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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 Radware Q1 2018 earnings. (Operator Instructions)

I would now like to turn the call over to Anat Earon-Heilborn, VP of IR.

Anat Earon-Heilborn

Thank you, Michelle. Good morning, everyone, and welcome to Radware's first quarter 2018 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. 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 are not limited to, general business conditions and our ability to address changes in our industry, changes in demand for products, 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 from time to time with the SEC, specifically, the company's last Form 20-F is filed on March 28, 2018.

We further refer you to the presentation and webcast replay of the investor meeting the company held in New York on February 20, 2018, which are available in the Investor Relations section of our website where additional disclosures can be found. Please note that in May, management will participate in the Jefferies Technology Conference in Beverly Hills, and in the Oppenheimer Israel Conference in Tel Aviv. In June, management will participate in the Jefferies Tech Track in Tel Aviv, and in the Baird's Global Consumer Technology and Services Conference in New York.

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 first quarter, with revenues and earnings at the high end of our expectations and continued growth in our total deferred revenues balance.

Revenues for the first quarter were $54.5 million, up 11% from Q1 last year. Revenues from the Americas were up 32% from last year and accounted for 44% of total revenues. Revenues from EMEA increased 4% from Q1 last year and represented 28% of total revenue, and revenues from Asia Pacific were down 5% from last year and represented 28% of the total.

We delivered solid year-on-year growth in both product and service revenues and strong growth in subscriptions. As a result, recurring revenues, which includes subscriptions and support, represented over 60% of total Q1 '18 revenues. This gradual increase in the proportion of recurring revenues reflects the growing quality of our revenue and the greater predictability of our business, that enables us to provide full year outlook, which I will discuss at the end of my remarks.

I will now discuss expenses and profit, all in non-GAAP terms. The detailed GAAP to non-GAAP reconciliation is presented in the financial table accompanying our press release as well as in the investor kit posted on our website.

Non-GAAP gross margin continues to be stable at around 82%, a level at which we expect it to remain.

Operating expenses were $43.4 million, compared with $40.7 million in Q1 '17 and in line with our guidance. The main factors driving the increase from last year are the stronger Israeli shekel, which had an impact of approximately $1.9 million, and higher sales and marketing expenses.

Let me remind you that Radware adopted ASC 606 in the modified retrospective method, which means that we are not restating 2017, but have accumulated the difference in the January 1 retained earnings opening balance. As we disclosed in our Form 20-F, the magnitude of this cumulative impact was approximately $10 million, which will be amortized as an expense over time. Although commissions are now recognized in parallel to revenues, this positive impact is partially offset by these expenses. Therefore, the net positive impact is small and we expect this to be the case throughout 2018.

Headcount at the end of March 2018 was 975, at a similar level as in the past 2 years, which is expected to be consistent also through 2018.

Tax expenses in the quarter were 13% of our non-GAAP pretax income. For the remainder of the year, we continue to estimate our 2018 non-GAAP tax rate at approximately 14%. Non-GAAP net income in Q1 '18 was $2.6 million or $0.06 per share diluted, compared with net income of $700,000 or $0.02 per share diluted in Q1 2017.

We ended the first quarter with approximately $358 million in cash and financial investments. Cash generated from operations during the quarter was $12.2 million, up from $6.3 million in Q1 '17. Operating cash flow for the last 12 months was therefore $37.3 million.

As of the end of March, we had total deferred revenues balance of approximately $148 million, up 15% from approximately $128 million as of the end of March 2017.

Let me remind you that the total deferred revenue balance doesn't reflect full bookings. For example, deals that were booked late in the quarter and not yet invoiced are not part of this balance.

Total deferred revenues growth that is higher than revenues growth reflect our business model, which calls for a growing proportion of cloud and subscription sales. In the coming 12 months, we will recognize revenues approximately $93 million out of the total balance or 63%. This compares with $78 million or 61% a year ago.

