RADCOM

Q2-17 Financial Results Conference Call

Management's Prepared Remarks and Q&A

August 7, 2017

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Radcom Ltd. Second Quarter 2017 Results Conference Call. All participants are at present 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 star-zero. As a reminder, this conference is being recorded, August 7, 2017.

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 the 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 2017 financial guidance, including revenues, gross margins, quarterly fluctuations and profitability.

The expected impact of the changes in Israel Innovation Authority grants, cash available for new opportunities, strategy, market share growth, and extension of its leadership position, potential pipeline and opportunities, investments in the infrastructure and research and development to support the company's growth, expected continuance of the company's momentum in the second half of 2017, AT&T's continuance as an important customer and a key reference, and its plans to virtualize approximately 55% of their network by the end of 2017, and projected sales cycles and relationships with top-tier carriers. 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 set forth in the presentation and in 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 charges, 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 performance – on a consistent basis for the – 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. 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. Please go ahead.

Yaron Ravkaie:

Thank you, Operator. And thank you all for joining us today. We were very pleased with our execution during the second quarter, as we made significant progress on our key initiatives. In particular, our relationship with AT&T continues to grow. On their most recent earnings call, AT&T again emphasized their network virtualization efforts being one of the main factors for their improved operational efficiency.

Also, AT&T reiterated that they are well on their way to virtualizing 55% of their network functions by the end of 2017, up from 34% at the end of 2016. As a result, we continue to expect AT&T to remain an important customer and key reference for the company, as we continue to play a major part in their network virtualization strategy over the coming years.

Regarding our pipeline of opportunities, we are pleased to say that we finalized a very comprehensive NFV trial with a top-tier service provider, which we now expect to result in a new important NFV project for the company. We continue to engage with other top-tier service providers, executing trials as well as expanding our sales activities. We are focused on the service providers that are either planning on migrating to NFV, or those that have already begun their NFV transformations.

As a reminder, we expect the NFV transformation to be a five- to ten-year cycle, with the early adopters being followed by additional service providers. We now see the industry gravitating around open stack as the operating system for cloud networks, as well as ONAP being the open-source standard for advanced service in network orchestration.

We are closely following these industry trends, which are very favorable to Radcom, as AT&T continues to drive the underlying architecture and requirements significantly, and we are a major part of this ecosystem. As NFV is a transformation that is at the cutting edge of technology, it is difficult to forecast the path of the transformation.

However, with the NFV trial mentioned previously, we see that when a service provider decides to virtualize their mobile network, Radcom is the go-to standard and leading the industry for NFV service assurance. Another important factor is that we are reiterating that the decision-making cycle for the service providers is not short.

This is driven primarily by their ability to finalize their NFV transformation plans, and move from trials that they are executing on their entire mobile network, and then moving to actual deployment decisions. We are assuming that as more service providers transition to NFV, the technology maturity and standardization with ONAP will drive more service providers to start actual transformation, and move from the lab stages.

We also expect service providers to significantly reduce their equipment spend, as they don't want to create throwaway as they evaluate and move forward with their NFV plans. This can create pent up demand, which, again, is very favorable to us, and can have a positive impact in the future.

Given our strong and growing pipeline of opportunities, we are confident that our investment in infrastructure will pay off, and as Ran will highlight in a few minutes, we plan to increase our investments to support this new NFV relationship. With this significant inflection point for the company, we are expecting to remain with a moderate non-GAAP operating profit, as we capture the NFV market.

We believe the increase in investment will result in future returns, allowing us to capture additional opportunities as well as advancing our product leadership, given that a significant part of our investment is made into our R&D.

Now, moving on to our results for the second quarter. We are very pleased with our second quarter results, and as you can see on slide 6, revenues for the quarter increased by 24% year-over-year to 8.9 million dollars. Our GAAP net loss was 204 thousand dollars, or 0.02 dollars per share.

We achieved a non-GAAP net income of 0.4 million dollars, or 0.03 dollars per diluted share. Similar to the past few quarters, we are focused on continuing our close relationship with AT&T, executing on existing contracts, including expansions with current customers, running trials with new customers, and investing in our engineering resources as we move to a new phase, and prepare to engage with an additional top-tier operator.

During the quarter, we are pleased to have closed an additional purchase order with one of our key accounts in APAC, Asia Pacific, and an important expansion deal with a tier-1 operator in Latin America. The progress during the second quarter highlights the advantage of being a first mover in this space, and participating in the most aggressive transformation today.

