher prices, we will get a bigger share.

Operator

And our next question will come from Andrew King with Colliers Securities.

Andrew King

Congratulations on the good quarter. I just wanted to dive into the guide a little further. Can you just detail out what the supply chain implications do you have built into your revenue guidance for this next quarter? And what you have built in when you say you're looking to grow 7% to 9% for the quarter FY '22?

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

The question was what we built in terms of the guidance into the supply chain costs in the first quarter?

Andrew King

Yes, for the first quarter and for the full year.

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

Yes. Okay. So we took slightly lower the gross margin. You saw already some of it in Q4 results. For next year, we think it might be a little bit lower, depending if the current pricing environment would stay, which is our current assumption. So it doesn't depend only on the components. It also depends on our product mix. But our current assumption is for a slight decline in the gross margin.

Andrew King

Got it. And then can you just detail out within your new customers, how many of those were emergency onboarding versus traditional sales processes?

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

How many of them were what on onboarding -- emergency onboarding? This quarter, yes, I don't think we had many emergency onboarding this quarter, maybe around 10 or so. So this Q4 was not a massive quarter, I think, in terms of emergency onboarding. But we did see many, many customers coming simply because of the overall environment. With so many customers that came after a failed attack, a block that they experienced in previous months, and now, they're revamping security. So the environment is very, very active and customers understand that there's -- it's not enough to say I have a security solution, you really need to make sure it will block the attack. So I think that is the large enterprises, this notion of really going deeper into the success of the technology in real life to block attacks, this notion is becoming more and more critical in the decision process.

Operator

And we do have a follow-up from Alex Henderson of Needham.

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

Great. So you've given us a guidance on the revenue of 7% to 9% for 2022. You've also said that you're going to increase investments. So if I think about the OpEx line, should I be anticipating that, that's growing at or faster than the 7% to 9%? Is that what you're implying? I mean I think the exchange rate versus last year is still somewhat negative in the first half. But it's kind of flattened out and actually rolled a little bit so that it's not as onerous as it was in the back half of the year. So can you talk a little bit about what you're thinking in terms of OpEx growth?

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

Yes. It depends on multiple factors. It might be at the high-end of the revenue growth, maybe a little bit higher. At this point, we are not trying, I would say, to optimize the operating margin or the cash flow of the company. We reached already $70 million per year cash flow. We are investing for growth. So that would be our prime consideration for 2022.

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

And given the environment around the inflation around parts, I would assume that your gross margin will remain under some pressure, therefore, flat to at least to down somewhat. Is that fair?

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

I said a slight decline, yes. I think. In addition to the inflation, there are also significant salary hikes in the cyber market. Meaning, if you look on the macro of supply chain issues, like interest rates going down and therefore, financial income going down, FX, salary hikes, et cetera, the macro is putting some pressure. But on the other hand, our business in cloud security, the trends we're seeing, the strength in the market, causing us to invest more.

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

Yes. So you tapped into my next question, which was on the churn rate and the wage inflation environment and your ability to hire. If I recall, I think you were seeing a little bit of an elevated churn versus the, say, the 2019 time frame. Obviously, it's different versus the 2020 period. And you were also seeing wage inflation. But you'd also said that I thought that you were seeing some pressure on your ability to hire. Has that improved? I've heard a couple of companies say that they're seeing some improvement in hiring availability. So could you comment on those 3 metrics?

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

I would say, Alex, we're trying harder. So I don't think the market is difficult in that sense, both on the retention and the wages. But we try harder. We double down on the hiring and recruiting resources and efforts. And we are growing the headcount.

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

Okay. So there's no change in conditions on either churn, wage inflation or ability to hire? Is that fair?

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

Yes.

Operator

And with no further questions, I would like to turn the call back to Roy Zisapel for closing remarks.

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

Okay. Thank you, everyone, and have a great day.

Operator

And this concludes today's conference. Thank you for your participation, and you may now disconnect.
