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PRESENTATION

Operator

Welcome to the Radware Conference Call discussing First Quarter 2021 Results (Operator Instructions)

As a reminder, this conference is being recorded, May 5, 2021.

I would now like to turn the call over to Yisca Erez, Director, Investor Relations at Radware. Please go ahead.

Yisca Erez

Thank you, Amitris. Good morning, everyone, and welcome to Radware's First Quarter 2021 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 forecast and estimates.

Factors that could cause or contribute to such differences include, but are not limited to, impact from the COVID-19 pandemic, general business conditions and our ability to address changes in our industry, changes in demand for products, the timing in the amount of orders and other risk details from time to time in Radware's filings.

We refer you to the documents that the company files and finishes from time to time with the SEC, specifically the company's last annual report on 20-F as filed on April 20, 2021. We undertake no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date of the such statement is made.

I will now turn the call to Roy Zisapel.

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

Thank you, Yisca. And thank you all for joining us today. We are pleased to report a strong first quarter, driven by solid performance across our business and specifically our growing cloud business and robust markets. This quarter is testimony to our strategy being firmly in place and working across all fronts. We continue to execute well on our growth drivers. Our cloud and subscription business continues to grow, as more customers choose our cloud offerings.

This is reflected in our total ARR, which reached yet another record of $176 million. Our successful OEM and GSI partnerships continue to expand our footprint, capturing new opportunities and bringing new customers on board, and our financial results were strong right across the board.

In the first quarter of 2021, we reported an increase of 11% in total revenues to $67 million and improved profitability, led to a 22% increase in non-GAAP earnings per share to $0.17.

In recent years, we have witnessed a couple of transformations that have accelerated in the past year. First, the acceleration in digital transformation as more and more transactions move online and, in many cases, to the public cloud. More assets and transactions online create more targets for attackers, which makes cybersecurity even more critical.

Second, last year, due to the lockdown, organizations were forced to rapidly move their employees to work from home. The new reality of hybrid workforce creates an increase in attack surface with millions of new entry points, which has led to an all-time high level of cyber activity. The outcome of these 2 forces is that organizations are experiencing more attacks in their network and in applications, both in terms of increased volumes and increased complexity.

In the first quarter of 2021, the number of DDoS attacks mitigated in our scrubbing centers was 2.5x higher than in Q1 2020. The total number of web application attacks we blocked in the first quarter of 2021 almost tripled. And the number of bad bot requests we detected increased more than 80% compared to Q1 2020.

It is clear now, more than ever, that our solutions are mission-critical and essential for the operation of organizations. This is evident in the deals we closed in the first quarter. We signed a large deal with multinational pharmaceutical and consumer goods corporation. Their previous vendor solution failed to mitigate a large attack. Through Cisco, we expeditiously upgraded them from on-demand to always-on cloud DDoS protection worldwide and replace the primary protection from their ISP to ensure business continuity and better ongoing protection.

Another example I'd like to share is a deal with a large bank in EMEA, which was looking for strong cybersecurity solutions to protect its digital channels. They needed a robust and broad cybersecurity suite, and they chose to invest in Radware's web application firewall, bot manager and analytics amongst other solutions.

Digital transformation and specifically the transition of organizations to the cloud, which accelerated in the past year creates vast opportunities for us. Our cloud business continued to grow as more and more organizations adopt our offering, which is reflected in the continued growth of our ARR. This ARR growth was driven mainly from cloud and subscription ARR, which increased 27% in the first quarter of 2021 compared to last year.

Let me share a few more examples. We signed a cloud deal with one of the largest insurance companies in Europe. The customer expanded its relationship with us, adding cloud DDoS protection to all its sites. Another deal is with a leading stock exchange, which upgraded its hybrid cloud solution to always-on-cloud deals.

Our technology is a key factor in the buying decisions of organizations. Organizations realize that in light of the increasing attacks, the criticality and the complexity of security, and to ensure continuity of operations, they must have superior protection. The breadth and the depth of our attack mitigation portfolio from DDoS, web application firewall, bot manager and API to cloud workload protection, and our superior technology plays a pivotal role in the decision of customers to choose our solutions again and again.

