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PRESENTATION

Operator

Good morning, my name is Virgil and I will be your conference operator today. At this time, I would like to welcome everyone to the Radware Q4 2017 Earnings Conference Call. (Operator Instructions)

Anat Heilborn, you may begin your conference.

Anat Earon-Heilborn - *Radware Ltd. - VP Investor Relations*

Thank you, Virgil. Good morning, everyone, and welcome to Radware fourth quarter and full year 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 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. We wish to caution you that these statements are just predictions, and we undertake no obligation to update those predictions. Actual events or results may differ materially including, but are 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.

I would like to remind you that on February 20, Radware will host an investor meeting in New York where members of the executive team will provide an update on the company's business and outlook. If you'd like to join us, please e-mail me at ir@radware.com

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 strong results for the fourth quarter with revenues and earnings above our expectations and a record level of total deferred revenues of $148 million.

Revenues for the fourth quarter were $58.5 million, up 13% from Q4 last year.

Revenues from the Americas were up 27% from last year and accounted for 49% of total revenues.

Revenues from EMEA increased 1% from Q4 last year and represented 26% of total revenues and revenues from Asia Pacific were up 4% from last year and represented 25% of the total.

Full year revenues were $211 million and up 8% from 2016.

Full year revenues from the Americas increased 16% from 2016, revenues from EMEA increased 5% and revenues from APAC declined 2%.

Full year revenues from the Enterprise vertical grew 2% from 2016, and the service provider vertical revenue grew 21%.

Next, I will discuss expenses and profit in Non-GAAP terms.

A detailed GAAP to non-GAAP reconciliation is presented in the financial tables accompanying our press release, as well as in the investor kit posted on our website.

Non-GAAP gross margin was 82.3% in Q4 2017, compared to 82% in Q4 last year.

For the full year, non-GAAP gross margin was 82.2% compared with 82.4% in 2016.

Our operating expenses were $45 million, compared with 40.6 million dollars in Q4 2016. The main factors driving the increase from last year are the stronger Israeli shekel, which had an impact of approximately $1.3 million, the consolidation of secular, which had an impact of approximately $700,000, and higher sales and marketing expenses and sales commissions.

Compared to Q3 2017, the main driver for OpEx increase is higher marketing activities and sales commissions on increased business activity.

Headcount at the end of December 2017 was in line with its level in the past 2 years. We expect this cost structure to continue support our growth also through 2018.

Tax expenses in the quarter were $632,000 or 14% of our non-GAAP pretax income leaving full year tax rate at 18%.

Note that our non-GAAP tax expenses were not affected by the change in the federal corporate income tax despite a re-measurement of deferred tax assets, that increased our GAAP tax expenses.

Going forward, we do expect an impact from this change and estimate our 2018 non-GAAP tax rate at approximately 14%.

Non-GAAP net income in the fourth quarter of 2017 was $3.9 million or $0.09 per share diluted, compared with net income of $2.5 million or $0.06 per share diluted in Q4 2016.

For the full year, non-GAAP net income was $7.6 million or $0.17 per share diluted, compared with net income of $8.9 million or $0.20 per share diluted in 2016.

As of December 31, 2017, we had approximately $344 million in cash and financial investments.

Cash generated from operations was $8 million in Q4.

For full year 2017, operating cash flow was $31.5 million compared with $38.5 million in 2016.

During Q4 as well as in third quarter, we made a $5.5 million tax settlement payment for prior years, so operating cash flow is not fully comparable to the fourth quarter and full year of 2016.

Our total deferred revenues balance continues to grow. As of the end of December, we had total deferred revenues balance of approximately $148 million, up 22% from $121 million as of the end of December 2016.

This is the second year in which we delivered such robust growth in our total deferred revenues. The proportion of revenues due for recognition within 1 year remained stable at 62%.

Therefore, in the coming 12 months, we will recognize as revenues approximately $91 million out of the total deferred revenues compared with $76 million that we recognized out of total deferred revenues a year ago.