I will conclude with our outlook for the second quarter of 2018 and full year 2018. We expect Q2 revenues to be between $56 million and $57.5 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 Q2. Non-GAAP EPS for Q2 is expected to be between $0.07 and $0.08. Our total deferred revenues balance and the enhanced visibility and predictability that is inherent in our business model enables us to provide full year outlook for 2018. We are maintaining our full year guidance of 8% to 10% revenue growth, stable gross margin and a modest increase in non-GAAP operating expenses. We also expect total deferred revenues to grow at a faster pace than revenues.

I will now turn the call over to Roy.

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

Thank you, Doron. Today, we report strong Q1 performance across all parameters. With double-digit revenue growth, book-to-bill significantly higher than 1, a 15% growth in our total deferred revenues year-on-year and an increase in profitability and cash generation. First quarter revenue grew at a double-digit rate for the third consecutive quarter, and our guidance for the second quarter suggests a fourth one is underway. Total deferred revenue continue to reflect faster growth than that of revenues. This is in line with our business model and our drive to continue growing our cloud and subscription business.

Looking at all these metrics and our robust pipeline, we clearly started 2018 on the right foot and are very excited about the opportunities that lie ahead of us.

The market is ready for a strong 2018. Our customers are committed and ready, and our business model shows strong traction. Large customers are investing more in solutions such as ours and are thinking about attack mitigation much more strategically. This is reflected in the large number of 7-digit deals we won in Q1 across multiple sectors. Among our large customers in Q1 were 2 of the largest software as a service company, an Asian government entity, which we announced last week; a European Homeland Security Authority; an Asian smart cities project; 2 leading e-commerce companies; and others. We believe we are growing our wallet share in the large customer segment, integrating tighter into their operations and playing an increasingly critical role in the availability and security of their infrastructure.

Acceptance of cloud and security solutions outside North America is rising. EMEA trends are now similar to North America. And we're seeing a notable positive momentum in Asia Pacific.

Our focus is on availability and security solutions for the data centers. Customers with critical operations view availability and security as integrated components to ensure operational continuity. One example is the win we announced last week of a $7 million deal with an Asian government organization. This is in fact a military branch, setting up a next-generation network, and therefore, require very high degree of guaranteed availability, quality of service, adaptability and security. As a result, they're purchasing appliances and subscription services for both application availability and perimeter security from Radware. This will help guarantee the connectivity of multiple bases and administration territories.

We continue to invest in our cloud and security portfolio. In the first quarter, we announced 2 new solutions. The first is Active Attackers Feed, which is a new subscription service that identifies and blocks known attackers even before they attempted to attack. Based on intelligence from our cloud security services and our Deception Network, a global network of honeypots, as well as the analysis of our Emergency Response Team, an intelligence feed of bad actors is generated and then updated to our cloud and on-prem attack mitigation solutions.

The second new solution is Cloud Malware Protection, which can now detect malware infection attempt even before the malware becomes active and includes mitigation capabilities. This solution recently won a Fortress Cyber Security Award and is gaining strong customer traction. We categorized both new solutions as part of the big data and machine-learning plane, which is one of our 4-plane solution strategy.

We are consistently executing on our go-to-market strategy and are fully committed to increase our market reach and footprint. In the first quarter, our relationship with Cisco continue to develop and contribution has grown from previous quarters. We are pleased with the pace of the ramp up and believe we will see sequential growth in the second quarter and throughout 2018 in Cisco bookings.

In summary, we are very pleased with our results for the first quarter. We delivered strong bookings and growth in revenues, profitability and total deferred revenues. From a product portfolio perspective, our competitive advantage is significant and multi-dimensional, including unique behavioral-based detection, automatic mitigation, strong integration between security layers and very high performance. In an ever-evolving threat landscape, we continue to provide our customers with a comprehensive data center attack mitigation solution and to expand our cloud and security solutions. At the same time, our market reach is our top priority and we are committed to tight management and field execution. We expect our clear vision and strategy to enable us to enjoy the cloud and data center security industry growth and deliver long-term growth and profitability.

I will now open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first questions comes from Ittai Kidron from Oppenheimer.

