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PRESENTATION

Operator

Welcome to the Radware conference call discussing second quarter 2021 results, and thank you all for holding. (Operator Instructions)

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

Yisca Erez

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

A copy of today's press release and financial statement 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 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 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 statement 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. I'm excited to report a strong second quarter that exceeded our expectations with record revenue and accelerated growth. Our strong performance extended across all business lines and all geographies, including growth in large deals, record new customer business and record in new cloud levels. Our achievements demonstrate the continued expansion of our cloud and application

security businesses, our ability to execute on strong demand to our solutions and our ongoing success helping our customers protect their critical applications.

Second quarter revenue was a record \$70 million, representing year-over-year growth of 19% and one of the fastest growth rates we had in recent years. Cloud and subscription ARR continue to grow strongly at 27% in the second quarter, reaching another record quarter. These results are underpinned by the accelerated transformation of enterprises to digital and the increase in global cyberattacks that make it critical for our customers to ensure they have the best possible cybersecurity solution for their business and applications.

In the second quarter, the strong demand for our solutions led to solid growth in bookings and we earned some impressive wins.

So why do we win?

First, we are winning because of our superior technology. At the core of our technology, our sophisticated algorithms. They combine machine learning, fuzzy logic algorithms as well as various behavioral based detection and protection algorithms. Combined, these technologies enable our solutions to automatically adapt to the changing threat landscape and differentiate between legit and attack traffic. That, in turn, positions us to deliver the widest, fastest and most accurate security protection in an environment of constant attacks.

One example is a large video gaming company in Asia Pacific, which experienced a complicated DDoS attack, both inside and outside the country. When their existing security solution couldn't mitigate the attack and since time was of essence to present a severe disruption to their customers, they turned to us for an emergency cloud DDoS solution. Shortly thereafter, they expanded their solution to a hybrid cloud DDoS by placing our defense for appliances at the edge of their data centers.

Another example is a Fortune 500 company, which is one of the largest rental companies in the U.S. This company received a ransomware letter, which was followed immediately by a DDoS attack that exceeded their Internet capacity and brought them down. Our partner, Cisco, reached out to us and we mitigated the attack. Following our success, the customer chose Radware hybrid cloud DDoS protection based on our unique ability to manage these threats.

These are just two examples that demonstrate the strength of our technology and our ability to successfully mitigate complex cyberattacks in real time.

The second reason we are winning new business is because of the breadth of the cloud security offering. Hackers are utilizing a large set of attack tools, and enterprises are looking for sophisticated security solutions to protect their applications and mitigate these cyberattacks. Our broad cloud security offering provides end-to-end protections for their assets and applications. We offer fully managed, integrated web application protection, Bot attack mitigation, API security and DDoS protection cloud service, coupled with public cloud security.

There are two notable cloud wins I'd like to share from the second quarter. We signed a very large cloud application security and DDoS deal with one of the largest construction equipment manufacturers in the world. This Fortune 500 company was facing challenges, protecting their applications. They chose Radware because of our deep security expertise and our ability to execute and deliver web application security in any form factor. In the end, it became evident that Radware offered the best solution for securing several thousands of applications over many different environments.

The second major cloud win that we signed in the second quarter was with the largest service provider in Latin America for a suite of application security solutions, web application security, Bot management and DDoS. The customer was severely impacted by both attacks and DDoS activity. After failing to contain the attacks using rate-limiting solutions, we walked the customers through the right way to approach them. We offered the best protection and proved it from day one in real traffic proof of concept.

The third reason we are winning new business is because of our proven reputation and our ability to expand our business across our existing customer base. Our customers continue to acknowledge our industry leadership and our ability to keep their applications safe and protected. For example, one of the largest e-commerce companies in the world, a long-time customer of our DDoS appliances, added last year, our cloud DDoS

solution. In the second quarter, they decided to strengthen their application security by adding our Bot manager to their solution to meet their growing security needs.

Fourth, we continue to win new business because of our partnerships. In the last couple of years, we've been working on expanding our channel relationships. We continue to invest in training and educating our partners and expect these investments to bear fruits over time.

In the second quarter, we signed a deal with a large U.S. hospital, which was looking for more visibility and reporting. With the help of our partner Checkpoint, we presented the hospital our latest capabilities and upgraded their solutions.