Before I turn to Q1 '18 guidance, I would like to share some of our assumptions for full year 2018.

Our total deferred revenues balance enables us to expect an 8% to 10% revenue growth in full year 2018.

Our business model, which consists of a growing proportion of cloud and subscription sales means that total deferred revenues growth will be higher than the revenues growth.

Starting Q1 '18, we will begin implementing ASC 606 in the retrospective method. We expect immaterial impact on revenues and a small positive impact on profitability.

I will conclude with our outlook for the first quarter of 2018.

We expect Q1 revenues to be between $53 million and $55 million. Non-GAAP gross margin is expected to be approximately 82%. Non-GAAP operating expenses are expected to be between $43 million and $44 million in Q1. As mentioned, we expect non-GAAP effective tax rate to be 14%. Non-GAAP EPS for Q1 is expected to be between $0.04 and $0.06.

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. We ended 2017 on a very strong note, delivering strong performance across multiple business parameters.

Fourth quarter revenue grew by double-digit compared to Q4 last year reflecting growth in all of our geographic regions.

Q4 was a record bookings quarter with book-to-bill ratio once again significantly larger than 1.

The main drivers are our very robust performance in the security business and the excellent growth we experienced in cloud and product subscriptions.

The quarter concluded a strong year for Radware. In 2017, we had record bookings, revenue growth of 8%, a book-to-bill ratio significantly larger than 1 and total deferred revenue growth of over 20%.

Bookings grew in all 3 geographical regions and across both the Enterprise and the Carrier segments.

We begin 2018 in a very strong position with excellent visibility and therefore we are very confident in our growth prospects in 2018 and beyond.

As Doron mentioned in 2018, we expect revenue to grow 8% to 10% over 2017 and total deferred revenues to grow faster than that reflecting continued strength in our cloud and subscription business.

I want to take a couple of minutes and provide more color on our performance in data center security and in cloud and product subscriptions.

Starting with cloud and product subscriptions, we continue to expand our offering and grow this business. For example, in 2017, the number of cloud customers grew by more than 60% over 2016. About half of them completely new customers to Radware.

Our offering addresses our customer needs for data center security delivered as a fully managed cloud service. It positions us as a strategic trusted partner that provides best-in-class security.

This quarter, we expect to launch additional cloud and product subscription offerings.

We will expand on that in over investor meeting later this month.

In Q4, we continued to invest in our global cloud infrastructure.

This past quarter, the global mitigation capacity of the security center we use for our cloud security services has grown.

In addition, more centers are now operational.

These new centers not only increase our ability to mitigate attacks of the largest scale but also allow localized security services often a mandatory requirement to comply with local regulations.

Our success in the cyber security space is a direct result of Radware's approach to provide our customers with a comprehensive solution against attacks targeting the data center. We do not sell DDoS or WAF or IPS point product but rather a comprehensive data center attack mitigation solution. Whether it's an intrusion or a DDoS attack or a scan attempt, encrypted or not, our solution will detect and block it. In addition, our solution is based on a battery of unique mathematical algorithms for behavioral-based detection all field proven. The fact we use automated algorithms dramatically reduces the time to detect and the time to mitigate an attack.

These capabilities are very well received by our customers.

For example, in December, we announced we won a new Tier 1 U.S. carrier with an initial order above $1 million. This carrier selected our solution based on our ability to support the scale of the requirements and our ability to support their operations as an MSSP so that they are positioned to offer better cyber protection to their customers.

Today, we announced successfully securing one of the top 10 global telecom groups as a result of 3 separate competitive displacements that we won in Q4.

The incumbent solution could not keep up with the newer, more complex and destructive cyber attacks. Radware was chosen to deliver both in line data center protection and the global scrubbing centers for several operating units of this global telecom group.

Furthermore, we continue to work closely with our OEM partners, Check Point, Cisco and Nokia and we are pleased with their increased level of commitment to our business and the increased exposure that these relationships provide us to new customers. In 2017, these 3 OEMs relationship brought us dozens of new customers. Specifically, in the new global carrier win we announced today, two of our OEM partners participated in the deals we mentioned.

