

THOMSON REUTERS STRETEVENTS

EDITED TRANSCRIPT

RDWR - Q2 2019 Radware Ltd Earnings Call

EVENT DATE/TIME: JULY 31, 2019 / 12:30PM GMT



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

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*

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

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

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

PRESENTATION

Operator

Good morning. My name is Sharon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Radware Q2 2019 Earnings Conference Call. (Operator Instructions) Thank you.

Ms. Anat Earon-Heilborn, VP, Investor Relations, you may begin your conference.

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

Thank you, Sharon. Good morning, everyone, and welcome to Radware's Second 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 second quarter are available in the Investor Relations section of our website.

During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. 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 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 or furnishes from time to time with the SEC, specifically the company's last annual report on Form 20-F as filed on April 15, 2019. We undertake no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date that any such statement is made.

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

Doron Abramovitch - *Radware Ltd. - CFO*

Thank you, Anat. Good morning or good afternoon, everyone. I'm pleased to provide a review and analysis of our second quarter results.

The quarter reflects solid execution on our strategy, and the results met or exceeded our guidance for revenues as well as gross, operating and net profits. Revenues for the second quarter were \$60.5 million, up 6% year-over-year. Revenues for the first half of 2019 were \$122 million, growing 9% over the first half of 2018.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

Revenues from the Americas represented 46% of total Q2 '19 revenues and increased 16% from Q2 2018. Revenues from EMEA decreased 15% from Q2 last year and represented 28% of total revenues. And revenues from Asia Pacific grew 17% from Q2 last year and represented 26% of the total.

The geographic mix of revenue was strongly affected by the dynamics of revenue recognition. The Q2 revenues reflect, with some delay, the bookings trends we talked about in previous quarters, meaning the transition into subscription in the Americas and the softness in EMEA we referred to in our Q1 call.

For the last 12-month period, Americas revenues increased 3% from the previous 12-month period, EMEA revenues increased 19% and Asia Pacific revenue increased 10%.

I will discuss now 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 second quarter grew to 83.2% from 82.4% in Q2 last year, benefiting from higher proportion of subscription revenues. The transition to subscription-based business model has a positive impact on our gross margin due to the high gross margin associated with software subscription and as the capacity utilization of the cloud scrubbing centers increases. Of course, product and geographic mix in a specific quarter can cause some fluctuations around this trend. For the first half of the year, gross margin was 83% compared with 82.4% in the first half of 2018.

Operating expenses were \$43.1 million compared with \$43.3 million in Q2 last year and at the low end of our guidance. Our head count at the end of the quarter increased to 1,058 employees, in line with our plan to increase our sales force and support staff in order to support our growth. We maintain a balanced approach between investing in the business and accelerating hiring in key positions and controlling expenses in order to deliver operating leverage.

Our operating margin in Q2 2019 was approximately 12%, up from 7% in Q2 2018. Our tax rate was 10% compared with 12.8% in the second half -- in the second quarter last year.

Q2 net income was \$8.9 million or \$0.18 per share diluted, up from \$5 million and \$0.10 per share diluted in Q2 last year. This quarter includes the full effect of the recent acquisition of ShieldSquare, which was approximately \$0.02 dilution and a bit better than our expectations.

Turning to balance sheet and cash flow. We ended the quarter with a total deferred revenue balance of approximately \$172 million, up 12% from June 2018. In the coming 12 months, we expect to recognize as revenues approximately \$105 million out of the June total deferred revenues balance, up from \$97 million at the end of Q2 last year, reflecting a stable proportion of 60% to 65% of total deferred revenues scheduled to be recognized as revenues within 12 months.

Operating cash flow in the quarter was \$5.1 million and led to first half operating cash flow of \$29 million, nearly double from the first half of 2018. We ended the quarter with approximately \$414 million in cash and financial investments.

As for our use of capital, during the quarter, we spent \$10 million on repurchasing approximately 411,000 of our own shares. We therefore have \$30 million remaining on our recently announced share repurchase plan. We believe our balanced capital allocation approach will allow us to continue to invest organically in the business, pursue acquisitions and execute share repurchases.

In summary, we are very pleased with how the business performed in Q2, and we remain confident in our ability to execute on our plans for the long term. Accordingly, looking ahead to the third quarter, we are expecting another solid quarter.

I will now turn to the specifics of our outlook for the third quarter of 2019. We expect Q3 revenues to be between [\$62 million] (corrected by company after the call) and \$64 million, non-GAAP gross margin to be approximately 83% and non-GAAP operating expenses to be between \$44 million and \$46 million. We expect tax rate to be approximately 10%. Non-GAAP EPS for Q3 is therefore expected to be between \$0.16 and \$0.18.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

I will now turn the call over to Roy.