This is illustrated through existing customers, continuing to expand the relationship with us and the increased deal value. In the past quarter, we signed a very large deal with a large cloud provider. We extended its relationship with us and is planning to buy additional solutions in the near future. We also signed a deal with a large airline company that was looking for superior security performance and upgraded our bot manager service to protect more of their production domains.

Our strength in technology has also received recognition from industry analysts. We were named the leader in Forrester 2021 DDoS Mitigation Solution Report. In this report, we achieved the highest possible score in 18 different assessment categories, the most among any of the vendors listed in the report. Forrester positioned us as the vendor with the strongest current offering, saying "Radware knows DDoS attacks better than anyone."

In addition, Radware was recognized as the customer choice in the 2021 Gartner Peer Insight Web Application Firewall Report. Radware has an overall rating of 4.7 out of 5 in the Web Application Firewall market, which is based on product capabilities, integration and deployment criteria, among others.

Our performance and the addition of new customers is also being driven by successful relationships with our OEMs and GSIs. We signed significant deals, some with new customers, including with one of the largest public health care systems in the U.S., one with a large health service organization in Europe, one with the PAN European telecom group, to name but a few. We continue to invest in these strategic relationships, and we believe this journey is only at the beginning.

In summary, we are very pleased to start the year on a high note, and we continue to focus on executing our strategy, expanding our cloud business, delivering innovative offerings and building strong relationships with our partners. We have the right assets in place, and we're excited to capitalize on many opportunities ahead of us.

Before I turn the call over to Doron, as most of you know, we announced that Doron will be leaving us next month. On behalf of myself and the entire company, I want to thank Doron for his dedication and support during his 6 years at Radware. As CFO and a valued member of our management team, he contributed to the success of our business. I wish him all the best for the future.

I will now turn the call over to Doron.

Doron Abramovitch - *Radware Ltd. - CFO*

Thank you, Roy, and good day, everyone. I'm pleased to provide the analysis of our financial results and business performance for the first quarter as well as our outlook for the second quarter of 2021. We had an excellent quarter with both the top and bottom line results exceeding our expectations. First quarter 2021 revenues were $67 million, representing an increase of 11% year-over-year. Total revenues were driven by our cloud business performance as reflected in the total ARR, which normalizes timing differences in bookings, invoicing and revenue recognition and reached a record of $176 million in Q1 2021. This record result is an increase of 10% compared to Q1 2020, driven by 27% growth in our cloud and subscription ARR.

Recurring revenues accounted for 66% of total revenues compared to 65% in the same period last year. We continue to focus on our cloud business and expect to see further growth, over time.

Looking at geographies, Americas and EMEA were very strong with 15% and 16% growth, respectively.

Americas revenues accounted for 50% of total revenue, EMEA revenues accounted for 32% of total revenue and Asia Pacific revenues accounted for 18% of the first quarter's revenues.

I will now discuss expenses and profit all in non-GAAP terms. The differences between the GAAP and non-GAAP results for the quarter are detailed in our press release.

Gross margin for the first quarter of 2021 reached 82.4% compared to 83.1% last year. Our gross margin can fluctuate from quarter-to-quarter, as a result of product and geographic mix. We have been successful in maintaining high gross margins over the past few years, and we expect to continue doing so.

Operating expenses in Q1 were $47.5 million, up 6% from Q1 last year. The increase is a result of higher headcount costs, including higher commissions, offset predominantly by lower travel expenses. Excluding FX impact, operating expenses would have been $1.6 million lower.

Operating income increased 55% to $7.5 million, demonstrating the good leverage in our model. Operating margin in Q1 2021 expanded by 320 basis points to 11.2% compared to last year.

Financial income was $1.9 million compared to $2.7 million in Q1 last year. As we highlighted in previous quarters, the financial income is impacted by the declining yield on marketable securities.

Tax rate for the quarter was 14.9% compared to 11.3% in Q1 2020. The expected tax rate for 2021 is approximately 15%.