In summary, we are very pleased with our performance in both the fourth quarter and the full year and with the progress we made on all aspects of our strategy.

We delivered solid growth as well as set the stage for our future growth by enhancing our solution portfolio, broadening our customer base and go-to-market channels and further developing our product and cloud subscription business.

We are committed to continue to do so in 2018 and are excited about the opportunities that lie ahead.

In 2018, we expect to deliver growth in booking, in revenues, profitability and total deferred revenues, at the same time, we expect to continue to leverage the dynamics of our fast-growing cloud and subscription business, which ensures Radware's long-term success, growth and profitability.

I will now open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Alexander Henderson with Needham.

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

Great job, started to really pay off all of this investment you made over the last couple of years. And that's really the [knucks]of the question. So as you're now shifting to a mature SaaS model, it certainly seems like there ought to be a catch up in the profitability as a result of that. Now, you saw some of that in the quarter but how should we anticipate the gradual shift to higher profitability module here -- will your margins be adding a couple 100 basis points a year for multiple years? Will it happen more rapidly? What's the slope of that? And then could you talk about 606?

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

Okay. So we're not guiding yet for the full year profitability but you're absolutely right. We do expect an improvement in profitability and I think it's clear from a -- our prepared remarks about the growth we anticipate in 2018 and keeping the base -- the cost of the number of employees relatively flat because we believe it fully supports our model. We will share more details in our investor meeting.

Doron Abramovitch - *Radware Ltd. - CFO*

As for the 606 question, so starting Q1 '18, we will begin implementing the 606 in the modified retrospective method, which means that the total impact will be adjusted in the retained earnings without updating the prior year's numbers. As for the expenses, it will be -- sales will be related into the commissions, which would be better for our margins but we need to correct some of the commissions on the outstanding total deferred revenues and this will be some offset for this benefit. Overall, in terms of profitability for 2018, as I said, it will be a small positive impact.

Operator

Your next question comes from the line of Ittai Kidron with Oppenheimer.

Ittai Kidron - *Oppenheimer & Co. Inc., Research Division - MD*

And like Alex, I like to see the transitioning happening. Good job. A couple of questions, first for Roy on the subscription side, I know you've tried to emphasize that you're selling a solution, the attack mitigation solution but can you tell me if there's really a concentration from a service standpoint in 1 of the categories, are the DDoS protection services still the bulk of your customers and revenue? Is that the right way to think about it?

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

I will not say that DDoS but the DefensePro related solution, which includes DDoS, IPS, anti-scanning and network behavior, that would be the bulk.

Ittai Kidron - *Oppenheimer & Co. Inc., Research Division - MD*

Okay. And as we -- if we would talk about this a year from now, do you think that's going to be materially different? Or is still that's where the concentration is going to be?

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

I think some other aspects of our subscription business model are growing now faster than this, also this is also growing very, very strong growth as you see from our numbers and the underlying total deferred.

Ittai Kidron - *Oppenheimer & Co. Inc., Research Division - MD*

Got it, okay. And then regarding your first quarter guidance Doron, I'm kind of just looking at the model, it looks like just at the midpoint of your guide, you're looking at about a 7.5 plus/minus quarter-over-quarter decline, which is higher than past first quarters and I'm just kind of wondering if under the assumption that cloud and recurring subscriptions are bigger portion of your revenue today than any other quarter in the past, why shouldn't we see less seasonality, why are we seeing more seasonality in your first quarter guide?

Doron Abramovitch - *Radware Ltd. - CFO*

Well, it's not -- we still see the seasonality. You know that we are looking q-over-q. So we did compare ourselves to the first quarter. The fourth quarter is always - and it will continue to be - because we benefit some of our subscriptions, some of our services and maintenance mainly in the second half and then particular in the fourth quarter. So overall, the 8% to 10% growth for 2018 is compared to '17 is one element and the second of course is our guidance for the first quarter is higher of course than the Q1 '17. I suggest we will keep this method of comparing queue over queue and not the previous one.

