Q3-18 Financial results conference call

Management's prepared remarks and Q&A

November 7, 2018

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the RADCOM Ltd. Third Quarter 2018 Results Conference Call. All participants are currently in a 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 star-zero. As a reminder, this conference is being recorded, and will be available for replay on the company's website at www.radcom.com from November 7th, 2018. On the call today is Yaron Ravkaie, RADCOM's CEO, and Amir Hai, 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 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/investor-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 statements about its 2018 revenue and other performance guidance, such as gross margin, strategy, maintaining and enhancing our leadership position, launching new products and potential sales of such products, our pipeline, our long term prospects, the future of NFV and additional transition to NFV, industry trends including 5G development, AT&T's and other top tier carriers' continuance as important customers, AT&T's plans to virtualize its network, our relationship with the Galaxy operator and prospects of doing business with this operator, projected sales cycles, expanding relationships with top tier carriers and entering into new contracts with additional operators and potential customers, length of sales cycles, and levels of investments in research and development and potential results of such investment. The company does not undertake to update forward-looking statements. The full Safe Harbor provisions, including risks that could 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 Investors 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 over the call to Yaron. Please go ahead.

Yaron Ravkaie:

Thank you, Operator. And thank you all for joining us today. During the quarter we continued to execute on our deployments with existing customers. We continue to work closely with AT&T as they maintain their leadership role in software defined networking.

This quarter we expanded our business with AT&T as they move ahead with their NFV transformation, AT&T remains on track with their virtualization goals which are a crucial part of deploying services on the network edge and for the ultralow latency in 5G. We also continued our efforts with the previously mentioned Galaxy operator as we work through their procurement processes and early planning for potential initial deployments. We maintained our business development and sales and marketing efforts with new operators and are in the early stages of several proof of concept demonstrations with top tier operators. Through this activity, we see new use cases in 5G and NB-IoT, which we are well equipped to handle due to the cloud native architecture of our solutions and our ability to deliver automation and high performance for such use cases.

We continue to invest in research and development to maintain and extend our leadership position within the software defined virtualized network space. A growing product portfolio provides end to end network visibility, probe-based service assurance and customer experience management. It offers tangible benefits to operators as they transition to virtualized networks and build their 5G ready clouds.

We firmly believe that our ongoing investment in R&D will enhance our leadership position and result in innovative growth engines for the future. One of our new solutions is RADCOM Network Visibility which we announced earlier this year this cloud native solution is specifically designed to help operators gain full network visibility while efficiently managing and load balancing the virtual traffic for their NFV transformation.

We are actively demonstrating this solution's capabilities and creating a pipeline. Our position and long-term prospects are enhanced by our strong balance sheet, which allows us to continue to execute on our technology and sales strategies of targeting top tier operators transitioning to NFV even when facing longer sales cycles and lumpiness in our revenues.

We are proud that by leveraging our leadership in telco network virtualization, the experience gained from our current deployment, RADCOM remains go-to NFV trend for virtual probe-based service assurance and customer experience management. Yet the pace of NFV deployments and operators' decisions on spending is not in our control and is slower than we previously expected. That being said, we continue to see interest in our solutions; there is ongoing activity around NFV transformations. We also see increased activity around 5G, where we believe our solutions are needed. As a result, we remain confident in our business strategy, the future of NFV, the superiority of our NFV offerings, and the role RADCOM expects to play in the NFV transformations to come. With that, I'll turn the call over to Amir Hai, our CFO, to discuss the financial results. Amir, please.

Amir Hai:

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 excludes share-based compensation.

Revenue for the quarter was 8.5 million, down by 12% year over year. Our gross margin for the quarter was 81% on a non-GAAP basis, in line with our expectation and mostly due to increased software sales. As a reminder, we expect gross margins to continue to fluctuate depending on quarterly revenue mix and levels.