Earnings per diluted share for the first quarter of 2021 was 17 cents, an increase of 22% compared to last year.

Turning to the balance sheet and cash flow items. Cash flow from operations in Q1 2021 was $16 million, and cash flow from operations in last 12 months was $59 million.

During the first quarter, we used $30 million to repurchase 1,130,000 of our ordinary shares.

Total cash and financial investment at the end of March 2021 were $435 million. Most of our cash is invested in highly liquid U.S. dollar marketable securities and deposits.

As of the end of the first quarter 2021, nearly $50 million remain available under our repurchase plan that was announced last quarter and will continue until the end of 2021.

I will conclude my remarks with guidance for the second quarter of 2021. We expect Q2 total revenues to be between $65 million and $66.5 million. We expect the continued strength of the Israeli shekel to cause year-over-year increase in our dollar operating expenses throughout 2021 and the magnitude of this impact to be higher than in 2020. We expect our operating expenses to be between $47.5 million and $49 million. This operating expenses level reflects an estimated $1.3 million negative impact from FX compared to Q2 2020 rates.

With that, Q2 2021 diluted earnings per share is expected to be between $0.15 and $0.16. If we kept exchange rate flat at Q2 2020 level, our forecast for operating expenses in 2021 would have been approximately $46.2 million to $47.7 million and expected earnings per share would have been higher by approximately $0.03.

Before I open the call for Q&A, I would like to say that I'm proud to have been a part of the company's achievements during the past 6 years. I would like to thank the investors and analysts for your support. It was a real pleasure working with you during the time here at Radware.

I will now open the call for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of George Notter with Jefferies.

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

Doron, best wishes to you in your next adventure. It's been great working with you. I guess, maybe the question that's topical. I think through earnings season here is just component availability and supply chain impacts. And I get it, declining component of your business is coming from hardware these days. But can you maybe talk about what you're seeing on the supply chain impact on revenue, impact on margins? Yes, I noticed your inventory was down sequentially. So any more flavor you can give us there would be great.

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

Yes. We're obviously seeing the pressures that everyone else is seeing. We're trying, obviously, to accommodate it with longer commitments. And obviously, we're seeing also increased prices. But all in all, at least for the second quarter, we don't see a material impact from that.

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

Got it. Okay. And then, I guess, I also wanted to ask about capital allocation. You guys are obviously buying back a fair amount of stock here in Q1. And I know there's been some talks historically about you guys looking at acquiring businesses and businesses that are more developed. But can you talk about where you stand right now on capital allocation? What's the thought process on repurchase versus M&A versus other opportunities you have?

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

Yes. So we continue to be active looking for companies. Obviously, some of the valuation metrics in today's market might be a bit challenging for us. But we constantly look and this continues to be the prime use of cash that we intend to. In the meantime, as we've announced in the -- previously, for this year, we have an $80 million buyback plan, which we executed $30 million already in the first quarter, and we have another $50 million. So all in all, in our side or in parallel to us looking for acquisitions, we are actively buying back our shares.

Operator

Your next question comes from the line of Tavy Rosner with Barclays.

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

This is Peter Zdebski on for Tavy. Congratulations on the quarter and the solid results. I wanted to dig into the customer verticals a little. The sequential decline in carrier was a little surprising, since we've seen some improving trends in spending in that market, overall. Could you discuss some of the drivers there? And maybe your thoughts on next quarter?

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

Yes. So at a high level, our business is more focused towards enterprises and the cloud subscription and the product subscription are generally consumed by enterprise customers. So over the long term, we believe, and we've seen it also in previous results that enterprise -- our enterprise business or that portion of the business will provide the higher growth rate. In carriers, in general, we continue to play in the network. There are opportunities looming with 5G, and we are tracking them. But all in all, our company is highly focused on enterprise, cloud security.

Operator

Next question comes from the line of Tim Horan with Oppenheimer.

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

Can you talk a little bit about the competitive intensity and what you're seeing particularly from the cloud service providers or the larger cloud service providers and some of the new CDNs, how do you kind of compare and contrast? And how do you win business versus them?

