Q2-18 Financial results conference call

Management's prepared remarks and Q&A

August 7, 2018

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the RADCOM Ltd. second quarter 2018 results conference call. All participants are currently in listen only mode. Following management's formal presentation instructions will be given for the question and answer session. For operator assistance during the conference, please press *0. As a reminder, this conference is being recorded and will be available for replay on the company's website at www.radcom.com from August 8th, 2018.

On the call today is Yaron Ravkaie, RADCOM's CEO, and Ran Vered, RADCOM's CFO. By now, we assume you have seen the earnings press release which was issued earlier today. It is available on all the major financial news feeds. Please note that management has prepared a presentation for your reference that will be used during the call. If you have not downloaded it yet, you may do so through a link on the Investors section of RADCOM's website at www.radcom.com/investors-relations. If you have any trouble, please send Mark Rolston an e-mail at markr@radcom.com, and he will send it to you right away.

Before we begin, I'd like to review the Safe Harbor provision. Forward looking statements in the conference call involve a number of risks and uncertainties, including, but not limited to, the company's statement about its 2018 revenue and other performance guidance such as gross margin, levels of growth of revenues in the third quarter and the second half of 2018 and levels of expenses and investment in infrastructure, momentum, sufficiency of capital, resources and plans to expand the company's workforce, receipt of additional grants, strategy, launching new products and potential sales of such products, size of pipeline, expansion into new countries including timing thereof, additional transition to NFV, AT&T's and other top tier carrier continuance as important customers and key references, AT&T's plan to virtualize its network over the long-term, our relationships with a Galaxy operator and with Red Hat, favorable industry trends and their effect on the company, project sales cycles, orders, engagement and expanding relationships with top tier carriers, and entering into new contracts with additional operators and potential customers. The company does not undertake to update forward looking statements. The full Safe Harbor provisions, including risks that can cause actual results to differ from these forward-looking statements, are outlined in the presentation and the company's SEC filings.

In this conference call, management will be referring to certain non-GAAP financial measures, which are provided to enhance the user's overall understanding of the company's financial performance. By excluding certain non-cash stock-based compensation expenses, non-GAAP results provide information that is useful in assessing RADCOM's core operating performance and in evaluating and comparing our results of operations on a consistent basis from period to period. The presentation of this additional information is not meant to be considered a substitute for the corresponding financial measures prepared in accordance with generally accepted accounting principles. Investors are encouraged to review the reconciliations of GAAP to non-GAAP financial measures, which are included in the quarter's earnings release, which is available on our website. I'd like to repeat the information about the presentation.

If you have not downloaded it yet, you may do so through a link on the Investor section of RADCOM's website at www.radcom.com/investor-relations. If you have any trouble, send Mark an e-mail at markr@radcom.com and he will send it to you directly. Now I'd like to turn the call over to Yaron. Please go ahead.

Yaron Ravkaie:

Thank you, operator, and thank you all for joining us today. We are very pleased with our second quarter results in which we delivered another solid quarter and continue to make progress on our key initiatives. During the quarter we continued to execute on a number of deployments with existing customers and are in the final stages of planning with the top tier Galaxy operator mentioned last quarter. We are very excited about the long-term potential of this top tier Galaxy operator who spreads and spans many countries. As a first step with this operator, we expect to commence deployment of our leading NFV software in three countries during the second half of 2018.

During the quarter, we also completed the initial deployment at the world's leading top tier operator that we announced in late 2017. We are very pleased with the progress and are actively working on expanding this relationship. We also continue to see changes in the industry, which create an environment that is favorable for our solutions. In January, AT&T publicly announced that their 5G services would rollout to 12 U.S. cities by the end of 2018 and last month they announced that their 5G Evolution technology is already live in more than 140 markets.

AT&T is also one of the operators that stood with the global wireless industry when 3GPP agreed on the first set of 5G standards a month or so ago, all of which shows that AT&T is aggressively pursuing the launch of their 5G services, which will be the first use case that runs on AT&T's network cloud and it's the first iteration of their new cloud platform. This will drive additional activity in the future with advanced 5G use cases running on top of virtualized technology.

