Q1-19 Financial results conference call

Management's prepared remarks and Q&A

May 7, 2019

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the RADCOM Ltd. First Quarter 2019 Results Conference Call. All participants are at present 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 May 8th, 2019.

On the call today is Yaron Ravkaie, RADCOM's CEO, and Amir Hai, RADCOM's CFO. By now, we assume you have seen the first quarter's results 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 Investor 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 2019 revenue and other performance guidance, including statements about anticipated gross margins, statements about the Company's strategy, leadership position, potential sales, pipeline, opportunities, sales cycles or long-term prospects, statements about continued investment in research and development, and statements about the future of NFV, industry trends including 5G deployment, and future plans of industry participants and customers, such as AT&T. The company does not undertake to update forward-looking statements. The full Safe Harbor provision, 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 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 over the call to Yaron. Go ahead, please.

Yaron Ravkaie:

Thank you, Operator. And thank you all for joining us today.

We are pleased to have started 2019 with our recently announced three-year contract with AT&T, which we believe demonstrates our strong partnership, and the essential role that we play in AT&T's transition to NFV. Over the last three years, we've been working closely with AT&T on their pioneering network transformation as they move to an automated software-centric cloud, for their current and future mobile services. This contract emphasizes our close working relationship and the advanced virtualized technology that we continue to develop, invest in and deliver. We are very pleased with this significant achievement.

Our rapid Agile approach to product development has been and will remain critical, as we expect to remain an essential part of AT&T's network transformation that transforms 75% of their network functions to NFV by 2020. Our mature cutting-edge technology is embedded into AT&T's network and monitors the subscriber experience as they change their underlying infrastructure to the cloud, making the transition transparent to their customers.

Revenues in the first quarter reached 6 million dollars. Despite the market lumpiness, we remain optimistic that once operators move forward with their 5G plans, NFV adoption will quicken, and RADCOM will be well positioned to take advantage of this transition. Taking these market factors into consideration, we are reiterating a revenue guidance of 28 to 32 million dollars for 2019.

We'll continue to provide more color as we gain further visibility into NFV adoption. Although we are not forecasting instant growth, we are confident that the complete suite of 5G-ready products that we offer provides comprehensive support for the 5G and NFV transformation process and will make us invaluable to our customers when they do decide to make the transition.

We recently showcased the value of these 5G-ready technologies at Mobile World Congress in Barcelona, Spain, which is the leading event in the telecom industry. The interest in our advanced 5G-ready technology was very positive, and we are engaged with several potential opportunities that came from this event. We are also focused on sales and marketing efforts for new opportunities. We are in the process of several proof of concept demonstrations with top tier operators in Asia, Europe, North America Latin America. We hope that some of these opportunities will turn into new customer contracts later in the year.

We believe we are well equipped to handle these use cases due to the cloud nature architecture of our solutions and our ability to correlate data from multiple sources to extract smart customer and service insights for the operator. These technological advancements, coupled with our AT&T contract and the experience we have gathered by working so closely with them during their transformation, is unparalleled and makes us a leader in this space.

We remain confident that our product offerings are best in class, and that we will play a vital role in the upcoming NFV and 5G transformation processes. With that, I will turn the call over to Amir Hai, our CFO, to discuss the financial results in detail. Amir, please go ahead.

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 exclude share-based compensation.

Revenues for the quarter were 6 million, down by 45% year-over-year. Our gross margin for the quarter was 70% on a non-GAAP basis. Gross margin was affected by level of revenues and product mix. As a reminder, we expect gross margin to continue to fluctuate depending upon the level of revenues and revenue mix of each quarter.

Our gross R&D for the quarter on a non-GAAP basis increased to 4.5 million from 3.5 million in the first quarter of 2018. We will continue to invest in Research and Development to maintain and extend our technological leadership and capabilities. Also, during the first quarter, we received 404 thousand dollars from the Israel Innovation Authority, compared to none in the first quarter of last year. As a result, our net R&D for the quarter was 4.1 million, an increase from 3.1 million in the comparable period last year.

