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PRESENTATION

Operator

Good morning. My name is Lisa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Radware Q2 2017 Earnings Conference Call.

(Operator Instructions) Anat Heilborn, VP Investor Relations, you may begin your conference.

Anat Earon-Heilborn

Thank you, Lisa. Good morning, everyone, and welcome to Radware Second Quarter 2017 Earnings Conference Call. Joining me today are Roy Zisapel, President and Chief Executive Officer; and Doron Abramovitch, Chief Financial Officer.

A copy of today's press release and financial statements, as well as the investor kit for the second quarter, are available in the Investor Relations section of our website.

During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. We wish to caution you that these statements are just predictions, and we undertake no obligation to update these predictions. Actual events or results may differ materially including, but not limited to 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 from time to time with the SEC, specifically the company's last Form 20-F as amended on May 16, 2017.

Please note that in August, management will participate in the Oppenheimer Technology Conference in Boston.

With that, I will turn the call to Doron Abramovitch.

Doron Abramovitch - *Radware Ltd. - CFO*

Thank you, Anat. Good morning, everyone, and thank you for joining us on the call today.

We are pleased to report solid results for the second quarter with revenues at the high-end of our expectations and earnings in line with our expectations.

The transition of our business model leads to a growing proportion of revenues from our subscriptions business. This coupled with growth in revenues from support contracts or appliances install base leads to a growing proportion of recurring revenues, which improves our visibility into the future performance.

Let us now discuss the results in more detail. Q2 revenues were $51 million, up 3% from Q2 last year.

Revenues from the Americas were up 10% from last year and accounted for 47% of total revenues.

Revenues from Asia Pacific increased 1% from Q2 last year and represented 27% of total revenues.

And revenues from EMEA were down 7% from last year, and represented 26% of the total.

I will now move on to discuss expenses and profit using non-GAAP figures. For detailed GAAP to non-GAAP reconciliation, please refer to the financial table accompanying our press release or to the investor kit posted on our website.

Non-GAAP gross margin was 82% in Q2 2017 compared to 82.7% in Q2 last year.

Our operating expenses were $41.7 million, compared with $39.6 million in Q2 2016.

The main differences from last year are the consolidation of Seculert, that had an impact of roughly $800,000 and the stronger Israeli shekel that had an impact of roughly $750,000. We also had higher investments in expanding our cloud offering compared to last year.

Operating expenses in Q2 were slightly higher than our guidance, mainly because the currency impact was stronger than we had expected at the beginning of the quarter.

Assuming exchange rates remain at their current level, our operating expenses for the remainder of the year will continue to be affected.

We expect operating expenses to increase in Q3 and more so Q4, due to higher sales commissions on the expected increased level of bookings as well as marketing activities.

Headcount at the end of June 2017, was 983 employees, essentially at the same level of previous quarters.

Non-GAAP net income in Q2 '17 was $1.2 million or $0.03 per share diluted compared with net income of $2.6 million or $0.06 per share diluted in Q2 2016.

As of June 30, 2017, we had approximately $326 million in cash and financial investments.

Cash generated from operations was $11.4 million in Q2 compared with $7.8 million in Q2 last year, leaving our operating cash flow from the last 12 months at approximately $40 million.

Our collection in Q2 was strong as reflected in the DSO ratio, which was as low as 31 days.

Once again, our total deferred revenues balance showed strong growth. As of the end of June, we had total deferred revenue balance of approximately $133 million, up 35% from $99 million in Q2 2016.

The average duration of the total deferred revenues balance was 1.78 years compared to 1.79 years in previous quarter and 1.76 years for June 2016.

So, in the coming 12 months, we will recognize these revenues approximately $83 million out of the total deferred revenues compared with $65 million that we recognized out of the total deferred revenues a year ago. This growth highlights the better visibility we are gaining with the increase in our recurring revenues.

Last, our outlook for the third quarter of 2017. We expect Q3 revenues to be between $51 million and $53 million.

Non-GAAP gross margin is expected to be approximately 82%. Non-GAAP operating expenses are expected to be between $42 million and $43 million in Q3.

We expect non-GAAP effective tax rate to be 16%.

Non-GAAP EPS for Q3, including the dilutive impact of Seculert is expected to be between $0.03 and $0.04.

I will now turn the call over to Roy.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Thank you, Doron, and good morning, everyone.

