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PRESENTATION

Operator

Welcome to the Radware Conference Call discussing Third Quarter 2022 Results and thank you all for holding. (Operator Instructions).

As a reminder, this conference is being recorded November 2, 2022. I would now like to turn this call over to Yisca Erez, Director of Investor Relations at Radware. Please go ahead

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

Good morning, everyone and welcome to Radware Third Quarter 2022 Earnings Conference Call. Joining me today are Roy Zissel, 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 third quarter are available in the investor relations section of our website. In 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. Actual results could differ materially from Radware was current forecast and estimate.

Factors that could cause or contribute to such differences included but not limited to track 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 the company files, the furnishes from time to time with the SEC, specifically the company's last annual report on form 20F 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 statements 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. During the last few weeks of the third quarter, we saw closing delays in some customer deals and an increase in multi-phase contracts in response to macroeconomic headwinds, these trends expanded globally and impacted our revenue which came in below the low end of our guidance. We expect this environment to continue to impact our business in the short term.

We continue to track the deals that did not close and at this point we are not aware that any have been lost to competition. We remain confident in our market position and competitiveness as evidenced by the continued wins we are seeing in large enterprises across all regions. We have a healthy pipeline and we see strong activity level among customers and prospects, which continue to be driven by a significant increase in cyber-attacks. Given that we're taking several measures to manage the business and leverage opportunities that will position Radware for long term success.

First, we will continue to focus on and cater to the large enterprise market with our state-of-the-art protection. We believe the current environment and spending behaviors are temporarily and expect to see strong demand from large enterprises in the future. We believe there are significant opportunities in the market, even if the deals take more time to mature.

For example, during the third quarter we closed the multimillion-dollar application security deal with the Fortune 500 SaaS company. We want the deal based on our strong partnership and unique application security capabilities. Other examples of large enterprise wins include the new logo deal with the leading service provider in Latin America for our complete cloud security offering. Our frictionless approach to security was crucial to the customer in protecting the complex environment.

The partnership with Cisco we also closed another new logo deal with a major US Financial Services Company to provide Hybrid Cloud DDoS Protection. We displace the incumbent who could not provide the level of visibility and protection that the customer needed.

The second measure we are taking is to increase our investment in cloud security and shift resources to our cloud growth initiatives. In times of financial uncertainty and an increased threat landscape, Cloud Security can help customers boost their security without committing to larger upfront CapEx investments. In response to the market needs, we are constantly expanding our global footprint by opening more cloud security centers.

During the third quarter we opened two new centers in Dubai and Italy to expand our market share. For example, in the Emirates several new customers are already on boarded to the Security Center. One new logo from the financial sector found our cloud DDoS solution critical to comply with regulations. Another new logo which is from the media sector moved from a private to public cloud and wanted to strengthen their application protection. The other new logo which we won jointly with checkpoint was from the Education Center. If customer, both our cloud WAF following the demonstration of our advanced capabilities and was convinced in Radware technology advantage, especially considering the local cloud center.

The third step we're taking is reallocating resources to expand our footprint in the medium sized enterprise market. The cyber security risks in needs of the mid-market are identical to the needs of the large enterprise market. However, the capacity and skilled talent that mid-market companies have to manage their security environments are more limited.

Our fully managed cloud security services are a great fit for this market, as evidenced by the significant number of medium sized enterprises that are choosing our cloud application security offering. To leverage this opportunity we are targeting mid-market security needs by expanding our channel relationships and offering cyber protection through our cloud first approach.

And lastly, we're taking measures to fine tune our operational expenses to ensure our business is profitable with strong positive cash flow from operations. This includes reallocating internal resources to focus on cloud growth initiatives, and making focused investments on long term growth opportunities that we expect will lead to better returns.

If we look at the state of the cybersecurity landscape, we believe there are several market forces playing to our advantage. First, the number and level of sophistication of DDoS, WAF and both attacks continue to increase. Hackers are relentless. Organizations will continue to invest in protecting the critical applications and infrastructure. And we believe Radware has the right offering to ensure the best protection for them.

In fact, in the third quarter, Gartner recognized Radware for its application security solution. In its critical capability report, the government once again ranked Radware the #2 solution out of 14 companies for API Security and DevOps Use Cases, as well as high security Use Case. According to Gartner, Radware provides a robust set of application security controls and offers one of the stronger API security offering on the WAAP market.

Second, companies continue to struggle to achieve consistent high quality application security. According to our multi cloud application security report, 70% of respondents are not confident in their ability to apply security across on-prem and multi cloud platforms. And 64% said that they don't trust the security offered by public cloud platforms. In short more organizations are looking to have a dedicated application security solution in the public cloud. A need that Radware is especially suited to meet.