Sales and Marketing expenses for the quarter were 2.3 million on a non-GAAP basis, a decrease from 3 million in the first quarter of 2018. G&A expenses for the quarter on a non-GAAP basis totaled 710 thousand dollars compared to 799 thousand dollars in the first quarter of 2018. *[pause]* Operating loss on a non-GAAP basis for the quarter was 2.8 million compared with an operating profit of 707 thousand dollars in the first quarter of 2018.

Net loss for the quarter on a non-GAAP basis was 2.7 million or a loss per share of 20 cents per diluted share, compared to a net income of one million dollars or 7 cents per diluted share for the same period last year. On a GAAP basis, as you can see on Slide 5, we reported a net loss for the quarter of 3.1 million or a loss per share of 23 cents per diluted share, compared to a profit of 322 thousand dollars or 2 cents per diluted share last year.

At the end of the first quarter, our headcount was 232. We expect our headcount to remain stable overall, with strategic additions to R&D, as we continue to invest in our advanced technology.

Turning to the balance sheet. As you can see on Slide 9, our cash and cash equivalents and short-term bank deposits at the end of the quarter were 56.8 million. We believe that our … cash balance place us on a solid footing to execute on the opportunities in front of us. That ends our prepared remark. 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]* The first question is from Bhavan Suri of William Blair. Please go ahead.

Bhavan Suri:

Hey guys, thanks for taking my question. I guess … start off at sort of a macro level here. I guess I'd just like to understand, as we've seen, sort of … contract. I'd just like to understand; how does that compare in terms of previous contracts. And then, as you look at, sort of, the 75% virtualized by 2020, how does that change, or potentially how do you think that changes the relationship with AT&T … 2020?

Yaron Ravkaie:

So, you really broke up Bhavan, something's bad with your line. But if I understand correctly, you asked some questions on the AT&T contract, right?

Bhavan Suri:

Yes. Was there any difference compared to the old contract? And then, given that they want 75% network virtualized by 2020, how does that relationship change post-2020?

Yaron Ravkaie:

So, as a reminder, the original contract on the AT&T project, and the information that was shared over the last several years, was an enterprise license, plus some additions that they needed over the years, plus some maintenance components. Those that were the main things.

Going forward, since they have already acquired a maint– an enterprise license for the software, there are components in the new contract that are primarily focused on things that they haven't licensed, plus maintenance. And since their network is dynamic, and they're introducing new technologies, on the virtualization, and, as well as, you know, investing a lot in continuation of their network transformations, those are the moving parts.

There's – they are not really dependent on that exact 75% target number, there are more, you know, generalized than that. But at the end of the day, I think the 75% number shows you that – how aggressive AT&T are in virtualizing their network and why we've been saying all the time that they are the most aggressive and most comprehensive, you know, tier – not even a tier one, a tier zero carrier, in the industry.

Bhavan Suri:

Got it. Got it. That's helpful. And then, if you look at the broader, sort of, … large deals, you know, we've seen some carrier announcements about launching a 5G network recently. I guess an update on the five-point deal you've discussed in the past, from the Galaxy operator, maybe the additional North American tier one operator, just some sense of the pipeline there. And then, a quick follow-up on that, just … number of …workshops you have in progress will be really helpful. Thank you.

Yaron Ravkaie:

So – as I think we ended 2019 – 18, sorry – with a note that we felt that there is slowness in the transformation, we can't now declare that, you know, there's an acceleration period. You will see carriers announce 5G deployments. These 5G deployments are – a lot of them are, you know, what we see as 4-1/2 G, or some very specific, very localized market trials that they are doing that don't require operators to do a massive change to their core network.

Our solutions basically monitor the core network. So, they're tied to an investment that they do comprehensive enough or start a comprehensive enough change in their network. We have, you know, I think, as we went through Mobile World Congress – Mobile World Congress and a lot of what the operators are looking for now is a combination of 5G and NFV. 5G is only available on virtualized technology. So, we see interest increasing, but we don't know how to translate it yet to – to, you know, really analyze in a high level of confidence the robustness of the pipeline.