We are pleased with our results for the second quarter of 2017, in which we continued to execute on our strategy. We delivered revenues at the high-end of our expectations. Total deferred revenues grew 35% year-over-year and cash generation was robust.

We continued to grow our subscription business. The subscription offering, which includes product subscriptions, our cloud service offering, and fully managed services, provides our customers with compelling security and application delivery solutions while reducing operational burdens on their internal sources. At the same time, this offering improves our visibility into future revenues.

An indication of this improvement is the ratio between our total deferred revenue balance and our quarterly revenue, which was once again more than 2.5x.

We continue to make progress in executing on our strategy. The first element of our strategy focuses on the integration of our application delivery and security offerings.

In Q2, we were delighted to win a cross-portfolio deal with the largest telco company in a Latin American country. The customer is preparing for the launch of a mobile payment platform, which is a critical service that requires optimal performance and stringent protection.

Radware was the only vendor capable of offering leading DDoS mitigation, web application security and application delivery technologies as an integrated system, and our holistic approach was highly appealing to the customer. We are glad to help this telco company mitigate the risk of operational disruptions caused by security attacks as well as ensure high availability.

The second element of our strategy focuses on the innovation of new solutions and services. In early June, we announced a new line of ADC devices called the Alteon D-line. The D-line enhancement focuses on industry-leading SSL performance in order to continue grow our security-driven ADC sales.

The new line supports the latest encryption standards and ensures industry-leading cost-effectiveness in processing encrypted traffic. The cost-effectiveness runs across the line, so that customers can benefit from SSL processing, which is up to 100% more efficient than the competition, whether their needs are modest or expansive.

Such processing power is a critical need as encrypted internal traffic takes up an increasing share of total traffic.

The ability to inspect encrypted traffic while complying with privacy standards, as well as reducing latency, is very important to our customers, and the D-line was well received.

One example is Tierpoint, a hosting company that is protecting its physical and virtual infrastructure with our technology and has recently introduced the DDoS defense service for its customers, which is powered by Radware solutions.

Last quarter, Till Point made a follow-up purchase that consisted of new Alteon D-line devices as well as our web application firewalls, providing high-performance SSL offload and web application firewall service to expand their in-house security offerings and enable them to differentiate their offering and maintain stronger relationships with their clients.

The third element of our strategy focuses on increasing our market footprint through diverse routes to market. Three weeks ago, we announced our relationship with Nokia. Our attack mitigation solution is now part of Nokia's offering to carriers and telco cloud providers. This means that when Nokia provides its complete network transformation solution for service providers, Radware is its DDoS mitigation partner.

During the first half of 2017, we already participated with Nokia in several deals and we currently see a solid and growing pipeline of additional opportunities Nokia is bidding.

The Cisco OEM continues to progress, in the sense that in the quarter following the introduction of our DDoS module on Cisco next-gen firewalls we have seen a marked increase in activity and in pipeline build up, as well as new wins which we will begin to recognize as revenues in Q3.

During the second quarter, we announced our largest deal ever with a leading CDN provider. This is an existing customer who expanded its engagement with Radware by purchasing additional hardware maintenance and subscription to attack mitigation updates.

This deal is separate from the one we announced in the first quarter, and discussed with you in April, and we are pleased with our increased presence in the content delivery network-provider space. We view this presence as a validation of the quality of our offering.

In summary, Radware performed well in the second quarter of 2017, and the visibility we have into the remainder of the year suggests this trend will continue.

The business environment is solid and we are adding new opportunities to the pipeline at an accelerated pace. We are confident in our ability to meet our plans for the year.

Our ongoing focus on research and development continues to bear fruit and our solution offering is industry leading in its ability to detect and mitigate attacks in flexible deployment options and to meet the challenges of an increasingly complex delivery environment and constantly evolving cyber threat landscape.

The digital transformation and the trends towards cloud migration present us with multiple opportunities. And we continue to sharpen our sales and marketing efforts in order to capture them.

We are confident in our ability to expand our mind and wallet share within existing customers as well as acquire new ones, resulting in long-term growth for Radware.

Before concluding, I would like to thank the Radware team, our partners and customers for their support.