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

Ittai, just I'm not sure I caught your answer. The guidance is not for $7.5 million less.

Ittai Kidron - *Oppenheimer & Co. Inc., Research Division - MD*

No. It's -- yes I know at the midpoint of your revenue guidance for the March quarter, which is $54 million, you're looking at a 7.5% decline in quarter-over-quarter revenue that's the seasonal element and outside of 2016, if I remember correctly, every other year was far less than that. Just wondering again, with cloud being a bigger portion of your business, why wouldn't we see less of a decline quarter-over-quarter?

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

Yes, so percentage wise, that's correct but -- as our model kicks in more and more every year, as Doron mentioned, I agree with you, it would be less of such impact.

Operator

Your next question comes from Zack Turcotte from Dougherty.

Zack Turcotte - *Dougherty & Company - Analyst*

This is Zack on for Catharine Trebnick here. Just a couple of things on the Cisco, Nokia, OEM relationships. Just if you could quantify at all, the revenue impacts from in the quarter? Or at least kind of how far along those relationships are? As well as kind of in relation to that, (inaudible) of the enterprise growth really bounced back last couple of quarters, just how much those partnerships contributed to the enterprise growth?

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

We don't break these numbers but across all the 3 OEMs, I would like to include also Check Point in that, we are very encouraged by the growth in these OEM relationships across the board and also by the growing commitment not only on what they're doing with us today but also in future planning. So I think all 3 are trending well. I mentioned that in the global telecom group, 2 participated in the 3 deals we mentioned. So we see them more and more involved also in the large deals. And as it relates to the enterprise market, I would say Cisco and Check Point are the ones touching the enterprise market. Nokia is focused obviously on the carrier market and to some extent, a small portion of the Check Point and Cisco business is also targeting carriers, so with these 3, we feel we have a good coverage and a growing coverage of the market, we're seeing very good trend of new customers, completely new customers, they're bringing to us and I mentioned that in my prepared remarks and we continue to be extremely encouraged by this relationship.

Zack Turcotte - *Dougherty & Company - Analyst*

Got it and just one thing real quick on the operating expenses, we saw R&D and sales and marketing increasing in numbers sequentially but really decreasing quite a bit as percentage of revenue throughout 2017. Do you see this trend continuing and to keep driving operating margins the level they were at in Q4?

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

Yes. As I said that we keep our cost structure as it was in the last couple of years. So eventually, we believe we know that it will continue with this trend and we feel our focus for 2017 will benefit and there will be some leverage on this 1.

Operator

Your next question comes from George Notter from Jefferies.

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

I guess I wanted to ask some questions about the Cisco OEM relationship. Could you talk about what kind of -- I think you've been selling with Cisco for, gosh, 7 or 8 months in aggregate and this is since they got their new hardware and software instances out on the FirePOWER platform. So I guess the question now is what are attach rates lookings like with the virtual DefensePro product? Also curious about which versions of that product customers are buying? And then also I would love to hear more about the effectiveness of the Cisco salesforce in selling FirePOWER along with the virtual DefensePro, can you just kind of talk about where their relationship is and what do you expect going forward?

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

So first I want to remind everyone that when we recognized Cisco revenues, this is a 45 days after their end of quarter. So basically, what you're seeing, the contribution to revenues in our fourth quarter is something they sold until end of July of '17. So there is a gap here in what we reported to you. Second, regarding their effectiveness, I think they are becoming more and more engaged. We are seeing mapping of accounts in the -- of the top 500 accounts. We're seeing more activity across the board and we're seeing them starting also some joint marketing campaigns. Together with that, I think there is a clear potential to increase the portfolio, the Cisco sales from Radware, and I believe that will happen also relatively quickly in 2018. All in all we're seeing increased activity. We're seeing wins across the board. I cannot speak regarding attach rate because I don't have the Cisco sales statistics and they don't share it with us but our pipelines are growing, activity is growing, the strategic nature is increasing and we're starting to recognize every quarter more and more revenues from this relationship.