We are excited about the potential because of the feedback that we're getting from the customers, and this is, you know, also the reason why we continue to press and invest on the R&D. Because we understand that we have, you know, a very good solution in the marketplace that is getting traction, but it's still early to say exactly at what pace and how it will transform.

Bhavan Suri:

Got it, got it, now that's helpful, and I appreciate the candor there. I guess one last one from me. When you look at the investments, obviously, sort of, and I think … virtualization needs a little functionality provided in offering some of the … et cetera. Your announcement of waiting for some of the carriers to catch up, you know, … roll it out at some point. But if you think of future investment in R&D, I think – I'd love to understand what sort of applications, what new applications you think and use cases, are you focused on, when you think about forward investment in R&D.

Yaron Ravkaie:

Aga– so, you know, we can talk, and not even days, like, we can talk weeks about this. It's a very – you know, very broad question.

I will tell you that in general, 5G combined with a fully virtualized technology, there's a lot of discussion in the industry, and you can see quotes from the AT&T CEO, Mobility CEO, Donovan, and you can see quotes from the Verizon CEO, and some others, both in the consumer electronics show in Vegas that happened this quarter as well as Mobile World Congress. They are positioning the evolution to 5G as the evolution that mobile networks went through, you know, with 3G and smartphones. And I think we all see how our lives changed in that evolution, and how the lives of the operators changed, and the challenges that they're facing, you know, with unparalleled growth in data traffic, and the – in the last couple of years, the shift to video, you know. Above 60, 70% of their network traffic, and in some cases even more, is video traffic.

The next round will be VR, and – and then, you know, the huge set of applications that – the way that they are positioning it is that there are going to be so many applications to the very high speed low latency, which is the characteristics of 5G, that the trillion devices connected to the network that are foreseen, you know, that we're going to break this number.

So, the use cases that we're working on, is in this, you know, very complex world that's getting more and more complicated with huge amounts of volume, huge amounts of devices, huge amounts of IoT devices, connected cars, all the way to remote surgeries that will require low latency – how to assure this type of networks that they're really performing to the level that the carrier's committing to it, and us as consumers consuming it, and how to help them reach such level of robustness and service, I guess, to us as – us as individual customers, and enterprise customers, et cetera, that this really will be a revolution.

So, that's the focus. We remain focused on assurance, but the assurance use cases will also grow very much. And maybe the last thing, you know, there – the cycles of deployment, and the deployment of 5G, is not a simple deployment. The amount of changes that are introduced by the carriers are huge. And sometimes it's also back to basics, that when you introduce a huge amount of change, you need the robustness of systems to make sure that this time to market to introduce these components are fast, and the quality is very, very high.

Of course, the architecture is much more advanced, and everything is automated, everything works by itself, introduction of artificial intelligence to help the carriers to do a lot of these things without human beings, without, you know, huge departments of Operations.

All of these are needed to deal with the enormous scale and the enormous amounts of traffic that these operators are going to face with the – and are already facing with each transformation. So, all of these things are the scenes and areas of investment where we invest heavily.

Bhavan Suri:

Got it. Now, that was really, really helpful. Thanks, guys, and thanks for taking my questions.

Yaron Ravkaie:

Sure.

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 we poll for more questions. *[pause]* The next question is from Alex Henderson of Needham and Company. Please go ahead.

Roger Boyd:

Hi, thanks. This is Roger Boyd on for Alex. I was wondering – just a quick question on the model. Does R&D continue to go throughout the year, as you kind of ramp up for 5G, does that continue to grow from the four million in the first quarter?