We also secured a large deal with a global online fashion retailer. This retailer was planning to extend their network, a move that potentially increase their exposure to DDoS attacks and threaten their ability to deliver goods to their customers without disruption. We replaced this retailer's incumbent solution with our hybrid cloud DDoS solution. The key success factor in closing this deal was not only the strength of our protection, but also our close relationships with Checkpoint.

In summary, the momentum in our business continues to be strong across the board, supported by significant growth in our cloud security business. Our pipeline is robust with the accelerating pace in digital transformation and the shift to the cloud, the market provides many opportunities for us and we are confident in our ability to execute on them.

Before turning the call to Michael, I would like to take this opportunity to thank our customers and partners for their trust in us. And I would like to thank our employees for their great efforts and dedication. Michael?

Michael Goldberger

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

We had outstanding quarter with both the top and bottom line results far exceeding our expectations. Second quarter 2021 revenue reached a record of \$70 million, representing an increase of 19% year-over-year, an acceleration growth from 11% growth in the first quarter of 2021. Total revenue was driven mainly by our application security and other cloud business. In the second quarter of 2021, cloud and subscription ARR grew 27% compared to Q2 2020, and total ARR was \$177 million, an increase of 8% compared to the same period of last year.

Looking at geographies, we had growth across all regions. Americas revenue grew 2% in Q2 2021 compared to the same period of last year and accounted for 40% of total revenue in the second quarter. EMEA and APAC were very strong. EMEA revenue grew 36% in Q2 2021 compared to the same period of last year and accounted for 35% of total revenue. APAC revenue increased 32% in Q2 2021 and accounted for 25% of total revenue in the quarter.

I will now discuss expenses and profit. Gross margin for the second quarter of 2021 reached 82.3% compared to 83.1% in the same period of last year. Our gross margin can fluctuate from quarter-to-quarter as a result of product and geographic mix. Operating expenses in Q2 2021 were \$48.6 million, up 10% from Q2 last year. The increase is a result of higher commissions as well as travel and marketing expenses that were lower in Q2 2020 due to COVID-19.

Excluding FX impact, our reporting expenses would have been \$1.4 million lower due to the weakening of the dollar versus the new Israeli shekel. Operating income more than doubled and reached \$8.8 million, demonstrating once again the good leverage in our model. The increase in operating income led to an expansion in the operating margin. In Q2 2021, operating margin expanded by 530 basis points to 12.6% compared to 7.3% in Q2 2020.

Financial income was \$1.7 million compared to \$2.6 million in Q2 of last year. Similar to last quarter, and as we highlighted in previous quarters, the financial income is impacted by declining yield of marketing securities and deposits.

Tax rate for the quarter was 15.4% compared to 13.1% in Q2 2020. The expected tax rate for 2021 is approximately 15% to 16%. Earnings per diluted share for the second quarter of 2021 increased 50% to \$0.19 compared to the same period last year.

Turning to the balance sheet and cash flow items. Cash flow from operations was \$9 million in Q2 2021 compared to \$18 million in the second quarter last year. Total cash and financial investments at the end of June 2021 were \$440 million. As of the second quarter of 2021, we used \$4.6 million to repurchase 163,000 of our ordinary shares. In the first half of the year, we used \$35 million to buyback our shares and thus \$45 million remains available under our 2021 repurchase plan.

I will turn the call back to Roy, who will provide the outlook for the third quarter.

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

Thank you, Michael. We expect Q3 total revenue to be in the range of \$70 million to \$72 million. We expect the continued strength of the Israeli shekel to cause year-over-year increases in our dollar operating expenses throughout 2021. We expect our operating expenses to be between \$49 million and \$50 million. This operating expense level reflects an estimated \$1.3 million negative impact from FX compared to Q3 2020 rates. With that, Q3 2021 fully diluted EPS is expected to be in the range of \$0.18 to \$0.20.

With our first half published results, the guidance we just shared for the third quarter and the continued strength we see for the second half, I would like to note that our yearly growth rate will be close to 12% year-over-year, well above our published model of 7% to 9% annual growth rate. This accelerated growth is driven by the growth in subscriptions and specifically cloud security.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of George Notter with Jefferies.

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

Congratulations on the nice results here, guys. I guess I wanted to start by asking if you guys had any supply chain impacts in the quarter. It seems like it's been a constant (inaudible) season in recent quarters. But I know you didn't expect to see much coming into the quarter, but just kind of following up on that, was there any impact in terms of either missed revenue opportunities or margin?