Operator

Your next question comes from Joseph Wolf from Barclays.

Joseph Eric Wolf - *Barclays PLC, Research Division - MD and Deputy Head of United States Equity Research*

I guess just another follow-up question on these OEM relationships. If you could go back into the -- when you talked about 2 of them participating in the win that was announced today. How does that -- is that -- they've introduced you and you're selling your own product. Does that mean they are selling their product? Can you talk about the scope of what that -- of how that relationship wanting and what that means in terms of the success of the relationship as you look at it? And then just on this deferred revenue recognition, is this a royalty and does this have any impact on the new accounting rule? For the adoption of the accounting rule, not new?

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

Okay. So regarding the OEM relationships in this specific telecom group, we worked on it for several years but one OEM introduced us to a new operating unit that we didn't have relationship with and we were able to leverage some of the other work we've done as a global group to close that as well. And the other worked with us on a major opportunity in that carrier. So we're seeing them introducing us to new operating units, new customers as well as jointly working with us on the core opportunities. In that telecom group, we sold our solutions because there was a clear need for very high capacity DDoS mitigation solutions.

Doron Abramovitch - *Radware Ltd. - CFO*

As for the OEM, Joseph, leave aside Cisco that Roy mentioned, how we recognize it only 1 time royalty, 45 days after Q end. All other sales are considered to be as all of our revenue was in the 606 will not change this trend significantly if at all.

Joseph Eric Wolf - *Barclays PLC, Research Division - MD and Deputy Head of United States Equity Research*

Okay. And then if we look at the relative growth rates just given -- with the visibility on the 8% to 10%, can you give us some feeling of how much what the growth rate of security related spend is versus that 8% to 10% or the cloud growth relative to that 8% or 10% in terms of how we think about the components of growth?

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

Obviously, I mentioned that security, cloud and subscriptions are doing exceptionally well for us. You should assume, are growing much faster than the 8% to 10%.

Operator

Your next question comes from Michael Kim from Imperial Capital.

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

Could you talk a little about maybe some of the differences in your geographies, America is obviously very strong but EMEA and APAC both a little bit flatter. Are you seeing some difference in sales productivity or that primarily a driver of mix?

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

I think from our booking point of view, we're seeing also already strength starting to happen also in the international. We were very satisfied with our EMEA performance in Q4 but in our model, some of it is obviously deferred and you're going to see it probably in 2018. So I think we're starting to see the strength going also internationally, especially as they are becoming more alert to security issues. Europe has now a new type of compliance coming in as well as they are more open to cloud environments, we've seen that in APAC, we've seen that in EMEA in the second half of '17. So we feel very good about the prospects also in the international markets. I mentioned some of the growth in our cloud security capacity and presence across the world, some of those investments were made either directly or through our partners in the international markets.

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

Got it. And then just on the growth and products excursions and cloud solutions. Are you seeing -- I think you call that a number of new logos. Are you seeing maybe a shift in higher growth from the new customers versus expansion with existing? And did you see consistent renewal rates?

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

So we saw consistent renewal rate. Regarding growth, obviously, the bulk of our revenues still coming from our existing customer and that's the growth engine. What we are seeing is the pickup in number of new customers, some of it organically I would call by our own salesforce and some of it, and in bigger numbers now, driven by our OEM partners. So we definitely see at this point our OEM partners putting us or increasing our footprint in the market and now we're building campaigns obviously to leverage that cross-sell and up-sell in those new customers to a complete Radware offering. So we're seeing another layer of potential business that we can do through those OEMs by leveraging the lands and expense strategy so to speak.

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

Got it and then just lastly on a high level, do you have a mix -- revenue mix between products and services for the full year '17?

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

Yes. We will mention it in our 20-F that we will publish soon.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

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

Okay. Thank you. I would like to thank everyone for joining us and have a great day. Thank you.

Operator

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