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RDWR - Q1 2019 Radware Ltd Earnings Call

EVENT DATE/TIME: MAY 01, 2019 / 12:30PM GMT

CORPORATE PARTICIPANTS

Anat Earon-Heilborn *Radware Ltd. - VP of IR*

Doron Abramovitch *Radware Ltd. - CFO*

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

CONFERENCE CALL PARTICIPANTS

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

Alexander Haig Frankiewicz *Joh. Berenberg, Gossler & Co. KG, Research Division - Former Associate*

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

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

Joshua Alexander Tilton *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate Analyst*

Kyle P. McNealy *Jefferies LLC, Research Division - Equity Associate*

Tavy Rosner *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

PRESENTATION

Operator

Good morning, my name is Michelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the Radware Q1 2019 Earnings Call. (Operator Instructions) I would now like to turn the call over to Anat Earon-Heilborn, VP IR, please go ahead.

Anat Earon-Heilborn - *Radware Ltd. - VP of IR*

Thank you, Michelle. Good morning, everyone, and welcome to Radware's First Quarter 2019 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 first quarter are available in the Investor Relations section of our website.

During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. These forward-looking statements are subject to various risks and uncertainties and actual results could differ materially from Radware's current forecasts and estimates. Factors that could cause or contribute to such differences include but are not limited to general business conditions and our ability to address changes in our industry, changes in the macro product, the timing and 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 or furnishes from time to time with the SEC, specifically the company's last annual report on Form 20F as filed on April 16, 2019.

We undertake no commitment to revise or update any forward-looking statement in order to reflect events or circumstances after the date any such statement is made. Please note that in May, management will participate in the Oppenheimer Israel Conference in Tel Aviv, and in June, the management will participate in the Jefferies Tech Trek in Tel Aviv, the Baird's Global Consumer Technology & Services Conference in New York, and the IDEAS Conference and the Piper Jaffray Symposium both in Boston. With that, I will turn the call to Doron Abramovitch.

Doron Abramovitch - *Radware Ltd. - CFO*

Thank you, Anat, and thank you all for joining us. We are pleased to open 2019 with revenues growth and increased profitability.

Revenues for the first quarter were $61.4 million, up 13% year-over-year. In Q1, we recognized revenues from several deals, including some which we had expected to recognize in Q2.

Revenues from the America were 40% of total Q1 '19 revenues and increased 2% from Q1 2019. Both EMEA and Asia-Pacific delivered revenues growth of 21% from last year, and each represented approximately 30% of the total.

I will discuss now expenses and profit all in non-GAAP terms.

Non-GAAP gross margin for the first quarter grew to 82.8% from 82.3% in Q1 last year. Non-GAAP operating expenses were $43.2 million compared with $43.4 million in Q1 last year and below our expectations.

Our headcount at the end of the quarter was 1,025 employees, including 62 from the ShieldSquare acquisition, which closed in mid-March. As such, the stable headcount was in fact below our plan and we are in the process of increasing our sales force and support staff. We are committed to ramp our investment in our business to facilitate our growth while delivering operating leverage.

Our non-GAAP operating profit in Q1 2019 was approximately $7.6 million, representing a 12.4% margin, up significantly from 2.8% in Q1 2018. We are clearly on track to meet our 15% operating margin target for 2020.

Non-GAAP tax rate was 11.5% compared with 12.7% in Q1 2018. Q1 non-GAAP net income was $8.9 million or $0.18 per share diluted, up from $2.6 million and $0.06 per share diluted in Q1 last year.

Turning to balance sheet and cash flow. We ended the quarter with total deferred revenues balance of approximately $160 million, up 8% from March 2018. In the coming 12 months, we expect to recognize as revenues approximately $103 million out of the March total deferred revenue balance or 64%. This is up 10.5% from $93 million in Q1 last year.

Operating cash flow in the quarter was $23 million driven by strong collections that's also reflected by the low DSO ratio, which was 21 for the quarter. We expect DSO to return to the high 20s and Q2 operating cash flow to offset some of the outperformance of Q1.

We ended the quarter with approximately $420 million in cash and financial investments, up from $401 million as of the end of 2018.

In line with our capital allocation policy, which includes both acquisitions and share repurchases, we announced today a new one-year $40 million share buyback plan.