Our gross R&D for the quarter on a non-GAAP basis increased to 3.7 million from 2.2 million in the third quarter of 2017. Also, we received 528 thousand dollars from the Israel Innovation Authority during the period, compared to 155 thousand in the third quarter of last year.

As a result, our non-GAAP net R&D for the quarter was 3.2 million compared to 2.1 million last year.

Sales and marketing expenses for the quarter were 2.3 million on a non-GAAP basis, similar to 2.2 million expenses in the third quarter of 2017. G&A expenses for the quarter on a non-GAAP basis totaled 647 thousand compared to 791 thousand in the third quarter of 2017. Operating income on a non-GAAP basis for the quarter was 762 thousand compared to 1.5 million in the third quarter of 2017. Net income for the quarter on a non-GAAP basis was 1 million or 7 cents per diluted share compared to 1.7 million or 14 cents per diluted share during the third quarter of 2017.

On a GAAP basis, as you can see on slide 5, we reported net income for the quarter of 634 thousand dollars or 5 cents per diluted share compared to 1.2 million or 10 cents per diluted share during the third quarter of 2017. At the end of the third quarter, our total headcount was 232.

Turning to the balance sheet, as you can see on slide 9, our cash and cash equivalents and short-term bank deposits as of the end of the quarter were 67.6 million. Now turning to guidance. We are reiterating our fiscal 2018 guidance we shared in our business update conference call on October 9th, which indicated a revenue range of 33 million to 35 million. That ends our prepared remarks. Yaron and I will turn it back to the operator and take your 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 star-one. If you wish to cancel your request, please press star-two. 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 we poll for your questions. *[pause]* I repeat. If you have a question, please press star-one. If you wish to cancel your request, please press star-two. We have a question from Alex Henderson of Needham and Company. Please go ahead.

Alex Henderson:

So, obviously, kind of rough numbers here over the short term. In the context of one of your largest customers, or potential customers, Verizon pretty sharply cutting back CapEx, I mean, they cut their CapEx back to essentially down over 20% for the fourth quarter.

Do you read this as kind of a timing issue around the tough conditions, is it just simply, you know, a slowdown in their spending and their process flow? Or alternatively do you think that there's some anxiety around how do we implement, how do we do this, some concerns around, it needs to be more cloud centric, that kind of stuff, that is slowing down the entire NFV adoption rate, you know, more broadly in the industry. Can you talk about whether you think this is just a short-term wobble in conditions, or something more in depth in the industry on the NFV space?

Yaron Ravkaie:

So, I can talk about the NFV space, Alex, but I can't talk about the specific customer because it's their issues, okay. And also, we are not disclosing – outside of AT&T and Globe, we're not disclosing information of specifics. I would say that specific customers might have some specific issues to their own way of how they are doing stuff.

In general, what I see across the industry is that there is no – like, everyone I think there's a consensus around NFV. I think, you know, and we all see it, AT&T is way ahead of everybody else. We also see that more and more carriers have gone through some sort of an initial planning stage with some initial launches, at a – I would say non-transformational approach, so different than AT&T. They use more of a piecemeal approach, and I think I've talked about that in the past. And in some cases, how they do the assurance of those, though they delay some of those decisions, as they're ready to take the next step.

We do see a lot of activity also with us, around planning and understanding, you know, what should they do, how they should do it, and they are taking a lot of our knowledge. So, I think I would summarize it as they're somewhat – I'm not sure the word stuck is the right word, but they are staying in this planning stage, until they understand how to roll the things out, and we see more and more of this planning. So, you know, I think at a certain stage they will move, but this is what I see in the industry. I see more interest and more planning and more activity, but still stuck at that stage with some moving forward.

Alex Henderson:

Relative to 5G, there seems to be a lot of activity around, you know, the fixed wireless piece but, you know, still has a way to go before we get into true radio access network deployment for, you know, consumer handsets. The timeline, though, does depend somewhat on network function virtualization, as I understand it, they can't really deploy the 5G architecture without an NFV architecture. Can you talk to that issue a little bit, and, you know, where do you see – you know, what do you see, there's a timeline around 5G?