Investing in and expanding our product portfolio is vital as we extend our leadership position within the software defined network space. In February, we announced the general availability of RADCOM Network Visibility. This cloud native solution is explicitly designed to help operators gain full network visibility while smartly managing and load balancing the virtual traffic of their NFV transformations.

We have seen significant customer interest and are pleased by the pipeline activity and we are entering into several proof-of-concept deployments with this new cutting-edge technology. When we showcase our product portfolio to operators, it is clear that the seamless integration between our end to end network visibility, probe-based service assurance and customer experience management provides real benefits to operators as they transition to virtualized networks and build their 5G ready cloud.

We have noted more and more operators want to adopt NFV and show interest in attaining the benefits of implementing our solutions on a virtualized infrastructure, even before they set up their private cloud. That was the reason for the collaboration with Red Hat that we announced in February. As a reminder, Red Hat provides operators a commercial version of OpenStack, which is one of the leading platforms deployed in operators' operating system that manages their cloud network. RADCOM's collaboration with Red Hat enables the operators to use our cloud native portfolio without the hassle of first building their private cloud infrastructure. This collaboration has already borne fruit with a solution already live in North America with one of our customers. Also, we'll be going live with another large-scale deployment this quarter with one of our major APAC customers. The solution robustness and strong collaboration with Red Hat will enable us to expand this offering to more and more operators who don't yet have cloud infrastructures, so they can also gain the clear benefits of our cloud native solution.

The company is now engaged in a new round of proof of concept as a result of the many workshops and engagements with top tier operators, as well as operators moving ahead with their virtualization plans. We already see new use cases in 5G and NB-IoT, which we are well equipped to handle due to the inherent cloud native architecture of our solution that delivers automation and high performance. The ... is now baselined to deal with the projects we need to execute, and the opportunities are ahead of us. Now investment in infrastructure is paying off.

Additionally, our strong balance sheet will allow us to execute on our strategy of increasing sales by leveraging our leadership in innovation around NFV and cloud-based solutions by taking advantage of the experience gained from our current deployments and by maintaining our technical advantage over our competitors by investing in our differentiated NFV and cloud-based solutions. Now moving on to the results of the second quarter.

We're happy with our second quarter results, as you can see on Slide 5, revenues for the quarter increased by 19% year over year to USD 10.6 million. Our GAAP net income was USD 757 thousand or USD 0.05 per diluted share. We achieved a non-GAAP net income of USD 1,423,000 or USD 0.10 per diluted share. So, to summarize, we are very pleased with our execution during the second quarter.

Given that RADCOM remains the go to NFV vendor for virtual probe-based service assurance and customer experience management. We are well positioned to maintain the momentum. With that, I'll stop and turn the call over to Ran Vered, our CFO, to discuss the financial results. Ran, please.

Ran Vered:

Thank you, Yaron, and hi everyone. Please turn to Slide 6 for our financial highlights.

To help you understand the results, I will be referring mainly to non-GAAP numbers, which exclude share based compensation. Revenue for the quarter were USD 10.6 million, up 19% year over year. Our gross margin for the quarter was 73.2% on a non-GAAP basis, in line with our expectations. As a reminder, we expect gross margins to continue to fluctuate, depending upon the mix of each quarter's revenues. Our gross R&D for the quarter on a non-GAAP basis increased to approximately USD 3.5 million from approximately USD 2.6 million in the second quarter of 2017, which was in line with our ramp up plan and highlights our strategy of investing to support future growth.

Additionally, we received approximately USD 754 thousands from the Israel Innovation Authority during the period compared to USD 312 thousand in the second quarter of last year. As a result, our net R&D for the quarter was approximately USD 2.8 million, compared to approximately USD 2.3 million last year. We expect the gross R&D expenses in the coming few quarters to be roughly the same level or slightly higher.