While these are challenging and uncertain times. I'd like to reiterate that the fundamentals underlying our business are strong. Our company is healthy with a large and diversified customer base, and robust balance sheet with more than $400 million on hand. We continue to generate cash from operations, build our annuity business and invest in our cloud security footprint and capacity.

Although this quarter revenue fell below expectations, we expect to end the year with record revenue. With cyber-attacks increasing in complexity and climbing in sheer volume, we believe the need for our solutions and specifically real time protection of applications will remain strong. As we continue to fight for the good guys in the cyber war, we are confident that Radware is on the right track and well positioned for long term growth. With that I will now turn the call over to Guy.

Guy Avidan - *Radware Ltd. - CFO*

Thank you Roy, and good day everyone. I'm pleased to provide an analysis of our financial results and business performance for the Third Quarter of 2022, as well as our outlook for the fourth Quarter of 2022.

Before beginning of 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 a GAAP and non-GAAP basis is available in the earnings press release issued earlier today and on the investor section of our website.

Third Quarter 2022 revenue declined 4% year-over-year to $70.5 million compared $73.4 million in the same period of last year. As Roy noted, we saw a longer sales cycle as well as resizing in some of our large enterprise and carriers customers. As a results of macroeconomics headwind, which affected our revenues across all regions.

Revenue in the Americas in the third quarter was $32.9 million presenting a 8% decrease in Q3 2022 as compared to Q3 2021. On a 12-trailing months basis, America's revenue decreased by 1%. EMEA revenue in the third quarter was $22.2 million, representing a decrease of 6% when compared to the same period of last year. On a 12-trailing month basis, EMEA revenue grew by 18%. APAC revenue increased by 10% to $15.5 million as compared to Q3 2021 and 3% increase on a trailing 12-month basis. In the third quarter Americas accounted for 47% of total revenue, EMEA accounted for 31% of total revenue and APAC accounted for the remaining 22% of total revenue.

I'll now discuss profits and expenses.

Gross margin in Q3 2022 was 82.9% compared to 82.6% in the same period in 2021, an expansion of 30 basis points. Our main gross margin improvement is related to the complete integration of SecurityDAM, partially offset by higher costs related to recently launched cloud infrastructure coupled with lower revenue.

Operating expenses in the third quarter of 2022 were $53.2 million, representing an increase of 9% as compared to the same period in 2021. The increase predominantly due to additional R&D headcount focused on our cloud and Hawks initiatives, the full impact of security time integration and increase in travel cost of COVID.

To improved profitability, we are reallocating internal resources as evidenced by headcount growth this quarter of only 1% compared to the second quarter.

Compared to Q2 2022 operating expenses decreased by 2%, demonstrating our ability to manage our cost structure in a responsible manner and in accordance with the market environment.

We continue to strategically look at all aspects of our business and are adjusting our cost structure as needed. While internally reallocating resources to key growth initiatives and investing in long term programs that support our customers need and will lead to long term growth.

Net income in Q3 2022 was $6.7 million as compared to $11 million in Q3 2021.

Radware adjusted EBITDA for the third quarter was $7.3 million, which include the negative $2.4 million impact on adjusted EBITDA of the Hawks group. An increase in the Hawk's adjusted EBITDA is a result of increasing investment in R&D resources.

Earnings per share was $0.15 compared to $0.23 last year due to a lower revenue in the quarter as compared to last year's revenue for the same period. Despite the decline in revenue in the third quarter, we met our earnings guidance, which is a testimony of our commitment to manage our expenses and our ability to navigate the company and generate cash even during challenging times.

Turning to the balance sheet and cash flow items. We generated $1.5 million in cash from operations during Q3 2022, as compared to $17.9 million during the same period of last year. In the third quarter we repurchase shares in the amount of approximately $6 million and we ended Q3 2022 with approximately $434 million in cash, bank deposits and marketable securities. Our strong balance sheet provided us with great foundation to navigate in the current market conditions and volatility, while focusing on long term opportunities to drive profitable growth.

During the third quarters, Radware board of director has authorized an increase of $20 million buyback of the company's ordinary shares. And as of today, the remaining approved buyback budget is $81 million.

I'll conclude my remarks with guidance.

Radware is a robust company with global teams of professionals, and profitable business model based on critical cyber solution, and strong balance sheet and loyal customer base. Moreover, RPO for the end of the third quarter grew versus the third quarter of last year. And all of which give us the confidence in the fundamentals of our business.