With that, I will now open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

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

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

I guess, I would like to just start by asking about the Cisco OEM relationship. I realize it's still early, I realize there's a lag in terms of getting updates from Cisco on sell-through of your software module alongside the FirePower platform. But any kind of early feedback you have from Cisco in terms of customer acceptance on that DDoS software module? Any data you have on attach rates? Anything you can tell us in terms of how Cisco is training their sales organization to market and sell that software module along with FirePower would be very helpful?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

So the feedback we are getting is very positive. When I mentioned that the pipeline is growing in an accelerated rate, Cisco is one of the, I would say, strong contributors to that. So we are seeing an increased pipeline from Cisco by the week. The early wins also suggest that, for us, this sales engagement might be of low touch, relatively low touch to what we are used to in the deals we are involved. And we contribute that first to the reach and customer relationship of Cisco, but also to the fact that we are an add-on module on the firewall, meaning it's not a complete standalone sale, it's an add-on and it adds security as part of an initial gateway sale. Regarding training and visibility, we just participated in Cisco Live in Vegas. It was extremely successful for us together with Cisco. We are part of the Global Sales Kickoff coming soon after their fiscal year-end. And there's another training for all the force there. So we are very encouraged with the momentum that this relationship has.

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

Got it. And then, as you look forward, is there a point where you give us metrics in terms of sales volumes with Cisco or attach rates? Or, when could we expect to hear more quantitatively?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

So on attach rate, I'm not sure we will have this information, given you know it's internal to Cisco. And regarding revenues I believe, given the, I would say, the gross margin and the high profitability of this engagement, once the sales are becoming meaningful, it will be easily seen in our P&L.

Operator

Your next question comes from the line of Catharine Trebnick from Dougherty.

Catharine Anne Trebnick - *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Data & Internet Protocol Networking*

Mine is quickly just on the Nokia. If you could provide -- you had said that there were some deals. I just wanted to clarify I heard that correctly, that they closed already or the pipeline? And then can you give us a little idea on which regions seem to be tracking with that opportunity for them?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay. So the deal is about the security solution for carriers for Nokia. It involved the routers, the Deepfield net flow detection capabilities that they've acquired and the Radware DefensePro as the mitigator. We already closed with them several customers, a couple in Europe, and some in Asia Pacific. I think, the most traction we're seeing is first in EMEA, then APAC and third is North America. The deals closed and some started to recognize.

Operator

Our next question comes from the line of Alex Henderson from Needham.

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

I was hoping to ask a question around the enterprise versus the service provider. I mean, clearly the service provider business is doing extremely well. And I guess, what I'm trying to determine, is there a difference in the way the service providers being recognized on revenue basis versus enterprise, is there more SaaS-related deferrals in the enterprise piece versus the service provider that accounts for the variance in the relative performance?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Yes, so that's a very good point. Well generally, when we sell to service providers, they buy from us equipment and they use that to build their service or their cloud services or network services to the customers. I gave the example of the CDN provider, I gave the example ofTierpoint. Those are basically equipment and maintenance sales, and some subscription, but predominantly product sales through this segment. Enterprises are the ones that are behind the growth in our cloud services, where they consume the security service or acceleration service directly from us. So most of the deferred, I would say, is impacted by enterprise purchasing cloud subscriptions or product subscription. In the service provider it's much more appliance-based sales.

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

I see. That makes a lot of sense. Second question, if I could. When you're dealing with the change in the architecture at Cisco to intuitive networking, a big piece of that was the integration of the content they are getting from their vast majority of environment information that they get off their routing and switching and security platform and feeding that back into a Big Data analytics platform. Are you getting any access to that kind of data as part of your partnership that you're feeding into your cloud platform? Or is that something where they're retaining that information for internal use?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay. I don't want to directly comment on that, Alex, for obvious reasons. I will just say that what we are doing in the Cisco environment and their intent-based networking is very tightly coupled. It's directly in line with the strategic announcement for Cisco.

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

So just going back to the cloud piece of that equation. Is there -- is that -- is your cloud-based database solution, data set, significantly increasing without tying it necessarily to the Cisco? I mean obviously, the R-squared is directly related to the size of that database and the currency of that database?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Yes. So I'll split between our own cloud services that we provide to customers, that has no relation or access to the Cisco information, and our integrations, our efforts together with Cisco on their own platforms. So, you know, we -- as a company in our own cloud services we don't have an access. But obviously, we are playing a part of the intent-based networking within the Cisco offering within our software embedded into their product.

Operator

Our next question comes from the line of Jess Lubert from Wells Fargo Securities.