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

Roy, I wanted to get into Asia a little bit. I mean, the quarter itself was not good, but clearly, you had a good big win there. I'm just trying to understand, as you look at that region going forward, outside of that deal, is there broad-based improvement? Or the region by itself outside of this deal is still not recovering? And this is an area we tried to recover for quite some time now.

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

I think the region is improving. Year over year we went down in revenues, but if you see the result itself versus, say, some of the previous quarters, it was actually one of the highest. And then, you're not taking into account that probably the large deal is not even in the revenue recognition side. So I think we are doing quite well. And we're seeing good signs of recovery. I mentioned in my notes, we're seeing an uptick in cloud activity and cloud security activity, which plays very well to our strength. So we are optimistic about APAC execution for this year.

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

Got it. And then, follow-up for Doron on the revenue. Just trying to reconcile your revenue growth for '18, your deferred, especially your short-term deferred growth, which, I think, for a third quarter in a row, is about 30% plus, minus. Can you help me kind of fill in the gap here, like how bad is your ADC business? Is that still declining? Flattish? How do I think about that business? And is there any opportunity there? Are you, at this point, it's just kind of being managed for cash. How do I think about it?

Doron Abramovitch - *Radware Ltd. - CFO*

Okay. So let me lead this answer. I would take some of the deferred revenues trends and then Roy will add some color on the business side and also on the ADC question. So we had a 15% year-over-year total deferred revenues growth, which is higher than the 11% growth in revenues, and therefore, exactly in line with our model that calls for this type of relationship. This is what our future growth is based on. As for the comparison to a previous quarter, so first, recall that in total deferred revenues, it doesn't reflect the full bookings, and I mentioned it in my prepared remarks that, as an example, at the end of the quarter, there are some deals that were not yet invoiced and, therefore, not part of this balance. The deal that Roy mentioned - the Asian deal, as an example, is one of them. In addition, cloud and subscription that are billed monthly or quarterly are not part of this balance, the total deferred. And as we said, that this part of the business is growing, and by nature, there is a part that it's not part of the deferred. And third, the book-to-bill ratio, as mentioned, was significantly larger than 1. So you can assume that if we are comparing to a Q4 '17 and the total deferred revenue didn't grow much, all goes to the backlog, which is growing in a way, it's the highest level ever. And last, I still recommend to view the trend of our total deferred revenues compared to previous year. This is the right way to view the health of our business. And as said, and I reiterate it, it was a very good quarter, the first quarter, in terms of growth compared to last year, 15%. And as I mentioned, our total deferred revenue in 2018 will grow in a faster pace than our revenue.

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

Okay. Regarding ADC, well, we don't share your view that the ADC market is in a bad shape at all. Actually, we also outlined that in the analyst meeting. We pivoted the ADC business around security for applications like protection against encrypted attacks, inspecting encrypted traffic, detect malware as well as for private and hybrid cloud environment. We're seeing now very good traction and business. And we're very satisfied with the performance of the ADC in Q1. So definitely, we're seeing there an opportunity. And as I mentioned, for example, when I talked about the large deals, customers see that as one integrated application infrastructure for availability and security. It allows us to take very large deals end to end.

Operator

Your next question comes from Joseph Wolf from Barclays.

Peter A. Zdebski - *Barclays Bank PLC, Research Division - Research Analyst*

This is Peter Zdebski on for Joseph Wolf. Could you give us a sense of how competitive the WAF, the Web Application Firewall offering from AWS' and compare that to the Radware offering?

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

I think the AWS also is mainly based on an open source with some static rules. I think it's very static in nature. Doesn't have all the advanced capabilities or the behavioral learning or the algorithm and so on. So I think it's a basic offering. We don't see that, at least today, maybe they will improve in the future significantly. But at least today, it does not provide a similar level of security to what our customers, the customer segment we are approaching, are looking for.

Peter A. Zdebski - *Barclays Bank PLC, Research Division - Research Analyst*

That's helpful. And then, following up on the revenue trend. How much of the incremental $6 million in the U.S. sales in the first quarter of '18 versus '17 came from subscriptions that were already in the backlog or the deferred? If you can quantify that?