Yaron Ravkaie:

We – we currently don't expect it to grow. If it will grow, it will grow somewhat, as we reassess exactly the investment areas based on some specific things that might happen in the next couple of quarters. So – so, if we encounter, like, something that we need to accelerate. Our current plan doesn't call for an increase. But we are, you know, with the fingers on the pulse to closely see if we need to increase. We don't expect, you know, if we do increase, we don't expect huge increases.

Roger Boyd:

Got it. Makes sense. And then, just quickly, I was wondering if there's any update on the partnership with Red Hat, and maybe, how that's helping you go to market, and whether you're exploring some more – some more partnerships.

Yaron Ravkaie:

First of all, we're – we're, I would say, working on several interesting angles of partnerships, but we haven't disclosed anything publicly yet. So, in the future, when we will be able to, we will be under Red Hat relationship.

Red Hat has been a good relationship for us. It's, I would say, as one of the biggest challenges that an operator has when they're transforming their network to become a virtual network is how to set up the cloud. And Red Hat is a significant player in this domain, that basically supports carriers in setting up their cloud. So, you know, there – it's basically in that domain. Because, you know, in – if they don't set up their cloud, they're not setting – starting a real aggressive transformation process to virtual, and that's – that, you know, will cause them to be late adopters.

If they are treating the transformation seriously, then they bring companies – Red Hat, or companies like Red Hat – in, or they're – some of them are doing it by themselves, which accelerates the thing, and then it accelerates the need for a new assurance stack, and that's where we come and play in.

Roger Boyd:

Makes sense. Thanks for the questions.

Operator:

The next question is from Josh Goldberg of G2 Investment Partners. Please go ahead. *[pause]* Excuse me? Josh Goldberg? Are you on the line?

Josh Goldberg:

Yes. Can you hear me okay? *[pause]* Can you hear me okay?

Yaron Ravkaie:

Okay, great. Yaron, obviously, your business is more project-driven than most companies in the public markets. And, you know, year over year, it looks like you had a 45% decline in revenue.

I don't think that's any indication towards the number of projects you're working on, or your pipeline, or anything else which has to be grown based on, you know, demand for 5G networks being dealt out recently to a lot of different companies in the ecosystem.

Maybe, just, help investors understand that a little bit more, without going … about your backlog or your pipeline. Just some of the opportunities that you have in front of you outside of the customers you already landed that could really mean for you to increase your business. And I have a follow up.

Yaron Ravkaie:

So, I can't give real – a lot of information. You know, in some cases, the – you know, a lot of these processes are competitive processes, and also, they – you know, they are under NDAs and proprietary with the customers.

I would say that we have several processes that are – some have been ongoing, some are new – all of them, each one has a bit of different characteristics. If I try to find some theme, everybody, you know, all the customers are starting to ask for 5G support.

We see some more – I would say, customers getting close to the point that they're pulling triggers on NFV, or they're doing some things that are requiring them to invest. And we're engaged – we feel that we're … with the correct set of customers and we're, you know, getting the right level of interest. And we're also getting very strong feedback on the advancement of our product and the fact that it's – that they are looking – you know, at the end of the day, most of the industry, or, you know, most of the operators have legacy solutions in our domain. So, they know the space, they know the competition, they're using a competitive product. But it's in the legacy realm.

So, we're getting a very strong feedback that the products that we're showing, and the solutions, are very advanced. And – and that's why, you know, we're heads down, continuing to push the R&D forward and these things, for – because we believe that this transformation is not simple for the customers. I think if, maybe, three, four years ago, we expected it to move a little faster, we see that it's not so fast. And I think it's also because of the fact that the NFV started, some were waiting, and then the 5G started on top of it, and now, these are being combined.

From what I see, we are well positioned from a technology perspective and from an engagement with the customers perspective. So, it's really being with them to see how, you know, they initiate these projects and spend cycles and we can capitalize on them. You know, there's exciting stuff that are happening, and we'll talk about it when we can talk about it.

Operator:

There are no further questions at this time. This concludes the RADCOM Ltd. first quarter 2019 results conference call. Thank you for your participation. You may go ahead and disconnect.

(End of conference call)