As we said in previous call, while challenging microenvironment posed some uncertainties on customer spending behavior, we expect cybersecurity demand to remain resilient in the long run. However, we're still witnessing protracting sell cycle and the growing preference for multi-phase deployment among large enterprises and carriers.

Therefore, we choose to take prudent approach in the short term. We expect total revenue for the fourth quarter to be in the range of $73 to $75 million. We expect our non-GAAP operating expenses to be between the $54.5 and $56 million. Given all these trends and developments reviewed earlier, we anticipate Q4 2022 non-GAAP diluted net earnings per share to be between $0.16 and $0.19.

I'll turn the call over to the operator for question.

QUESTIONS AND ANSWERS

Operator

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

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

I guess one of the things that stuck out to me was the annual recurring revenue number. I think I'm looking at $195 million number, I think that's flat sequentially. I assume there's some puts and takes in that number but can you kind of talk about why that number was flat and you're not seeing growth in that area?

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

In the end, it's -- I would say it's an outcome of the revenues. And I would say the missing revenues translate to that ARR. In general, we see continuous growth in cloud ARR and more challenging on the product and services side. But we believe obviously that this result is low, and should improve in coming quarters that's also in line with our increased focus on cloud security that we believe will drive the figure upwards.

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

Got it. And I assume within that -- I guess I assume the maintenance contracts that are inside that number that are on appliances or traditional hardware sales. Is that the piece that sort of softening and that's getting offset by, you know, cloud and product subscriptions and therefore you're getting to like a net, you know, flat sequential number. Is that the dynamic that's going on here?

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

That's correct, that's exact. However, with that we believe it should grow sequentially and of course year-over-year. So that is definitely in our model, but we believe that with heightened level of revenues plus even more focus on cloud security, as we've noted in our prepared remarks, that should drive the faster growth of the cloud piece to overshadow any decline is happening on the maintenance contracts.

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

Got it. And then, can you give us a cloud services and products subscription ARR growth number. I think last quarter you told us it was 18% year-on-year, I'm just curious what that was this quarter.

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

It was around 12%.

Operator

Your next question is from the line of Alex Henderson with Needham.

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

So, can you just talk about that the -- I know it seems mundane, but obviously you've got a very large cash balance and with interest rates going up a 3 points increase in interest rates would add about $8 million here to your numbers, if once it's fully rolled. Can you talk a little bit about how you expect the interest income line to trend, is the $2.4 or $2.5 million in the third quarter, the run rate and how will it step up as interest rate benefits Rule 3 of balance sheet?

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

So, we expect more or less same income from interest in the coming quarters of $2.4, $2.5 million per quarter. We also mentioned in the prepared comments that we will continue to do buybacks. So, we will use some of the cash for buyback.

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

So, just mechanically, I mean interest rates have gone up a lot more than 3% and probably going to go up another three quarters today in the US. Can you talk about how that -- how you're structured against that. Are your maturities going to roll over the next three or four quarters or you have to have a little longer maturities on that, those investments just to give us some sense of it?

Guy Avidan - *Radware Ltd. - CFO*

Strategically, we're shifting to short-term maturity. We are balancing between convertible bonds and investing in just putting the money in banks for 6 and 12 months, which currently yield even higher interest than bonds that actually fills in our investment policy. So, we're shifting more towards short term now.

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

Okay. So, looking out to next year, you're not going to get more -- a nice uptick in the interest income because it's a pretty big number. I mean, we're talking about -- again, on your cash and then in short-term investments. It's a 3-point swing which we've already seen is an $8 million change, and it's not trivial. So is that not going to step up $5 million, $6 million, $7 million in '23?

Guy Avidan - *Radware Ltd. - CFO*

No, definitely. Next year, we expect that function in our income from interest. And obviously, it will grow as interest rate -- even if interest rates will stay as it is today.

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

All right.

Guy Avidan - *Radware Ltd. - CFO*

We still have a --

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

Going back to --

Guy Avidan - *Radware Ltd. - CFO*

We still have lower interest in convertible bonds from the past.

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

What portion is variable?

Guy Avidan - *Radware Ltd. - CFO*

What do you mean variable?

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

Well, will roll over the next 3 to 6 months.

Guy Avidan - *Radware Ltd. - CFO*

It's about -- let's say, about half is still based on, let's say, convertible bonds that still have lower interest rates.

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

Okay. Going back to the competitive landscape. It does sound like EMEA is under a lot of pressure. It's pretty clear that conditions there are going to get worse over the next couple of quarters as winter comes in and the economies continue to decelerate. So, can you remind us a little bit just what your position is in terms of what portion is EMEA is local currency based and what portion is priced in dollars?