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

Yes. So the public cloud providers, a lot of our offerings, they are also targeting companies that are actually putting their infrastructure in the public cloud. So for example, if you look on our cloud-native protector, that's exactly what it does. It protects customers' infrastructure within AWS or Azure cloud, and we see the need to protect better cloud infrastructure as one of the core drivers for future growth of the company.

What we provide there is a comprehensive and across all cloud, a multi-cloud comprehensive security with state of the art capabilities. We believe that security, especially for our target customers in the finance, technology, online, larger enterprise segments is paramount, and they would not compromise on the level of security.

And hence, the ability to really protect end-to-end. Their on-prem data centers, their cloud data centers, hybrid, public, private, whatever form their application residing and to do it across multi-cloud is a very, very strong competitive advantage that none of the public cloud providers can offer. Regarding the CDNs, I put Akamai aside on that. The other types of CDN, I would say, are less competitive as it relates to security per se. They are selling some security capabilities as add-ons to their CDNs. By the way, some of them resell our cloud solutions as add-ons under CDNs, but I would say we see them less in the highly -- in the large enterprise and financial markets in the world as direct competitors to us.

Operator

Your next question comes from the line of Andrew King with Colliers Securities.

Andrew King

So obviously, you guys did really well with the OEM, but can you just give us a little bit more color into the Checkpoint and Nokia OEM partnerships, specifically, I know they're a little less mature than Cisco, but any color there would be great.

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

We don't break specific OEMs, but all in all, I think all of them are providing with us wins and so on. In my script, when I gave the examples, those are examples that are spread across all our OEM partners. So all are contributing in different geographies, in different segments. Obviously, Nokia is helping us much more in carriers. Cisco might be across. Check Point is more enterprise focused, but all of them are contributing. And I think one of the key points is their contribution to new customer acquisition. So we are really able to see very good results in leveraging their incumbency in customers to generate new logos for us. And that's been very successful, and we're planning to increase it further.

Operator

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

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

Just wanted to get a couple of details, first, for as question. Can you talk about the tax rate? It was 14.9%, I think you've been guiding to 14.5%. Should we be using 14.9% going forward? And similarly, on the interest line, do you expect it to decline sequentially as the interest rate on cash balances continues to decline over time. Just a couple of mechanics. And then I didn't catch our head count as well.

Doron Abramovitch - *Radware Ltd. - CFO*

Yes. So I said, in 2020, the effective tax rate that we take into consideration is approximately 15%, which represent the tax regime that we have. Last year, there was some tax relief in the U.S. that this year is not. So overall, 15% is the ETR that we take for Q2, similar to Q1 and for full 2021.

As for the interest, yes, the answer is yes. Unfortunately, the yields are declining. So I believe that, right now, the level of $2 million, and assuming that we will continue to generate cash, maybe a bit more. But overall, this is the -- with the interest rate that we see right now, it's less than last year. Last year, it was 2.7 million This year, 1.9 million. So overall, full 2021 will be less than 2020.

And as for the headcount. So we ended Q1 with approximately 1,100 employees, similar to last quarter. And similar to last year in a way. So overall, this is the level of employees that we right now have.

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

I see. I wanted to ask a question on the operational side. When we look at the results of F5. The company stated that they were quite surprised at a substantial increase in appliance ADC sale. So which vaulted to meet teen double digits.

And they indicated that, that reflected a sort of snapback in demand there because traffic growth and application adoption had driven up processor utilization rates, which was a little bit counterintuitive. We had expected digital transformations to be driving more stuff towards the cloud.

But nonetheless, the point is that ADC business, appliance business was much stronger than expected. Can you talk about whether you saw a similar dynamic where the underspend in ADCs over the last year because of COVID has now caused a pickup there? Or is this more on the software side and you're not seeing that dynamic?

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

Yes. We're seeing our customers transforming to -- transiting to the cloud. More and more, and we're seeing the plans on the on-prem, even if certain applications are definitely growing in capacity and usage, the total on-prem capacity is not, at least in our customers, is not seeing a dramatic increase.