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

We had very little impact on revenues. There is obvious impact on our cost. Some of those component pricing has gone up significantly, especially if we would like express delivery or to get more quantitative earlier. But overall impact is minimal, definitely, in comparison to what others are experiencing.

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

And then I guess I wanted to also ask about sort of the gross margin in the quarter. You guys are running, I think, north of 83% for a lot of quarters there. Now you're kind of below that threshold. I think you had been investing more in your scrubbing centers. But can you kind of talk about the gross margin performance? And what has that down a little bit year-on-year? And then how you see the outlook for the balance of the year?

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

Yes. I think, overall, it's a mix between product and cloud security and subscriptions. Obviously, we're investing a lot in building and scaling our cloud security infrastructure as demand is strong. And that has some minor, not big, negative impact on our gross margin. So we are guiding around 82% gross margin. We think for the time being, that's a conservative way to think about it. And as we scale, there's an opportunity, obviously, to improve that.

Operator

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

Andrew King

Congratulations on the good quarter. I just wanted to dive a little bit more into the growth of the ARR metric. Since you've been reporting, it's been slowing slightly, going from 12% to 10%, now 8%. Can you just give us a little bit more color into that trend?

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

Yes. It's obviously, the total ARR growth rate is a balance between our device or appliances service attached contracts. And on the other hand, the subscription and the cloud contracts we have. So we continue to see, as I've noted, very strong growth in cloud and subscription, continue to be 27% and scaling every quarter. We did have a weaker service attached ARR quarter, predominantly driven by one large customer that decided, although they refreshed our devices to next-generation devices, in the meantime they're staying without a valid support contract. So we saw some weakness in the service attached contracts. However, the cloud and the subscriptions continue to drive us forward.

Andrew King

And then in your press release during the quarter, you guys mentioned an increase in emergency onboarding as a result of attackers reemerging. Can you talk about how that balance between emergency onboarding versus traditional sales process was this quarter and how that differed versus historically?

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

Yes. So every time the cyber activity is going up and since the start of COVID, it's breaking, I think, new records every quarter. Obviously, that impacts our sales cycles. And specifically, it makes it more and more strategic and critical for our customers, not only to protect, but really to even upgrade their protections to what is considered best-of-breed or best they can afford. Every time a customer is under attack, especially under DDoS, it means they are experiencing downtime in their business. And as everyone moving digital and moving all the assets online, that's a huge business interruption and business risk. When customers are under those ransomware or under those attacks, today, they cannot defend it by themselves. There's just no, especially a large customer that would broadly experience a large attack, there's just no way to deal with it. And then they need to approach us, sometimes our competition, but more and more, I think, us to assist them. So definitely there's a positive impact for that. But the impact is even bigger because even if they are not -- if a customer is not attacked, directly by themselves, they see their peers in the industry. They see other customers. And obviously, the understanding of the need and criticality and budget allocation to cybersecurity is increasing.

Andrew King

And if I could just squeeze one more quick one in here. APAC really saw a nice bounce back in growth. Do you see those headwinds declining? Or was this just a onetime bounce back this year?

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

I think we've said in answer to several of the previous quarters about the declines in APAC. We said that bookings are looking to us good and it will eventually be seen in the P&L as well. Bookings in Q2 continue to be strong. And I think there's -- you're going to see, I don't know if to the extent of Q2, but you're going to see continued growth, I think, in Asia Pacific.

Operator

Your next question comes from the line of Tim Horan with Oppenheimer.

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

Why is the Americas growing so much slower than the rest of the world? And is there an opportunity for that to accelerate somewhat? And I just had a follow-up also on the bookings.

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

Yes. Overall, I want to say on the bookings, I know in revenues this time, you see a slight -- a very slight growth rate. But overall bookings continue to be strong and especially in U.S. enterprise. We didn't have a strong quarter in U.S. service providers and that impact the a bit the result. We expect that to change in the second half. But U.S. enterprise business continues to be very strong and actually lead our global business in terms of cloud business and subscription. So we're very happy with the progress we're doing in North America and the Americas in general and especially on the enterprise business.

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

And I think you said you've had a tripling in new customer bookings. So I guess that's for brand new customers. Can you talk about what percentage of your growth usually comes from new customers versus existing? Or any other color there?

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

Every quarter, the vast majority of our business comes from existing customers. This quarter, existing customers continue to do very well for us, but it was really an outstanding contribution from new logos.