Sales and marketing expenses of the quarter on a non-GAAP basis totaled approximately USD 2.9 million, compared to approximately USD 2.8 million in the second quarter of 2017. G&A expenses for the quarter on a non-GAAP totaled USD 799 thousand, compared to USD 775 thousand in the second quarter of 2017. Operating income on a non-GAAP basis for the quarter was approximately USD 1.4 million, compared with USD 380 thousand for the second quarter of 2017.

On a GAAP basis, as you could see in Slide 5, we reported net income of USD 757 thousand or USD 0.05 per diluted share compared to a net loss of USD 204 thousand or USD 0.02 per diluted share during the second quarter of 2017. Net income for the quarter on a non-GAAP basis was approximately USD 1.4 million or USD 0.10 per diluted share, compared to USD 416 thousand or USD 0.03 per diluted share during the second quarter of 2017.

At the end of the quarter our headcount was 218 employees. Turning to balance sheet, as you can see in Slide 9, our cash, cash equivalents and short-term bank deposits as of end of the quarter were approximately USD 71.4 million.

We believe that our strong cash balance places the company on a strong footing for addressing top tier operator opportunities. Now turning to guidance. We are reiterating our fiscal 2018 guidance range of USD 43 million to USD 47 million in revenues, given the strong first half results, combined with our current outlook with existing and potential new customers. While we don't ... on providing quarterly guidance, we wanted to point out that the revenue can becomes lumpy due to the timing of specific project milestones.

Therefore, we expect Q3 results to be approximately flat with Q2. Regarding profitability, while we don't plan to provide specific EPS guidance similar to past years, we expect to continue to invest in our infrastructure to support growth. As a reminder, we view and continue to manage our business on an annual basis because our quarterly result can fluctuate due to the timing of implementing milestones. That ends our prepared remarks. Yaron and I will turn the call back to the operator so that we can take questions.

Operator:

Thank you. Ladies and gentlemen, at this time we will begin the question and answer session. If you have a question, please press *1. If you wish to cancel your request, please press *2. If you are using speaker equipment, kindly lift the handset before pressing the numbers.

Your questions will be polled in the order they are received. Please stand by while we poll for your questions.

The first question is from Alex Henderson of Needham & Company. Mr. Henderson, please go ahead.

Alex Henderson:

Thank you very much. So, I was wondering if you could talk a little bit about your hedging policy, given the 6% improvement in the shekel versus the dollar during the June quarter and another 3% or so since then. How does that roll through your numbers and how do you, can you remind us what you are hedging approach is?

Ran Vered:

Yes, sure. Hi Alex, thanks for the question. So, as a decision we took, we're checking this decision every quarter, but we decide not to hedge the shekel expenses, which was turn out to be a good decision, because this quarter we enjoyed roughly USD 150 thousand to our expenses.

And if this shekel is actually-, is continuing to be-, to weaken against the dollar, it means that every quarter we are going to earn something like USD 150 thousands per quarter compared to our forecast.

Alex Henderson:

Could you give us your headcount, and I assume T was a 10% customer? So, can you give us an indication of what your top customer was?

Ran Vered:

Yes, sure. So, 218 employees, actually pretty flat from last quarter. In terms of customers, so in this quarter AT&T represented 54% from our revenue and Globe Philippines represents 34% from our revenue.

Alex Henderson:

Great. I've been getting some questions from a very persistence investor about FirstNet and AT&T opportunities around FirstNet. It seems like a great question and so I thought I'd pass it along and see if you had some thoughts on how that opportunity for capital spend at AT&T might fit with your product line.

Yaron Ravkaie:

Remember that we have an enterprise license in AT&T, so all these things affect us positively, but they don't have like a huge major effect because it's already taken in consideration in our ongoing relationship with AT&T, which again, we expect to carry on forward. So, our technology is being used there, but it's not-, I would say it's, you know, business as usual.

Alex Henderson:

And as I look forward, do you expect, then, the mix to start shifting away from AT&T to some of the other customers, as you ramp some of the more SaaS related type transactions?