Our outlook for the second quarter of 2019 is as follows:

We expect Q2 '19 revenues to be between $59 million and $61 million. 2019 first half revenues are therefore expected to grow approximately 7.5% to 9.5% over the first half of 2018. This is in line with our full year revenue guidance of 7% to 9% growth over 2018, which we reaffirm. Non-GAAP gross margin to be approximately 82.5% and non-GAAP operating expenses to be between $43 million and $45 million. We expect tax rate to be approximately 12%. Non-GAAP EPS for Q2 is therefore Expected to be between $0.12 and $0.15.

Let me remind you that this guidance includes ShieldSquare that is not expected to have meaningful contribution in revenue in Q2 given the subscription nature of the business.

The acquisition is therefore expected to have a dilutive effect of approximately $0.03. I will now return -- turn the call over to Roy.

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

Thank you, Doron.

As Doron noted, the first quarter results together with our outlook for the second quarter positioned the first half of 2019 in line with our expectations for the full year. From a booking perspective, Q1 in EMEA was not as strong as we had expected, although we believe our execution in the region is solid.

On the positive side, we continue to see globally strong growth for our subscription business and, in particular, our cloud business. Overall, we are pleased with our results for the quarter, which were above our expectations in revenue, profitability and operating cash flow.

We continue to focus on the market for private and public cloud application delivery and security solutions. In this context, our subscription business continues to grow strongly and is affected by 2 major and connected trends. The first trend is the transition of applications to the cloud, an environment that brings new security challenges.

In the first quarter, we broadened our portfolio of cloud security solutions with the launch of Cloud Workload Protection, which is an agent-less cloud-native solution for comprehensive protection of cloud assets.

Our first customer for this solution is Perion, an ad tech company that has a variety of services deployed in multiple AWS accounts. Perion was looking for visibility into account updates, ability to track usage of access permissions and protection from data breaches.

During the proof-of-concept phase, Radware Cloud Workload Protection already detected 8 attack scenarios. The CWP solution is particularly appealing to cloud-native companies, who are now traditionally our customers and it's broadening our addressable market.

The second market trend is the demand for cloud security services. While obviously part of the overall transition of applications to the cloud, we believe its main driver is wider than just that and is derived from the increasing needs for managed security services driven by attack complexity and skill shortage.

This growth affects our business mix and drives operational and infrastructural requirements. With the 11 scrubbing centers supporting our cloud DDoS service, and 24 points-of-presence supporting our cloud WAF service, we have one of the world's largest global cloud footprint for data center and application protection.

For example, during the first quarter, we won a new logo, a multi-billion dollar revenue, IT consulting and system integration company, replacing an existing solution provided by the carriers. This service was no longer capable of withstanding the increasing complexity of the attacks from these customers and it has selected to switch to a hybrid DDoS protection solution for its 2 main data centers.

Our hybrid DDoS customers rely on our operation and infrastructure at time of attack, and in today's cyber threat environment, some customers experience daily attacks. In addition, we are seeing strong traction for always-on cloud DDoS protections, which means that the customer's traffic always goes through our service, and they depend on us for their entire network connectivity. We are proud to be trusted by so many respected customers and be that strategic to their business.

In mid-March, we close the ShieldSquare acquisition, and we are very excited to welcome the new employees to Radware. We are progressing very quickly with the integration plan and already earlier this month, we released the fully integrated ShieldSquare Bot Management Solution in our cloud WAF. This launch provides our customers with the full cloud Bot Management Solution that requires no software installation on-premise.

We are also pleased with the progress made from a business perspective. We already won the first customer for this service, a new logo from the insurance sector, selected Radware to provide a fully managed end-to-end solution that includes cloud DDoS, cloud WAF and Bot Management. As this triple play deal illustrates, the Bot Management Solution is closely linked and highly complementary to our cloud WAF.

We're excited about the breadth and depth of our cloud security portfolio and the opportunity to broaden our customer base and address new market segments.

In summary, we have an expanded portfolio, which is aligned with customer needs, covering private, hybrid and public cloud data centers, coupled with fully managed service offering. We are committed to maintain our technology and innovation lead as well to invest in bringing our technology to a wider customer base and delivering operational excellence to our managed service customers.

We are on track to meet our full year 2019 goals, and we will continue to execute on our strategy.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from Alex Henderson from Needham.

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

I was hoping you could talk a little bit about the degree of what was pulled forward out of 2Q into 1Q, looking at the guidance for the second quarter. At the mid-point it's around 4% growth, which is well below what we would normally expect. So can you give us some granularity? Was it a couple of million dollars of pull forward? What are we looking at there?

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

Yes, its roughly a couple million predominantly from one carrier deal that will receive the acceptance ahead of what we thought will be the schedule.