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

Okay. Thank you, Doron. We are pleased to report solid second quarter results with robust business activity and consistent progress in our strategic initiatives. With first half of '19 revenue growth of 9% year-over-year, coupled with our guidance for Q3, we are confident that we will meet our full year targets.

Today, we are offering the widest and strongest protection against data center attacks spanning DDoS protection, web security, anti-bot, anti-scanning, encrypted traffic security and workload protection. We eliminate for our customers the trade-off between choosing a set of best-of-breed tools versus going with an integrated platform for data center security. We are considered by third-party analysts a leader in many of the individual components such as DDoS, anti-bot, ADC, SSL, et cetera, thus providing the strength of best-of-breed security with the operational ease and advantageous economics of an integrated platform.

On the financial side, this trend translates into very rapid growth of our subscription and cloud services, thus providing us with increased visibility and a consistent revenue stream. Based on the first half of 2019 bookings, we are well positioned to meet the goal we shared in the past 2 analyst meetings for subscriptions to exceed 30% of total booking of the company in 2020.

A few weeks ago, we announced a deal that is a good example of the way this broad and integrated offering serves customer needs. We announced a multimillion dollar 3-year expansion deal with an existing world-leading SaaS customer. This customer protects its global data centers and Software-as-a-Service solutions using our hybrid cloud DDoS. The solution is comprised of our DefensePro and Alteon appliances installed across the globe in their data centers, our cloud DDoS service and the fully managed security service by our emergency response team.

Another major win and a new logo for us came from a U.S. commercial airline. They chose Radware cloud WAF and cloud DDoS to protect applications across public cloud and legacy data centers. We see more and more enterprises relying on our cloud security services for protecting the mission-critical applications in a hybrid cloud environment.

We continue to invest in broadening our competitive advantage, specifically in cloud and security capabilities. Last week, we announced an extremely important and unique capability, which is protection from encrypted attacks without the need to decrypt the content. Radware defense SSL solution now includes new behavioral-based algorithms for protecting against SSL traffic. For organizations such as service providers that cannot hold the certificate of their enterprise customers, it's the only way to cope with encrypted attacks on their network. Enterprises and SaaS providers now have the scale needed to effectively mitigate HTTPS floods without adding latency to their application traffic. Customer reaction to this innovation is extremely positive.

Increasing our market footprint is a top strategic priority. We are particularly focused on our third-party reseller arrangements as we believe that they are key to delivering growth that is beyond the reach of our direct sales force and traditional channels. With Cisco, we continue to see progress in our partnership and delivered our strongest booking to date in Q2. We are glad to report that we have seen further ramp-up in July, and we continue to be optimistic about the future of this relationship.

In summary, we are pleased with our second quarter results and with our execution on our strategy. We see many opportunities as the market evolves and the need for our competencies increase. Cloud migration continues to be a major business driver, and Radware is unique in the breadth and strength of its data center attack mitigation capabilities and the ability to protect any infrastructure, be it private, hybrid or public cloud. We have full confidence in our competitive advantage and readiness to capture the market opportunities and deliver long-term growth and profitability.

I will now open the call for Q&A.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have a question from Alex Henderson with Needham & Company.

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

You broke up a little bit when you gave the revenue number. Could you just give me that revenue guide again?

Doron Abramovitch - *Radware Ltd. - CFO*

Yes, Alex. So we expect revenues to be between \$62 million and \$64 million for the third quarter.

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

So I was hoping you could talk a little bit about the Cisco stuff, give us a little bit more granularity. You said it improved. It's not that visible in the numbers to me. So I mean, is it bigger than a breadbox or smaller than a slice?

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

Yes. So as we reported also, I think, a couple of quarters ago, Cisco continues to enhance the product portfolio from Radware that they're offering to their customers as part of the global price list with full measurement on their sales force, and we're starting to see a rise in activity across the world. It's across the complete product line. So they now carry our DDoS software and appliances, our ADCs, our cloud WAF, our cloud DDoS offerings and so on, and we're seeing a mix of deals across the different business problems we solve.

In Q2, it's already started to translate into bookings that were higher than in previous periods. And also, our expectation now for Q3 is for another record booking quarter with Cisco. So all in all, there's a lot of traction in the field. We are seeing deals that we could not have approached before or without Cisco, and some of them, significant ones we've already won. So overall, good progress, and we -- and the team is very optimistic about the future there.