Yaron Ravkaie:

We believe that going forward, we will have a meaningful double-digit revenue coming in from AT&T, as they continue to expand their network and as I mentioned in the past, they've licensed from us the LTE network, the 4G network. So, as they deploy new use cases and similar technologies, they need additional licenses and they need ongoing enhancements to the way that their network works.

Long term, we believe that we will continue to monetize, and they will be a very significant customer. We're working with them on their plan for 2019 and beyond in a very open and straight forward way, in a very collaborative way, so we have-, we're starting to gain some visibility into it.

But as I mentioned in the past, we'll have more visibility into the-, in how that looks more towards the end of the year, in probably Q4. And beyond that we expect additional revenues to grow from the other customers. So, we do expect longer term that AT&T's percentage in our overall revenue mix will be lower and this will-, this is already baked into our 2018 and also into our longer-term plans.

Alex Henderson:

One last question and I'll cede the floor. The gross margins have been trending a little bit above what we've been modeling and certainly up from last year. Can you talk a little bit about what you think GM's will looking like in the back half, are we going to be up in that 73% range or down more in the 71%, 72% range?

Ran Vered:

So, it's really depending on the mix for each quarter and what customer and what projects are we going to recognize in specific quarters. What I could on an annual basis, the six months our gross margin was close to 74% and we'll do expect the remainder of the year, again, to be anyhow between 70% to 75%, which means, on an annual basis. So very close to what we already achieved in the first half.

Alex Henderson:

Okay. Thanks. I'll cede the floor.

Yaron Ravkaie:

Thanks, Alex.

Ran Vered:

Thanks, Alex.

Operator:

The next question is from Dmitry Netis of William Blair. Mr. Netis, please go ahead.

Dmitry Netis:

Thank you, guys. So, let me kind of zoom in on the second tier 1, I presume there was no contribution in the quarter from that tier 1, was there?

Yaron Ravkaie:

No.

Dmitry Netis:

Okay, sounds good. Do you expect anything in Q3, and I think you have been expecting additional purchase orders as you move to new domains within that customer, maybe adding additional features with that customer, you had mentioned in the second half, so can you update us on the status of that deployment progress as well as whether you are expecting anything in Q3 from that customer?

Yaron Ravkaie:

So, we're working with them and we're expecting-, we don't know if it will be Q3 or Q4, according to the plan it exactly falls in between, so we can't pinpoint it now, how it will affect the revenue. But it's in the works and it's not done yet. So, we need to secure it and then we need to execute on it, which is not that complicated because we have been working with them on it.

Dmitry Netis:

And is that the main reason why you may be pushing out, based on web consensus what's in Q3, your guiding is now to be flat, so you essentially, you're moving that million dollars of revenue into Q4. So, it gives you a pretty big steep ramp in Q4, possibly doable but walk us may be through the opportunities that you expect in that fourth quarter, that will get you there.

Yaron Ravkaie:

So, it's pretty straightforward. We need-, there are some projects that we're working on from the existing install base that we need to secure to Q4. Some of the work with this new Galaxy operator, we expect to recognize revenue in Q4 and some potential work, there are still five months in the year that we don't have line of sight to, but that's a very small amount. So what needs to happen in Q4, it's continued execution on AT&T, continued work, as we mentioned, now with this second tier 1, as you asked, and the things that I mentioned on top of that.

Dmitry Netis:

Galaxy, okay. Now, maybe touch on Galaxy operator then, back in June, you were maybe a month or two away from landing a contract. It sounds like, sitting here in the second week of August, you still don't have it in hand. You do expect it quite soon, you have identified the number of countries you're going to be participating in. So, things are pretty locked in, as it sounds. However, the contract is still not in hand. Can you tell us exactly why this is taking so long to get a purchase order? And if so, is there a sizable opportunity with a sizeable order that you're expecting in that Q4 timeframe?

Ran Vered:

So, first of all, it's not surprising us that it's taking this amount of time. We've reached a major milestone during the quarter with this Galaxy operator that all these Galaxy operators, they work in a several layers, okay?