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

Great. Second question if I could, the slowdown in Europe obviously accelerated over the course of the quarter post and when most people gave guidance. But it seems to me that, that's probably more on the ADC side and less on the security side. So can you talk a little bit about the delta between the growth between security-related transactions and ADC transactions? Did you see a decline in the ADC business, and was that particularly pronounced in Europe? How do we parse that?

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

We did see a decline in ADC business. But in Europe, it was mainly focused on a country basis. I think we saw weakness in the U.K. and, in particular, in Germany. That's our analysis, not necessarily ADC and security.

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

Just going back to the ADC piece, have you expected that to be up a little bit before, and so there was a variance in your expectation within that?

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

As you know, we are looking for our ADC business to be flat to 5% up given our focus, and we were able, if I'm looking like 12 months period, we are able to achieve that. In this quarter, specifically, we did not.

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

And then just going back to ShieldSquare. Clearly, you've got some cost kick in here, but it sounds like you've unbelievably executed that in terms of getting it in the marketplace that rapidly to get customers already. Can you talk about whether you should expect any revenue contribution over the course of the year from that? Or do you -- will take a fair amount of time for that to build to any meaningful scale? It seems like, certainly, looking at the competitive position of ShieldSquare, it's an outstanding asset at a reasonably attractive price here.

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

So we're definitely encouraged by the pace of integration and the customer feedback, so we are seeing already booking. I mentioned one customer in a -- the first customer in my comment, we're already winning more customers. It was just another win, and a very nice win today displacing competition. So we are progressing there. We see good pipeline, good activity, and now that it's integrated with our cloud WAF, I think it's extremely compelling offering to increase win ratio in both Bot management and the cloud WAF offering.

Doron Abramovitch - *Radware Ltd. - CFO*

In terms of the revenues, Alex, and I would say, the nature of the business is the subscription, so obviously, and I mentioned it in Q2, it's close to zero. I hope that with the magnitude, you will see something positive in terms of revenues in the third quarter. But as for the -- for Q2, we took almost nothing, but just because of the nature of the business.

Operator

Your next question comes from Ittai Kidron of Oppenheimer.

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

Roy, I did want to go back to Europe again because I -- frankly, I'm a little bit surprised you're disappointed by it. I mean 21% growth is a number that I'll take any day. I guess my question is, why are you not worried about the Americas? Over there for 4 quarters in a row now, year-over-year, well, there hasn't been any year-over-year growth really for 4 quarters in a row and a very low single-digit decline or very low single-digit increase, no movement at all. Why is that not a region you're worried about? What's going on there that's not conducive for growth?

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

Okay. So my statement was related to bookings, not to revenues. Obviously, the 21% in revenues in EMEA and in APAC, we're happy about. But those are, given the subscription business, a result of earlier bookings in '18 to some extent '17. As regards to Americas, we did have a nice booking result in growth in Q1, the region is -- grew double-digit figures. And I think, given our model, you will see that in revenues in the coming quarters.

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

Okay, very good. And then as a follow-up, just on Cisco, Doron, can you talk about the contribution business activity there, how is that progressing?

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

Yes, I'll take it. The Cisco revenue is below our plan. And it's not in line with what we obviously expected. However, we still believe in the relationship, and we do see meaningful contributions down the road. We know we said it and repeated it several quarters by now, but that's our view.

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

Okay. Any color why you think it's not moving as fast as you'd hope?

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

There's multiple ones in terms of our, I would say, affinity to FirePower on one end. At the other end, we just now expanded the joint portfolio, the focus of the teams and so on. We've done some -- we are seeing larger pipelines, significantly larger pipelines. We are seeing involvement in larger deals. But we do see our pipelines from Cisco to have longer sales cycles. In terms of time than what we used, those are general, larger deals, more involving multiple products, not only specific opportunities. And we just see there a -- probably, we'll need to get used to these longer sales cycles.

Operator

Your next question comes from George Notter from Jefferies.

Kyle P. McNealy - *Jefferies LLC, Research Division - Equity Associate*

This is Kyle on for George. I'm curious to get your perspective. You launched some new cloud subscription services in the first quarter. You also had a number that you added to the menu in 2018. I'm just wondering if there's anything you can add to how those are doing in the market? Is there anything new in terms of attach rates or total deal size with your customers? And I have a follow-up.