Furthermore, when I looked on other ADC vendors in the market like Citrix and A10, I didn't see in the reports similar indications. So I believe the transition to the cloud is happening. We were up on ADC. We had solid business there, but in line, I would say, with our guide and expectations, we didn't see this pent-up demand coming to the ADC on-prem market. So what we are seeing is more applications moving to the cloud, more customers requiring more capacity and protecting more applications with cloud services, and that's where we're seeing the bandwidth upgrades and the number of application upgrades.

Together with that, we're also seeing increase in the size of attacks. So we're seeing larger and larger attacks, which also, of course, increasing the demand. And by the way, forcing many of the enterprise to go into cloud solutions because they cannot handle with their bandwidth, there's just no way, unless they want to buy 10x or 20x the bandwidth they have today, they cannot cope with it in their own data centers. So we're clearly seeing a continuous strong move to the cloud.

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

That's very helpful. Just if I could, on the cost side of the equation, flat headcount sequentially. The shekel impact increasing. Can you talk a little bit about whether you think your OpEx will continue to increase over the course of the year, based on the shekel or whether your hiring changes are going to accelerate? And to what extent that reflects back into the mix. If there's a delta between, say, sales and marketing and R&D?

Doron Abramovitch - *Radware Ltd. - CFO*

Yes. So I would take the financial part and leave Roy some -- to answer some of the strategic recruitment that we plan to do in in the next few quarters.

But as for the numbers, so we took into consideration in second quarter, the impact, of course, of the Shekel, I mentioned something like $1.3 million versus the 2020 rates. Although, the headcount is relatively flat, we do see some increase, obviously. And the good part is mainly because of commissions that we pay due to the increased performance and stuff like this.

Together with some offset because of the COVID-19 impact on travel, et cetera. So you see that we guided the first quarter approximately $47.5 million to $49 million, same guidance for second quarter. We are in this range, and again, mainly because of the FX.

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

Yes, Doron, I got the second quarter guide. The question really is, as the year progresses, do you expect the currency impact to increase into the back half? Or do you expect it to stay flat at the current levels? Should we be anticipating further increases, given the flat hiring and the currency should -- will the OpEx continue to increase as we go into the back half of the year based on where we are on the shekel?

Doron Abramovitch - *Radware Ltd. - CFO*

Yes. So again, I mentioned it last quarter, and I will reiterate, we are -- estimation about the Israeli Shekel is continued to be strong in 2021. So give or take, $1.3 million this quarter, same as previous quarter. I assume that next quarters will be the same impact per quarter. I think that we mentioned last quarter, $0.10 to $0.12 impact because of the FX. It will continue unless something happened in this area, FX will continue to impact.

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

And as it relates to hiring, Alex, we were planning to increase hiring and in the following areas. First in field, in sales and system engineering. We see a lot of opportunities, demand there. And in cloud operations and in cloud R&D. So cloud security, coupled with increased go-to-market capabilities are the prime areas where we are planning to increase headcount. And with that obviously the OpEx will also increase regardless of the currency exchange rate.

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

Doron, I just want to say thanks for a great run at Radware and I hope to hear from you when you get -- when you land to the next shop. We will miss you. You were certainly a key piece of the puzzle here.

Doron Abramovitch - *Radware Ltd. - CFO*

Thank you, Alex.

Operator

Your next question comes from the line of Joshua Tilton with Berenberg Capital Markets.

Unidentified Analyst

This is Drew Smith on for Josh. Can you comment on the strength in bookings in Q1? And has there been any meaningful change in the performance of the business going into Q2? And would it be possible to comment just a little bit more on which products are specifically fueling the growth?

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

Yes. So in general, the growth is led by security, by our security business, and specifically, the cloud and subscription offerings there. I think it's across all our cloud security offerings, almost A to Z. Going into Q2, it's reflected in the guidance. We believe we've provided a strong guidance. We feel good about the business. We feel good on how we open the year. So we try to reflect that in our guidance.

Operator

At this time, there are no further questions. I would like to turn the call back over to management.

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

Okay. Thank you all for joining us today, and have a great day. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