They have group layer, some of them have a procurement company that some of them share between several Galaxy, so it's very complicated with these Galaxy operators, but again, as I mentioned in the past, the price is, once you're in on a gradual basis you're able to deploy, these three countries are just the tip of the iceberg.

We basically reached a major milestone that everything is locked and loaded for everything at the group level and we've done already enough work with three of the OpCos that we expect POs, that's what purchase orders against those group level contracts. So, just think about it, we needed, or they needed, the group needed to negotiate these group contracts with us. It's not one contract and I don't want to overburden you with this information, but they have their own structure, so it takes time. But this is business as usual for them.

So, any company that does business with them goes through the same hoops. So now we're very optimistic, the relationship is very positive with this operator. We believe that overall, the relationship with them can be double digit millions but we're going to need to grow it to be there. And we also see some initial signs that the projects might be bigger than we thought, but it's very initial and I'll continue to give some more color as we get line of sight. But they're excited around our technology and it's all very positive.

Dmitry Netis:

Got you. All right. So, it sounds like more of a three, maybe three POs from each of the operators that you're working with under that Galaxy umbrella and each of them could be multimillion dollar sort of POs that ... double digit number?

Yaron Ravkaie:

Yeah, they'll be-, we believe that they will be, they'll differ in size, because these OpCos differ in size, so we'll see a big one, a medium one, and maybe a medium to small one, something like that.

Again, these are the first three, so we expect in 2019 to get more and also maybe to expand our relationship with these three, because not all of them are buying everything that they can buy under these enterprise contracts. So again, it's a very good beginning, it gives us a big anchor within this Galaxy and now it's sitting there and working with them and expanding and delivering and doing what we know how to do.

Dmitry Netis:

Got you, very good. Thanks for the color. And if I may, there was another potential tier 1, I think it sort of makes up that four POCs that you had coming into the year. I think you've landed three by now, there's one more hanging out there.

So, and you were saying that you're pretty confident you may be able to bring that in into the year as well. So, any update on that fourth POC you were working on with the tier 1 customer?

Yaron Ravkaie:

So, we still believe that we will bring another contract this year, it's in our plans. The specific POC that we did with a specific tier 1 that we thought was maturing that didn't go-, or they don't want to progress now, so there's a delay there. But there is another one that's now being accelerated that might yield there.
So, talking about past and potential things, that's a little dangerous because things change, I did decide to always give some color on it because of the journey that we're doing in disrupting the market.

Everything is going to turn out for the good because some of the things in that one that fell we didn't like, some of the things that we needed to do, they were more in the legacy area, and they want pure... and NFV and now we have an accelerated opportunity with another one. So, we still think that in Q4, Q1, we might be able to bring another top tier.

Dmitry Netis:

Got you. May I ask you also on the AT&T. You have mentioned some additional, keep doing the work and keep expanding with that customer. So is there a chance in Q4 timeframe when you're expecting obviously a big ramp relative to your guidance for the year.

As AT&T becomes a bigger contributor as a result of them, of your ability to move into wireless network, and start landing kind of that part of the network as well, or do you still expect that to be a 2019 scenario?

Yaron Ravkaie:

You're asking specifically about AT&T?

Dmitry Netis:

Yes. Specific to AT&T, as it relates your expansion into kind of a wireless network. Do you think that's a Q4 event or is that 2019 event?

Yaron Ravkaie:

So, the wireless-, we are doing, a little reminder on AT&T, okay? Everything that I'm saying is a little bit of history, right? We're doing, in our contract, they've licensed, and we've been executing everything we need to do for them, for their NFV migration of their wireless 4G network. And this is what they've been migrating to NFV.

Dmitry Netis:

I stand corrected. I stand corrected. I meant 5G, actually, Yaron.