Yaron Ravkaie:

Yes. So, you know, there's also a lot of public information. You see AT&T, and you see also Verizon, and you see – in the U.S. – and you see T-Mobile, and you see everyone moving to 5G. You know, with AT&T, of course we have more knowledge that – so I'll revert to the public knowledge. But they're all very aggressive on the 5G, and I think I see them more aggressive in North America than in other places, while we see beginnings, I think of course, the Globe – including in some of our emerging market, existing customers and future potential customers.

In North America, I think they understand the use cases that they want to deploy, and, you know, there is also differences between the use cases that they're deploying. Verizon is more focused on deploying fixed broadband, AT&T have a different strategy. I think you can – it's public information, so you guys can look at it. It's still a question mark when handsets will be available for this, I think I just saw, you know, the latest and greatest article from this morning says that the Chinese handset providers will have in 2019 already handsets that are 5G or supporting 5G.

You know, at the end of the day, it's the modem in 5G and the handsets is a different modem, and today Qualcomm provides a modem, not clear how mature it is. Intel is planning to provide a modem, Apple works more with Intel, and the Chinese more with Qualcomm, so there's a complete, you know, happening around that piece. But it seems to me that that it is being accelerated.

Now, when they deploy 5G, there is a need to do something with the assurance, or, you know, they can decide not to assure it, which probably won't happen in, you know, economies like North America. And there are changes in the way that the network behaves, there is new interfaces, new protocols. And maybe the last thing about 5G, 5G the initial rollout will be, you know, let's call them a quick and dirty rollout, without the full architecture and benefits of 5G. But already at that stage – at this initial rollout, things change, so they need to do investments in the assurance.

There is a new interface, new – the network behaves in a different way, that they need to adapt to it. In the future there is even more changes, which I think will drive two things. Will drive a lot of innovation of how assurance is being done on those networks, and this is, you know, probably 2020. And we're already working on these types of things, and showcasing it to customers, being very advanced cloud native and the things we've talked before. And we continue also to make R&D investments in this area. And we believe that those two things will be, you know, a good strong driver for business.

Alex Henderson:

So, as we look out to CY19, you know, do you think you're able to get back to, you know, double digit growth? Or do you think you're still, you know, still declining, probably in the first half at least, but maybe recovering in the back half and able to get 5 or 10% growth in the – you know, for the year? Or, you know, what's kind of the shape of the curve into '19? I realize that there's a ton of unknowns in that question, but, you know, for people who have to model it out, it's an interesting problem.

Yaron Ravkaie:

Agree. You know, at the end of the day, with all the uncertainty, you know, and with the – I would say the hit that we took compared to our plan, you know – we don't believe it will be declining. We might have some more uncertainty in the first two quarters, although I don't want to predict now decline in the first two quarters, you know, the nature of our business is very lumpy, and it's enough that one PO comes in January a one PO in March, and they can create the opposite effect.

So – and there are things in the works. And – double digit growth for next year, I think the chances are slimmer. So – and I think we haven't done our planning for next year, but I think going into that planning, we will be looking at, you know, basically continuing our investment in R&D, which we've talked about also several weeks ago. And we'll be looking at some growth, maybe making sure, I think, that the company is fully focused on booking and capturing deals as they come along.

Alex Henderson:

Given the shekels at a 52-week low, given the choppy outlook for the near term – are we talking about, I think you're just under 15 million in R&D, excluding the NRE benefits. Would we be looking at, you know, 16 million-ish type spend next year? And so, continuing to keep the pedal down? Or are you going to alternatively look at the world and say, I need to conserve my cash a little bit, and wait for this to recover.

Yaron Ravkaie:

I don't think – we didn't make those decisions yet, so I think, pre-decision, I would keep the – our R&D spend intact. But we haven't gone through the budget planning, you know, at the end of day Board approvals, et cetera. So –

Alex Henderson:

Okay. Well, I'll cede the floor. Thank you.