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

On the European side, you had indicated after the first quarter that you saw a real erosion in bookings and that despite a very strong print on the revenues, that you were concerned about the outlook. Obviously, the revenues came in, not surprisingly. Have you seen any meaningful pickup in the bookings in EMEA? And how are we thinking about that as we look out into the back half?

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

Yes. So no, I don't want to go into bookings per quarter, et cetera. But sometimes, even if bookings increased, and they did even significantly, overall, our view of Europe is -- continues to be cautious, especially on Germany and the U.K. So I would separate the specific booking results, which, again, were really good versus our current view for the year that we still see weakness in Europe.

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

One last question, then I'll cede the floor. Can you give us any break between your kind of conventional, traditional business and the security and SaaS-related stuff? Any metrics around the newer portion of the business security versus traditional would be very helpful.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

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

Not any new specifics to share beyond my comments that we see real strength in cloud and product subscriptions and that we are on our -- very strong on our way to -- for the subscription portion to be 30% not only of "new" bookings but of the total bookings of the company. So very strong progress there.

Operator

Next question comes from Ittai Kidron with Oppenheimer.

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

Good quarter. Roy, can you talk about enterprise, which, again, for another quarter, I guess, this time was going flat on a year-over-year basis? Is this just a reflection of the transition to subscription where a lot of that revenue actually is counted as service provider because it goes through third-party service providers? Help me understand the dynamics there.

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

Yes. I think it's a mix. One, in -- overall, in enterprise, the deferral of revenues is higher. And you see, I think, the growth on the total deferred is a result primarily, of course, from our enterprise business and the fact that most of the cloud subscriptions, product subscriptions are going into that segment. So that's obviously one.

Second, I think, last year, we had some very nice growth in the enterprise, and in some regions, we have weakness, as I've mentioned in EMEA, and better execution that we would like to see maybe in the U.S. I would not read too much to it. I think the deferred revenue does show a very strong brand in bookings in the enterprise. Our cloud business and product subscription is in all-time high. So overall, from that perspective, I'm quite satisfied with the performance there. However, I think with leveraging our partners, better execution on our end, there's definitely room for acceleration there.

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

Okay. Then speaking of partners, you mentioned also in your prepared remarks the importance of building third-party kind of reselling motion. Can you give us some more color on how many partners do you have now? How many are critical to your subscription businesses? Any concentrations, regional color? How many -- you've never really given too much color on that front.

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

Yes. So we have multiple sets of channels. We have what we call the traditional channels, the networking and the security VARs. On that, we have definitely over 100 across the globe. And then we have the ones that we are treating more strategically because of their scale and ability to bring us in front of many of the very large enterprise customers and the fact that they carry only us as their solution, unlike a traditional VAR that can carry multiple competing product lines.

So over there in the OEMs, we announced publicly Cisco, Check Point and Nokia. We do have other OEM partners, but they are not -- we cannot share publicly their name. This is a very important, we think, and highly -- high-potential channel for us, and we are seeing many, many large enterprise wins through these channels - predominantly Check Point, Cisco -- are bringing us; and some new carrier opportunities that we are unable to go alone to through Nokia.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

Then there's a set of channels that we treat as the cloud and hosting providers and the global system integrators that adopt our offering as their offering to the customers, as a service to the customers. Also here, we are investing more, and we're seeing good growth. We've seen several Fortune 500 wins in the second quarter through that channel, and we are adding resources also to cover better and leverage the relationships that we have in this segment. So all in all, we're seeing good progress in the strategic channel. We're seeing good revenue and booking growth. But we think we're very early still in the -- if we look versus the potential we have, we're still very early in the cycle.

Operator

Next question comes from George Notter with Jefferies.

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

I guess I was really interested in your comments about Cisco and the bookings improvement there. And I'd love to learn more about that. I certainly heard what you said about more of the products going into the Cisco price list. Does that -- is that the simple reason why the Cisco trend seemed to be inflecting here? Or is there something else going on in terms of training their organization or some of their sales and marketing effort that's getting that business going? So any more color there would be great.

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

I think there's multiple parameters here. So first, if you recall, our initial deal was integrated DDoS software on top of their FirePOWER next-gen firewall. And in those deals, we were limited in the potential to where Cisco sold an NG firewall and when that NG firewall was Internet-facing, where DDoS was a problem. Once the product portfolio was enhanced even in DDoS to cloud DDoS and to apply -- and stand-alone appliances, not to mention the broader portfolio with SSL inspection and WAF and cloud WAF, et cetera, we are now -- we can now cover way more opportunities with the Cisco team. So this is item one, the fact that we are not confined to FirePOWER sales only.