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

So the -- as I've mentioned, the subscriptions business as a whole, and cloud in particular, continue to grow very strong. We've seen -- I shared some information in Analyst Day, for example, on one of the cloud subscriptions, the ERT active attackers feed and we gave some -- at that point, it was I think 600,000 quarter-to-date, and we were looking for 3 million for the year. I think we're finishing above our expectation, and at this point, the specific subscription probably grows even further, and this is just an example. So we're seeing very nice contribution from subscription. We're seeing bigger adoption of multiple subscriptions from the company, be it cloud or product subscriptions. We came out with several bundles of subscription that also look to be accepted well by the customers. So this whole area of our business, we're very, very bullish on.

Kyle P. McNealy - *Jefferies LLC, Research Division - Equity Associate*

Great, thanks a lot. And then I know you added the Global Elastic License, and I mean aside from the other subscriptions you added, is there any headwind to call out like you've experienced in the past that would -- that we should think about in terms of the year-over-year growth rates? Pretty impressive growth, but I'm wondering if there's any headwind associated with some of the new subscription services, any transition to those?

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

As we discussed, there is headwind given the model, but we took it into account in the guidance of -- the yearly guidance of 7% to 9%. So obviously, when you take a cup -- a perpetual deal and move it to subscription, there is some headwind to revenues, but it's in the model. We don't see any reason to change. As we've said, we're pretty confident on the yearly guidance we've given, and we will be there just above '18 H1 and I'm sure we will continue to execute accordingly.

Kyle P. McNealy - *Jefferies LLC, Research Division - Equity Associate*

Okay, great. And one last one. Typically, Q1 is your low point for profitability. And given the strong results this quarter and your comments, appreciate those around OpEx, does your view change for the year? Are you still going to see margin -- operating margin ramping through the years as you've seen in the past? Or will this year be different given your comments?

Doron Abramovitch - *Radware Ltd. - CFO*

I think we will continue to see the growth from 2018 as we expected, and as I saw some in of your models. The change between the quarters, in a way right now is a bit meaningless because if you take the revenues quite flattish between the quarters, so overall, we will improve 2018 and we'll see the leverage as we've said in the Investor meeting.

Operator

Your next question comes from Catherine Trebnick from Dougherty.

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

One is, could you give us any more detail on how you're doing with Check Point? I know that relationship last year was struggling a bit. You weren't really getting some of the performance through it? And then -- and how the Nokia relationship is involving? And then the second piece of the question is, how did you manage -- I mean you did a great job in Asia-Pac, up 21% year-over-year, I know that's been in past years a frustration. Any changes in the sales team or new wins in that area you could discuss?

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

So first on Check Point and Nokia, those relationships continue at the same pace, I've mentioned that we've now expanded also the portfolio with Check Point. And I think also with Nokia, we're starting to engage in more carriers. So all in all, we feel good about these relationships. They are developing, they're not growing significantly, but they're quite steady. Regarding Asia-Pacific, as we mentioned on several calls, the revenues at that time were not showing growth, but we told you that we're seeing the booking and it's progressing well. You're starting to see the evidence for that also on the revenue side. And we constantly do adjustments in the region. We think in Asia-Pacific, there's more potential for growth and we will update you as things progress.

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

And one final question, what are your 5G plans? Because you do have a strong carrier presence in multiple data scrubbing centers. What would be -- any specific products you're coming out with or to go after 5G?

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

So we mentioned that in the Analyst Day. We obviously see that as a growth area. There's new requirements for traffic management, there's new requirements for security. We are working with our partners there - Cisco, Nokia - to address this market. I don't think its a 2019 opportunity. I think it's starting in 2020, and probably we are working on specific solutions to address this potential. So we see that as a great opportunity, but it's not coming in 12 months. It's longer cycle, and obviously, we are preparing ourselves to that.

Operator

Your next question comes from Tavy Rosner from Barclays.

Tavy Rosner - *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

Most of them have been asked, so I guess 2 quick ones. First one, can you talk a little bit about the acquisition pipeline? Given where your cash balance is, are you seeing anything out there that would be relevant for you guys? How do you think about this?

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

We continue to be active in the market. We are meeting companies and possible targets, but we will continue to have the same policy of being very conservative on tech acquisitions, looking for business impacts and the return on our investment. But definitely, we are looking in the market. We think there might be some good opportunities for us. And as we've mentioned, given the increasing cash level, we have a lot of options how to execute it.

Tavy Rosner - *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

Maybe just a final quick one on -- last quarter you disclosed the recurring revenues were about 65% of sales. Is that -- in Q1, was that something similar to what we saw in 2018?