Operator:

The next question is from Matt Stilter of William Blair. Please go ahead.

Matt Stilter:

Hi, guys. Thanks for taking my question. Just a couple of quick ones here. One, I'd just be curious to get an update on competition. It's something you guys talked about on the business update calls, but I'm curious, you know, as you talk about lengthening of evaluation cycles at potential customers, you talk about them exploring different options for NFV strategies.

Do we have these, are any of these more or less favorable to you, from a, you know, competitive standpoint? Or are you seeing any change on that front, and what your potential customers are evaluating here?

Yaron Ravkaie:

Look, from the competitive landscape, what we see – primarily what we are hearing from the customers, that we have the most advanced NFV offering. That's the feedback during the sales cycle. And the sales cycle is not like, you know, a one-hour meeting, it's a deep dive and proof of concept and really popping the hood up.

Saying that, when I look at competitor activity, I see that they try to mimic our approach, which also, I think, is a good thing because I think creates the market. And I think from what I see, we're able to maintain a very nice competitive advantage. And, you know, I've talked about this in the past – the fact that AT&T is the most aggressive transformation out there and we're participating in it, it drives the product forward and it drives the knowledge of all the engineers forward.

So, it's hard to beat somebody that is really deep with AT&T. You know, of course, assuming that AT&T continue with full force as they've been doing, which this looks like to be the case.

Matt Stilter:

Right. Okay. That's hopeful. And then, just one more. You know, as you've been talking and obviously, the recent business updates, and in your prior quarterly calls, just, you know, you've seen the pace of adoption slow as far as NFV goes, probably for these reasons we've discussed. Are you seeing that pace stabilize? Or is there – do you see, you know, continuing incremental slowdown as we kind of get to the back end of the year here?

Yaron Ravkaie:

So, I want to be a little careful, because it's only four weeks from the previous call. So, I wouldn't expect like a major change. But I would say that the company is all the time busy, and I mean good busy, in doing a lot of sales processes and – technical sales processes. So, you know, proof of concept, workshops, things like that – with potential top tier carriers. And this is not slowing down, and I would say we continue to get requests and new requests for this activity.

So, I want to be careful not to say, okay, it's picking up or it's slowing down, because it's very hard to assess what does it mean. I think, at the end of the day, the bottleneck – and I touched on it when Alex asked these questions – is that they're stuck in this planning stage. So, you know, at the end I think it's a good trend, that more and more are starting or are in their planning stage.

Now when are they going to go and issue real POs and – that can affect our numbers, yet to be seen.

Matt Stilter:

Right. Okay. Thank you very much.

Operator:

The next question is from Sasha Karim of IPI. Please go ahead.

Sasha Karim:

In the past, you've talked about potentially – there could, down the line, be acquisitions. Could you give us a feel for whether you're any closer or farther away to making them, and if so, what kind of size? Thanks.

Yaron Ravkaie:

So, you know, I – what I said in the past that we might look at, and, you know, acquisitions are the most sensitive thing in this marketplace. I can tell you that in general, if we will do something, it won't be something that tactical just to, you know, get us through a quarter.

You know, we are looking at ideas that the company has around strategic things, and so, you know, they might take time, and, you know, I can't say anything further than that.

Sasha Karim:

And, you know, you look at your own cash balances, I think it's 67 million dollars, and you've always said you need some kind of a cushion there to give tier 1 operators confidence that you're a viable going concern. Is it possible that you would consider actions which take you below your required cushion for that confidence? Or, you know, would you maybe rate equity to fund larger acquisitions if they are required?

Yaron Ravkaie:

It's – I would say it's theoretical questions at this stage. So, I'll, you know, I'll take the Fifth, as we say.

Sasha Karim:

Okay.

Operator:

If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by while we poll for more questions. *[pause]*

Operator:

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

(End of conference call)