Guy Avidan - *Radware Ltd. - CFO*

Revenue is all in dollars.

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

It's 100% in dollars?

Guy Avidan - *Radware Ltd. - CFO*

Yes, close to 100%.

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

Okay. And then going to the operational environment, can you talk about pipeline. And to what extent there's been an erosion in the pipeline or whether that's still robust, and how are we set up as we go into the next couple of quarters, given the pipeline generally is 3, 6, 9 months kind of structure?

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

So, I would classify the pipeline as very robust, even very close to record levels, if it's not at that level. And it is driven also by the delays in closing some deals. So, it's not only the creation that continues and depends on the region might be more challenged or less challenged but also because of delays of closing that obviously increases the current pipeline. But overall, pipeline is robust, a lot of activity, deals that we think are maturing.

And as I've mentioned, we did not see competitive pressure or losses on the pipeline. So going forward, at least trying to not -- to put aside the sales cycle or the lengthening sales cycle, we feel very good about the pipeline.

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

One last question and then I'll see the floor. The multistate deployment, how big an impact is that -- how does it -- how does it manifest?

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

I'll give you an example of an expected carrier deal that we had for mobile protection. Initially, they were talking about doing 30 MAX in one shot, around $3.5 million product deal. They ended up with saying, okay, we'll do 10 first 1/3. The next year as we deploy the MAX, et cetera., we will do another one and maybe towards the end of the year or the year after another 10.

So, they are -- because of supply chain budget, whatever, they are phasing their own deployments and they're phasing our orders. So, in that case, a product deal that's generally creates immediate impact on revenues, of course, for us, immediate recognition is moving from $3.5 million to $1.2 million.

Operator

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

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

I think you said some large customers are resizing. I'm assuming they're grooming or trying to cut their expenses. Can you elaborate on that a little bit more?

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

Yes, I think. So first, I just gave an example of those phasing, et cetera. We are seeing, for example, customers that instead of taking the full cloud security solution at one shot, they're trying to stage it for cloud and then some appliances, et cetera, we were used to, I would say, get all of that in one piece. So, it has different shapes and forms, but budget allocation, more lengthening sales and approval cycles. All of that we see either of the whole deal pushed or some of the deals getting booked and then delayed.

Now we don't see it across the board. We see it in very large deals. The regular midsized deals or even medium to large, we did not -- maybe yet, but we did not experience that. But on the larger commits in the very large enterprises or carriers, that's where we see this phenomenon.

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

Yes. Well, are you seeing existing customers or are they maybe reducing spend on some of their -- or are they trying to reduce what they're spending with you now for existing customers on either legacy products, not new customers, existing?

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

We see that also in large existing ones. And for example, the example I gave from the carrier, it's an existing large customer of Radware. The deployment towards 5G is new. But over there, we do see that phenomenon.

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

Got you. So, any idea how long the slowdown can last here, can companies go 2 years without really investing. Is it a 2-quarter phenomenon, what do you kind of expect on the timing?

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

So, I would split it to where we are part of a new infrastructure build and then it might be on the long side because it depends on their plans for a new data center or deploying 5G, et cetera, et cetera. And then I would say we are aligned towards the overall business environment and investment capabilities. So that's one end.

On the other hand, when it's serving existing infrastructure and existing business, I don't think it can be delayed too much because the hackers and the cyber activity is there. So, you can delay budget, you can try to resize it or to fit more your current needs versus buying or 3 years ahead of time, et cetera, et cetera. But the investment you would need to make. Otherwise, it would be vulnerable.

So, I think the heightened cyber activity levels would actually accelerate budget spend in our areas. As long as it belongs to existing infrastructure, existing applications, et cetera, I think it's hard to delay too long.

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

And lastly, I know you haven't lost any deals, but have you seen a step-up in activity on the competitive front, either from hyperscalers or any other competitors?

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

No, no, no. I think we're doing quite well on the competitive landscape actually. I know it does not show in the current quarter numbers. But in general, we've seen especially in cloud, our win ratio is going up in the last 3, 4 quarters.

So, we feel good about the competitive positioning. I mentioned Gartner report, we have other reports attesting to the same and very strong customer references in Gartner Peer Insights, et cetera. So, on all the competitive front, we feel good. We do need to take the steps we've mentioned, going more cloud, strengthening the mid-market, and to accelerate our growth.

Operator

At this time, there are no further questions. I will now turn the call over to Roy for any closing comments.

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

Thank you very much all for attending, and have a great day.

Operator

This does conclude today's conference call. Thank you all for joining. You may now disconnect.