Jess Ian Lubert - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Analyst*

I also have a couple of questions. Maybe just to start, I wanted to dig a little deeper into what you're seeing in your enterprise business. We've now seen sequential declines here in 9 of the last 10 quarters. So I guess, I was hoping to understand if this was a function solely of subscription headwinds? If there were other factors that play here into the extent? It's a subscription issue. When do you think we'll begin to net positive where subscription tailwinds are more than offsetting some of the headwinds and start to see the enterprise business starting to trend a little bit highedr?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay. So from our booking perspective when we see the complete picture and we look in the total deferred et cetera, the enterprise business is doing well. We're seeing excellent traction, for example, in North America and so on. Some of the business is being sold through multiple channels today. Some of them were selling directly to the enterprise business, some were using cloud resellers to reach them. But I think we need to understand that some of the environment is changing and the type of channels one can use are changing. It's not always we are selling directly to the enterprise, many of them we're just fulfilling today through our cloud partnerships as well. Overall, I think the enterprise business is healthy, and as I said in previous answer, that's the engine behind the growth in our total deferred business, which is substantial. So in our analysis, we're doing quite well there. We believe we will continue to do well. I cannot give you the exact timeline when you will see the enterprise - analyzed by itself, regardless of cloud resale, regardless of the balance of total deferred - starting to grow, but it's healthy there. We don't see a problem.

Jess Ian Lubert - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Analyst*

And then, I was hoping maybe you could touch a bit on what we're seeing in Europe and the European business continues to trend downward, is that also a function of subscription? Or are -- there's some macro factors there, a number of your peers have talked about some weakness in Europe. So just would love to understand what you're seeing there?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

So from geography point of view, the U.S. is the one most participating in subscription, then EMEA, and then APAC. So that's one comment I would like to note on our EMEA performance. The second comment is that this quarter, it was down, but if you look on the first half, it's actually up 4% without taking into account the deferral that takes place. So overall, we think we're seeing solid trends in EMEA and also we are forecasting for the third quarter a solid demand there as well.

Jess Ian Lubert - *Wells Fargo Securities, LLC, Research Division - Director & Senior Equity Analyst*

And may be just the last one for Doron. I was hoping you could help us understand to what degree you would expect to see operating margin improvement in the second half of this year. Relative to last year it seems like investment levels are trending a little bit higher for a couple of reasons.

But is there a proactive decision here to invest ahead of sales for future opportunities? Or if revenues come in as you expect, should we see some operating margin improvement in the second half?

Doron Abramovitch - *Radware Ltd. - CFO*

Okay, I think that you noted from Roy's comments that there is a gap between -- of course, between the bookings and between the revenues ,they are -- the actual business reality is that OpEx are related to the booking. So we are doing quite okay in terms of booking, you see it in the deferred revenues, et cetera. And revenues are a bit behind, so as for the improvement, we will see some improvement, but I mentioned in my remarks, that we will add some OpEx expenses in Q3, it should be between $42 million to $43 million. In Q4, it should be even more than this. I assume something like $43 million and above. So it's all related at the end of the day to a level of the fourth quarter revenues. But overall, I believe that we control and monitor our expenses very good. But in a way when it relates to the booking, there is some gap that I believe that we will close it in the next few quarters, but I'm not sure that in Q3.

Operator

Our next question comes from the line of Michael Kim from Imperial Capital.

Michael Wonchoon Kim - *Imperial Capital, LLC, Research Division - SVP*

Could you provide an update on the activity around the DDoS protection suite that you introduced last quarter? And how that's progressing on AWS?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay. So I think one of the strengths of our capabilities is the ability to run and cover every environment. So today, we're covering on -prem protection in enterprises. We are covering DDoS scrubbing in carriers. We are providing cloud services and since last quarter, we are also covering -- we are the first solution to cover the AWS environment without being always on, in terms of coverage. So we are seeing that as another layer of a comprehensive attack mitigation service we provide. And for the large enterprises, where they have some assets in the private data centers, and some assets in the cloud, this is a very, very strong offering and unique. We are the only ones in the world that can provide that. We've started to see some of our major customers adding up this capability and taking also that into account in the new tenders. So again, it's another step in our leadership in the space. It's one dimension out of many others, but it consolidates our position as not only the market share, I believe, leader, but also the innovator in the space.

Michael Wonchoon Kim - *Imperial Capital, LLC, Research Division - SVP*

And can you remind us if you have a similar fully managed service for Azure at some of the other public hot platforms?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

So Azure, we said is next. It's coming soon. We started with AWS, obviously, for the sheer size of the market share.