Yaron Ravkaie:

So that's what I thought you asked. So 5G is a significant opportunity. We believe that we will materialize it in 2019. We might be-, we might, probably in Q1 of-, we don't have full line of sight yet, but it will impact 2019. We're working with them on it, so, it's not-, we're working with it as the incumbent on this.

So, it's not-, it's not something that is like a competitive situation, okay? It's more of a natural evolution of the NFV network into 5G. They need to buy licenses for it and they need some additional stuff for it, and it's in the works and will be already deploying some initial stuff this year for that. But to see it impacting the revenue, it will be into next year.

Dmitry Netis:

Got you. Okay. If I may, just one last question, I appreciate your time and those on the call giving me the ability to ask this question to you. I'm curious about your Amdocs relationship and whether there's any incremental progress there, do you think it's status quo, Amdocs seems to have indicated NFV opportunity expanding within their ecosystem, they mentioned Comcast on their call, as part of the SDWAN deployment, and as it relates to you and your partnership with them, with Amdocs, are you seeing any more incremental contribution coming up as a result of that partnership?

Yaron Ravkaie:

We actually received the-, like some, a small new PO from that relationship, it might yield some additional work in the future, but we didn't mention it because of its size. So, there are some indications that we can grow that relationship.

It's too early to say. I would say-, we're in a very close contact with Amdocs, I would say that their current wins are not in the mobile space. We primarily operate now in the mobile space, that's the area where there is the high demand for customer-, probe-based customer experience management. In the Comcast of the world and things like that, they don't typically deploy these types of solutions in the things that they contracted Amdocs for.

Now, Amdocs is also busy in the mobile space so that might yield some relationship. And we also do a lot of collaboration with Amdocs beyond just PO. We do some joint planning, we do some-, do a lot of comparing notes on how we see the market and strategy and that's helping both companies, even if we don't book together, we do collaboration, try to assist each other even if each one of us, separately, get the POs.

Dmitry Netis:

Very good. Thank you very much for this, Yaron, and keep doing the good work you're doing.

Yaron Ravkaie:

Sure. Thank you, Dmitry. Good talking.

Operator:

If there are any additional questions, please press *1. If you wish to cancel your request, please press *2. Please stand by while we poll for more questions. The next question is from Mark Jones of Highlight Data. Mr. Jones, please go ahead.

Mark Gomes:

Hey, it's actually Mark Gomes from Pipeline Data. How are you doing, guys?

Yaron Ravkaie:
Okay.

Mark Gomes:

I was just hoping you would maybe give us a little bit of an update on how you see the competitive environment, not only that, but how third parties may be seen, gardener group, things like that, where you stand in terms of maintaining your lead technologically and what you're doing to maintain or expand that lead and what enables you to do that? Thank you.

Yaron Ravkaie:

Sure. The probe vendors are a well-known community, so we pretty much know who competes with us. Today, we remain the most advanced solution that is 100% cloud native, being cloud native, it means that the system can be deployed on any cloud with a very high amount of automation, so it can adapt itself automatically to the cloud. That is something that from what we see is unique to us, no one has that.

The main reason no one was challenged by that by a very aggressive operator like AT&T, which is at the forefront of this entire evolution to NFV. And that of course fits all the other wins and expansions that I've been talking about, etcetera. Through the investment that we do in R&D, and you can see that we've been with our pedal to the metal, as I would say, we continue to invest in-, not in yesterday's technology, but in tomorrow's technology in assuring that we're dealing with very advanced processes and automatic processes that are needed to the continuation of the evolution of NFV.

This coupled with the fact that now we fit in the most advanced transformation that there are in the industry, it gives me the comfort level that we will maintain probably, a couple of years, two years, maybe even a little bit more, advantage on competition.

So, I see where we were at several years ago and I see where we are now and competitors like NetScout just probably a couple of quarters ago announced stuff that we had available in 2014. So, we feel very good about that.

Mark Gomes:

Great. Thank you very much.

Operator:

There are no further questions at this time. Thank you. This concludes the RADCOM Ltd second quarter 2018 results conference call. You may go ahead and disconnect.

(End of conference call)