Doron Abramovitch - *Radware Ltd. - CFO*

So Q1 obviously went a bit down because of some of product recognition, et cetera. But I've said in other areas, therefore, 20 -- for the rest of the year, we will be back on the -- in the neighborhood the 60s, but Q1 was a bit below.

Operator

The next question comes from Josh Tilton from Berenberg.

Joshua Alexander Tilton - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate Analyst*

In regards to the carrier strength, I understand that much of the cloud business goes through the enterprise side. Was the cloud growth in the quarter in line with your expectations?

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

Yes, even above.

Joshua Alexander Tilton - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate Analyst*

And then, is it safe to say that the cloud mix is still 90% going toward in the enterprise?

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

Yes.

Joshua Alexander Tilton - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate Analyst*

So is it possible maybe to comment on how much of this business is net new to Radware?

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

We don't break it, but it depends on the offerings. Some of the offerings, there's a significant portion, let's say even 50% net new. It depends on the some of the newer offerings, of course, CWP and the anti-bot is almost 90% net new. So it really depends on the offering.

Joshua Alexander Tilton - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate Analyst*

Okay. And then maybe just asked a little differently. So last quarter, you mentioned a multi-year cloud security deal that was one of the largest in the company's history. Are we seeing the same continued momentum that we saw last quarter?

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

Yes. As I mentioned in my comments, it's a very, very strong business for us.

Operator

And your next question will come from Alex Henderson from Needham.

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

I was hoping you could talk a little bit about the strategy for a second. You guys have gone through a period of pretty tight cost controls because you've been transitioning from your traditional perpetual business to SaaS and to cloud into security. The really flattish OpEx spending that you're mechanically delivering here seems inconsistent with a company of your size and the opportunity in security where most of these companies choose to accelerate their growth even at the cost of margins. And I'm wondering if you have rethought at all of this approach to fairly tight cost management, pushing margins up to 15% in lieu of the fact that virtually every company that I look at in the security space has a premium on growth and a much lesser premium around margin structure. So wouldn't it be making sense to push these growth rates up and take further advantage of this market instead of being fairly cautious on the spending side?

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

We agree. As Doron mentioned in his comments, our OpEx was below our plan, meaning we are not in line with our hiring plans and where we took measures to accelerate that, but definitely, we're seeing the opportunity for growth. We're definitely adding people in our plan across all departments of the company. So we also guided for higher OpEx in the coming quarters. So we are definitely focused on that. There's major hiring we're doing in all geographies. And as we said also on the operating margin, we are ahead of plan there. We have this early -- bigger recognition of this carrier deal, obviously, with our 80-plus gross margin, it impacts margins considerably. But there's no hesitation in our mind, we are going after growth, and we are going after adding people and leveraging the opportunity.

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

So if we were to look past 2019, which is obviously an investment period based on your comment you just made, should we be thinking about the company as a 10% plus growth company in the headlights beyond '19.

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

So in our model, we gave a 9%, 3-year, we gave it a year ago. We still feel very comfortable with that. As we showed one year has passed. We are on our way to achieve the second year. And so far, we feel confident in our ability to continue in that pace. And hopefully, with the investments we will make, we would be able to accelerate that. But it's early to discuss that. Currently, we're reaffirming the 7% to 9%, and we are reaffirming the 2-year 9% CAGR. We will be a bit above it. And going to the third year, hopefully with the investments already behind us, we might be able to accelerate it, push it forward.

Alexander Haig Frankiewicz - *Joh. Berenberg, Gossler & Co. KG, Research Division - Former Associate*

If I could, one more question. So your growth rate in the June quarter, obviously, because of the some of the pull-ins into 1Q, is a lot lower than most people were modeling. But it seems that, that probably belies to your pipeline. Can you talk about the deal pipeline? To what extent are you seeing strengthening in the pipeline, which may not be consistent with the revenue growth, given its a SaaS model and bookings could be quite a bit stronger? Would we be looking at a book-to-bill in the quarter that's solidly above 10%? Or how do we think about the pipeline relative to the slow growth rate?

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

Yes, so for the full year, I don't want to speak, say, quarterly booking guidance. But for the full year, obviously, we're looking book-to-bill above 1, and that would support the next year, 9%, and that's the part of the model -- that's how our model works. So definitely, we are there and reaffirming the guidance, meaning that, that's what we are seeing and believing in.

Operator

I have no further questions in queue. I turn the call back over to presenters for closing remarks.

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

Thank you very much for joining us and have a great day.

Operator

Thank you, everyone. This will conclude today's conference call. You may now disconnect.