Michael Wonchoon Kim - *Imperial Capital, LLC, Research Division - SVP*

Got it. And then switching gears to capital allocation. I don't think I saw any share buybacks in the second quarter. Have there been any buybacks in the third quarter? And maybe how you're thinking about capital allocation through the second half?

Doron Abramovitch - *Radware Ltd. - CFO*

So for the vast majority of Q2, we didn't have a court approval to execute any buybacks. So we didn't. Since mid-July, we have such an approval and we have the 10B-5 plans in place in accordance with our board guidelines. So this is for the first part of the capital allocation. And the second part, we continue to look for opportunities, in terms of the M&A, we mentioned this more than once, so these are the 2 elements that are combining of our capital allocation.

Operator

Your final question today will come from the line of Joseph Wolf from Barclays.

Erica Gayle Piserchia - *Barclays PLC, Research Division - Research Analyst*

It's Erica for Joseph. We just had a couple of question. I guess, maybe following on to some of the earlier questions, a broader one. Can you give us any color at all in terms of sort of where, given some of the dynamics you were talking earlier with enterprise versus service, where you are in terms of your move to more of a subscription model? Just trying to kind of sync that with what you were talking about earlier? And then I have a follow up.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

So I think you can see from our total deferred metric that it's progressing very well. The biggest, I would say, contributor to that growth is the additional subscriptions that were booked and invoiced, and did not translate to revenue recognition. But we are seeing a strong growth in these elements of our business. As Doron mentioned, it gives us visibility, it gives us also, over time, a bigger budget allocation from our customers in a very intimate relationship. So I think we're progressing well and we continue to invest in that, some of the OpEx additions are targeting more build outs of our cloud environments across the world as we see better and better traction for these initiatives.

Erica Gayle Piserchia - *Barclays PLC, Research Division - Research Analyst*

Okay. So I mean if most of the deferred is enterprise, and enterprise is cloud, then can we infer that -- can we look at that and say, that's kind of where you're sort of trending on a subscription versus nonsubscription basis?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Yes. So most of the addition in cloud is related to enterprise. And for obvious reasons, most of the total deferred or the subscription business is enterprise driven. What I mentioned is enterprise driven can be either we resell it directly through our channels to enterprise, or some of our channels that our cloud service providers resell our solution to enterprise. Both are contributing to our total deferred going up and both are in the end, new wins in the enterprise space, whether directly or through our cloud reselling partners.

Erica Gayle Piserchia - *Barclays PLC, Research Division - Research Analyst*

Okay. We can follow-up a little bit more later. And the other question I just had was on -- just general momentum going into the end of the year on sort of DDoS and security budget planning. Are you seeing increased interests on sort of a seasonal basis? And lastly, with regard to Seculert, how are you going to treat that sort of going forward? Is that going to turn into sort of a third product line? Or are you going to be reporting that in with everything else? How do we think about that?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay. So first, regarding seasonal trends. We don't factor it in. It's obvious that Q4 is generally stronger in past years. But we're still focused on the third quarter. We're just seeing solid demand across the world for security, whether it's coming from our secure ADC solutions or our attack mitigation solutions or cloud, it doesn't matter. It's really across the board security, continues to be very strong and top of mind. And regarding Seculert, as I've mentioned, it's going to be a cloud service, so it's going to add to our subscription build out in the future once we release the product. And it's going to add another layer for attack mitigation solution. One of Big Data and analytics on top of our solutions, basically opening another dimension of securing data centers.

Erica Gayle Piserchia - *Barclays PLC, Research Division - Research Analyst*

Okay. And I guess, just one last one if I can just really quickly ask. The OpEx in the second half, is all of the increase in that going to be from like a sales commission kind of perspective? Or is there anything else in that sort of expectation or it's just that ramp up in sales that you were talking about earlier?

Doron Abramovitch - *Radware Ltd. - CFO*

In a way, part of it relates to the currency which I've mentioned. Even comparing Q1 to Q2 in terms of the Israeli shekel, the impact on our financials was something like $500,000 to $600,000. So if this -- the level of currency will remain, this is one part. The other parts are related to the business itself, to the commissions, to the marketing activities that we plan to do in Q3 and Q4. As I mentioned, the actual business reality is that it relates to the booking.

Operator

I will now turn the call back to the presenters for closing remarks.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President, Director and Director of Radware Inc*

Okay, thank you very much, everyone, for joining and have a great day.

Operator

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