Doron Abramovitch - *Radware Ltd. - CFO*

We do not disclose the subscription yet. I mentioned that there was a subscription there. Revenue grew significantly this quarter but it's not something we disclose. You can take the number of the total deferred revenues and see that the trend continue to be something like 60% to 65% of the total deferred, which is the majority of the growth year-over-year comes from the subscription, and you can assume that we continue to grow, but beside it, we don't break it for now.

Peter A. Zdebski - *Barclays Bank PLC, Research Division - Research Analyst*

That's very helpful. And just finally, could you talk a little bit about subscription trends in Europe? And I know you don't break that out on a quantitative level, but maybe just qualitatively?

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

Yes. I think, in subscription, we have 3 main streams of subscriptions. The first is all our cloud subscriptions. The second is product-attached subscription, meaning subscription we sell on top of an appliance or a virtual appliance that is being installed at the customer premise or data center, wherever it is. And the third is subscription to our professional -- some of our professional services offerings that are, for example, a fully managed solution and so on. We are seeing in EMEA very strong traction similar to what I mentioned previously on the U.S. going in strong into security and cloud. Starting last year, we're seeing very strong trends in EMEA as well. Definitely on cloud. We're seeing major opportunities and major wins in the theater as our bookings are growing significantly. We are -- also, product subscriptions are growing hand in hand. And we were able, in the past year and also in Q1, to increase the level of penetration of profile -- professional services subscription. So across the board, I think, EMEA is executing well and subscription is a core part that drives it.

Operator

Your next question comes from Zach Turcotte from Dougherty.

Zach Turcotte - *Dougherty & Co. - Analyst*

Zach Turcotte on for Catharine Trebnick here. First, just on the Cisco relationship, I was wondering if you have any detail on the attach rates of that and if it's included in the guidance as well as any contribution in the quarter from your relationships with Nokia and Check Point?

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

Okay. So we don't have the information from Cisco on attach rate. However, we are seeing a significant growth in activity in the field and, as I've mentioned, an increase in contribution and we focused also in risk contribution throughout the year. And it's definitely becoming a very, very large and significant opportunity and activity for us. In terms of Nokia and Check Point, in Check Point, we did not have a very strong quarter in Q1. We hope that it will be compensated in Q2. And Nokia continues in a very strong path of engagement in carrier projects throughout the world. And this relationship is continuing to be very, very positive.

Zach Turcotte - *Dougherty & Co. - Analyst*

Got it. And the other thing is the 7-figure deal with the Asian government branch. I was wondering if you could give any more detail on that as far as which country it was in? Were they an existing customer? And who you competed against?

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

Yes. We cannot disclose the country. But it was a new customer for us. And given the size of the opportunity, you can assume that all our competitors in the ADC market and in the security market were targeting the deal as well. It's obviously a large public tender and that is going on for quite some time. But I think, based on our technology, the integrated offering, the sales execution, we were able to win.

Operator

Your next question comes from Michael Kim from Imperial Capital.

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

Just following up on the geographic differences and going back to EMEA. With the growth in the cloud and subscription part of the business, what's the divergence with the Americas region? Is there more aggressive mix shift? Is there macro headwinds on demand? Or any commentary you can provide on difference between the growth you're seeing in EMEA versus Americas?

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

I think, I want to remind everyone that given our model we are booking, that some of the -- as Doron mentioned, some of the translation to revenues takes a bit time. I think I got similar questions a year ago on the enterprise declining, and we kept on saying, no, enterprise is doing well. Just wait, it will make itself into the P&L. I'm telling you the same on EMEA. EMEA is doing well. It's doing better than what you're seeing in the revenues. But it's deferred, given the subscription strength and so on. It will come into the P&L, as Doron mentioned, for the most part, during the next 12 months. So I will be -- I'm bullish on EMEA. I think it's a region where we're taking a lot of share. And we're seeing some of the fruits of the early investment in cloud security there.