Second, I think it's a time effect. As we are training more, as we are working more, as we're starting to win more, the news are -- is [spreading] (corrected by company after the call). And third, I think given the early wins and those strategic importance, the Cisco sales management for security is acknowledging the value of our relationship and are pushing even further the teams to explore more opportunities.

So I think, again, we're early on, but we've seen very encouraging signs. I think we're seeing very nice wins. And what I'm most interested in, some of these accounts are definitely accounts that we could not touch by our own sales force, so it's completely incremental to our own efforts. And we look forward to provide even better results in the coming quarters here.

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

That's great. And then, I guess I also wanted to go back and, I guess, hear more about your efforts on encrypted traffic. Can you just talk about how SSL capability kind of layers in with the rest of the product portfolio and how you see that in terms of ramping and opportunity for new revenue?

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

Okay. So I think this is a very big problem today in security because more and more of the traffic -- of the network traffic is now encrypted for privacy and other reasons, predominantly through SSL, PLS. When you encrypt the traffic, all your network security devices are blind to the content and cannot detect any attack that is passing through. The only way for you to bring back the power to those different systems is by terminating, by opening the traffic, going -- let all your security tools scan it and try to detect attacks that way.

But that means that you're terminating the encrypted traffic before the endpoint, before your servers. Some customers would like to do it, some would not. But in order to do that, definitely, the customer has to be in control or the one that wants to protect has to have the certificates, the



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

keys for the decryption. Now if you look on a service provider, the traffic flows through their network maybe to the end customer or in transit, they probably would not have the keys or the certificates. And as a result, they are blind to all the encrypted traffic flowing through those systems. So for them to be able to protect against encrypted attacks without opening or without decrypting the content, we think is -- and that's what we hear from them, is a game changer.

On the enterprise side and especially on Software-as-a-Service side, they can theoretically protect against encrypted attacks, especially flood, by building huge capacity of SSL termination. By itself, it's an issue, budget, operational and so on, but it's at least technically possible. But put aside the budget considerations, it adds a lot of latency. You terminate all connections or traffic even when you don't have an attack, and 99.99% of the time, you are not being attacked. So you will hit performance. You will need to put a very, very expensive and slow and limited infrastructure to do that, and your gain is security but it's quite limited.

What we are doing with this new set of algorithms, where we're changing the game, we can detect attacks without terminating. And then we can decide what to do, to block what we see as the attack traffic or to forward that specific portion of the traffic for decryption while all the rest continues to flow. So it changes latency in enterprise. It changes the budget trade-off for security. It improves customer experience and so on. So again, very, very important. We are very, very pleased with the capabilities and what we're seeing already in our cloud, on our cloud DDoS data, our ability to do that, and I think it's a very unique competitive advantage.

Operator

Next question comes from Tavy Rosner with Barclays.

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

I got disconnected for a minute, so sorry if you already touched on that. But can you comment on the deferred revenues? I mean we're looking at the evolution of the balance sheet, deferred revenue going down sequentially while the uncollected billed amounts were going up significantly. So anything to read into that?

Doron Abramovitch - Radware Ltd. - CFO

No. So this is why we refer to the total deferred revenues. And by that, it eliminates the short term, long term and what we billed and what we didn't. So I advise to look on the trend of this \$172 million in the break of what will in the next 12 months be recognized as revenues. This is the only trend that in our mind is significant.

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

Got it. And you mentioned Cisco and the announcement of the -- your products within their portfolio. What about Check Point and Nokia? Anything evolving over there?

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

They continue to contribute. With Check Point also, we are quite optimistic that we are gaining mind share and definitely new logos. But I don't think, at this point, it's in the scale of the Cisco relationship and the Cisco momentum. We are working, of course, with them to grow it further and to accelerate it.



JULY 31, 2019 / 12:30PM, RDWR - Q2 2019 Radware Ltd Earnings Call

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

Okay. That's helpful. And just the last one for me, please. Looking at the acquisition pipeline. Do you guys have any incremental target that you think could be accretive for you guys compared to last quarter?

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

Yes. So we continue to look and to be active in the market. Obviously, we will report only when something is -- we've concluded it. So at this point, nothing to share. But obviously, we're looking for more opportunities. We are very happy with how the anti-bot acquisition, the ShieldSquare acquisition is shaping up. We won several new customers. It's fully integrated now in our cloud WAF and our end-to-end stack. So the -- there's a lot of good feedback from our customers. Over all the integration is going well, and as a result, we are looking to seek there further opportunities.

Operator

At this time, I will turn the call over to the presenters.

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

Thank you very much, and have a great day.

Operator

This does conclude today's conference call. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.