Operator

Your next question comes from the line of Tavy Rosner with Barclays.

Chris Reimer

This is Chris Reimer on for Tavy. You talked about enterprises accelerating their digital transformation. I was wondering if you were seeing traction for your solutions covering public cloud infrastructures?

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

Yes, we do. So the main product we have there is the cloud-native protect, and that continues to grow well. Its customer base, it's ARR. We're adding to that in recent quarters, also our Kubernetes WAF, web security product that's targeting the application infrastructure, predominantly in public cloud, but also in private cloud. And together, we feel we have a very strong solution to protect the data plane, the application plane and the control plane of our customers when they put an application in the public cloud. We had very nice wins. I didn't specifically talk to them in my prepared remarks on that, but also there are new -- very nice new logos that approached us as well as growing with existing logos. So we definitely see more and more business, specifically into the public cloud. In general, our large enterprise, and I've mentioned some of the wins like this construction company, et cetera, many of the workloads we serve are across the hybrid environment, meaning some of them are in the legacy data center and a bigger and bigger portion over time of them are actually residing in AWS, in Azure, in GCP and so on, and we are protecting all of them, all applications across all environments. So a lot of our customers are already migrated or are migrating or in various stages of this hybrid infrastructure, and we are providing across the board, all applications, all data centers, what I believe is state of the art security.

Chris Reimer

And just is there any color you can provide on the M&A pipeline? You guys often emphasize that you're disciplined when it comes to multiples. I'm just -- I'm wondering how you see the space at the moment?

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

Yes. We continue to be active in that space. The pricing of private companies does not, I would say, does not help us to accelerate the pace of taking action, but we continue to look for opportunities.

Operator

The next question comes from the line of Alex Henderson with Needham.

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

So first off, great quarter. It's really nice to see. But I was hoping if you could give us a little bit more granularity on the portion of the quarter that came from what I would describe as the revenue stream or order stream coming from your partners in aggregates. I know you don't want to break out individual companies. I want to say, here are some Nokia, here are some Checkpoint or here are some Cisco. But could you give us an aggregate amount of what's happening with that because obviously that's a very positive development for you?

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

It was solid contribution. When I look on the group in total and specifically, and I think that is also aligned well to the new customer business increase that we had. Those partners brought to us significant new customers. So I mentioned the Fortune 500 by Cisco, there were -- I think there were more than one in the quarter. I mentioned the Checkpoint bringing us really Global 2000 customers. One of the examples I did not mention in my script is, I think, a top 5 global bank that placed through our Checkpoint relationship, a multimillion-dollar order for our security business. We continue to see very strong traction in large customers through those partners, carriers predominantly with Nokia enterprises, through Checkpoint and across the board with Cisco. So I think that's a core strategic element for us, especially in recruiting new customers and then, of course, adopting them and growing them.

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

So did the partnership revenue growth or should I say order growth, particularly in the cloud piece, outstripped the growth of the overall company? Or is it growing at the same rate? Or is it growing less than?

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

Yes in the cloud, I don't know. I think it's continued to grow strongly. If I think of the major deals we've done, all of them, I think, had the cloud and subscription PC needs. So I think they're growing -- they grow very, very well with us.

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

And if you were to look at your pipeline with those, is that same pipeline that you saw coming into the quarter as strong or stronger coming out of the quarter? Has the pipeline strengthened?

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

So although we had a record quarter, meaning record amount of closings this quarter, we're starting with a stronger pipeline. So definitely new pipeline generation was very strong.

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

And I assume that given your lack of constraints that you're not seeing any meaningful or a significant change in the amount of time forward that the orders are being offered in? I mean, I know when we talked to a lot of people with constraints on supplies that they've got visibility in orders out 2, 3 quarters. I'm assuming that's not the case given your lack of constraints, is that true?

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

Yes. For us, in that respect, business is as usual.

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

And then on the pricing side, I assume that you're not seeing a meaningful change in pricing either given you're mostly a software company. Is that also fair?

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

Correct.

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

And then one last question, if I could. So as I'm looking at the various partners, can you just give us a rank order of which ones were stronger and which ones were lagged? Was Cisco the strongest than Nokia and then Check or some other order?

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

Yes, Alex. Thanks a lot for the question. But unfortunately, I will not break it this time.

Operator

Ladies and gentlemen, I will turn the call back over to Roy, to you for any closing remarks.

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

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

Operator

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect at this time.

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