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

Got it. And then, just jumping over to the enterprise carrier mix. I guess, when we think about the growth in enterprise and that's had nice improvement over the last couple of quarters, I was surprised to see carrier actually down slightly. Is that also a function of mix? And what's the dynamics happening in the carrier market, from your perspective?

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

I think it's predominantly timing and some orders were booked and didn't make themselves into the revenues. The trends there are very strong. We continue to take a lot of share in cyber security in the carrier market. It's been a trend over the -- more than a year now. And we believe that from -- as was mentioned in the analyst day or in one of the conferences, from being a 3 out of 10 carriers maybe 2.5 years ago, 3 years ago, the top 10. Now we're 10 out of the top 10. And we continue to earn share in those top accounts while landing additional accounts. So we see carriers and service providers as a top opportunity. They need to protect their own data centers, they need to protect their own network, and they're starting to play or they're ambitious -- ambition to play a growing role in providing security services to their large enterprises. Across all those 3 opportunities in security, I think, we are the best solution out there. I think it's proven by our Nokia and other OEM relationships. And I think it's also proven by our continued penetration and success there. Yes, revenue for this quarter year-over-year went down. But again, we're very -- we have very strong confidence in our execution there.

Operator

And your next question comes from Alex Henderson from Needham.

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

So I wanted to ask a question on the adjustment to the balance sheet deferred revenues. Clearly, you brought down the unbilled or -- the billed, but not in -- on the balance sheet, not paid piece quite sharply. Does that have any reflection into your seasonal -- in the linearity during the quarter? Is that a function of -- any change in the way the demand came in during the quarter? Or is that a function of last quarter -- last 2 quarters? How do I think about that decline in that line item?

Doron Abramovitch - *Radware Ltd. - CFO*

All right. We try to talk only about the total deferred revenues, which takes into account also the uncollected amounts in order to flatten a bit some of the collections timing issues. And this is why we are referring, this quarter as an example, to the 148 compared to the 128 last year. So basically, the changes that you see in the balance sheet, in a way, sometimes, a bit mislead, it's just a matter of timing of collection that takes the number in the balance sheet up and down. And this is what we try to avoid. And I think that this quarter, which we talked about also to reveal total the deferred revenue in order to avoid such a misread between quarters, et cetera. So again, I would recommend to review mainly, and internally, we look on the total deferred revenues rather than the deferred revenue that are part of the balance sheet.

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

I understand and I totally agree with that line of logic. I just wanted to make sure that there wasn't a change in linearity during the quarter as a result, showing up in that line item with that decline, which is a pretty big break from prior quarters?

Doron Abramovitch - *Radware Ltd. - CFO*

No. It's not. There's no trend on this one...

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

It's shows seasonality of the timing then.

Doron Abramovitch - *Radware Ltd. - CFO*

Timing and then sometimes collection that is good or bad in this quarter. By the way, this quarter was a very good one, so you see that uncollected amount is less than the previous quarter. But it's -- no real evidence for something that -- again, look at 1 48. It's more than good enough.

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

Okay. Good enough. Second question I had for you was, talking to the boys over at F5, they've really shifted pretty aggressively to vADCs and pushing more into the cloud. That's been something where you guys had a huge competitive lead against them on application isolation and the like. Are you seeing any change in behavior there that's impacting your business at all? Or is that just simply not the focus anymore as a result of the shift to SaaS and to security, which is so much more articulated in your model than theirs?

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

Yes. So I think it's -- as I said, it's twofold. Number one, I think our business in security is very, very significant today and, as a result our competition with F5, hs lessened. As it related to the ADC, you're right, we have a strong lead there. I think they're trying to make inroads into a vADC per app and all kinds of different models. We think it's actually positive for us because if they would start promoting these models to the customers, I think, more customers will be more open also for our solution. So we see that as a positive. However, at the market itself, we didn't see yet a strong evidence of that push. I think it's early. And I give F5 the credit that we will start seeing it in the coming quarters, but I think we're very well-positioned on that. And as I said, Q1 was a very good quarter for our ADC business as well.

Operator

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

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

Okay. Thank you, very much, everyone, and have a great day.

Operator

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

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