Our approach of enabling a path to NFV, and future proof-in-purchasing decisions continues to resonate with customers, and we expect the momentum to continue during the second half of the year and beyond. So, to summarize, we are very pleased with our execution during the second quarter.

Given that Radcom remains the go-to NFV vendor for customer experience, we are well positioned to maintain the momentum. With that, I will stop and turn the call over the Ran Vered, our CFO, to discuss the financial results. Ran, please.

Ran Vered:

Thank you, Yaron and hello.

Since you have the financial result, I will just go over the highlights in slide 6. To help you understand the results, I will be referring mainly to non-GAAP numbers, which exclude share-based compensation. Revenue for the quarter was 8.9 million dollars, up 24% year-over-year. Our gross margin for the quarter was 71% on a non-GAAP basis.

As a reminder, we expect gross margin to continue to fluctuate, depending upon the mix of each quarter revenue. Our gross R&D for the quarter on a non-GAAP basis increased to 2.6 million from 1.6 million in the second quarter of 2016, which was in line with our ramp-up plan and highlights our strategy of investing to support future growth.

Also, we receive approximately 312 thousand from the Israel Innovation Authority during the period, compared to 756 thousand in the second quarter of last year. As a result, our net R&D for the quarter was 2.3 million, compared to 807 thousand last year.

We wanted to point out that we now expect to receive approximately 600 thousand dollars from the Israel Innovation Authority during 2017, compared to 2016, when we received approximately 1.7 million. This is due to changes in the way the government manages the plan. It is important to note that this does not exchange – change how we plan to operate the business, as we remain committed to innovation and extending our technology leadership.

Sales and marketing expenses for the quarter increased to 2.8 million on a non-GAAP basis, up from 1.7 million in the second quarter of 2016, due to headcount increase we had over the past year, aligned with our go-to market strategy. G&A expenses for the quarter on a non-GAAP basis totaled 775 thousand compared to one million in the second quarter of 2016.

Operating income on a non-GAAP basis for the quarter was 380 thousand compared with 1.6 million for the second quarter of 2016. Net income for the quarter on a non-GAAP basis was 416 thousand or 3 cents per diluted share.

On a GAAP basis, as you can see in slide 5, we reported a net loss for the quarter of approximately 204 thousand dollars or 2 cents per diluted share. Turning to the balance sheet as we can see on slide 9, our cash and cash equivalents as of end of the quarter were 36.2 million. We believe that our strong cash balance places the company on a solid footing for addressing the big tier-1 opportunities.

Now, turning to guidance. We are reiterating our fiscal 2017 guidance range of 36 to 29 million in revenues. Given the strong first half results combined with overall visibility with existing and potential new customers. While we don't plan on providing quarterly guidance, we wanted to point out that the revenue can become lumpy due to the timing of specific project milestones. Therefore, we can see Q2 revenue ranging from slightly down, down, or above Q2 results.

Given the several key milestones for …tail end of Q3, and can be pushed out to the next quarter where our annual guidance remains the same. Given our expectation of the new NFV trial to result in a project, we are increasing our R&D, our gross R&D expense to show that we have the appropriate resources in place to service this new tier-1 customer.

This, combined with the changes in the Israel Innovation Authority that I mentioned earlier, is expected to result in operating profitability during the second half of the year to be roughly the same level as the first half of the year as we continue to invest in infrastructure.

As a reminder, we view and continue to manage our business on an annual basis, because our quarterly results can fluctuate due to timing of implementation milestones. That ends our prepared remarks. Yaron and I will turn it back to the operator so we can take questions. Operator.

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. The first question is from Alex Henderson of Needham and Company. Please go ahead.

Alex Henderson:

Hi, guys. Just wanted to make sure I got a clean statement of what you're saying here. So, the third quarter, you're suggesting, is probably fairly close to the second quarter on the revenue, but you're not changing your full year, so – piling it a little bit more into the fourth quarter, based on timing issues. Could be up or down in the third quarter, is what I caught. Is that correct?

Yaron Ravkaie:

Yes. Could be slightly down, or slightly up. So there is a range there, and we decided to disclose it so everybody can model it accordingly.

Alex Henderson:

Yeah. And then, the second thing is, just to be clear, the NRE, coming in at 600 or so for the year – should we be using that in '18 as well? It's hard for us to know what the changes in the NRE program in Israel looks like. So, is that consistent with what we should be using next year as well?

Yaron Ravkaie:

It's hard for us also to say. I think, as you know, we modeled it a little bit different. I think – one model can be to carry to next year, and as we get clarity into exactly the plans, we'll share it. It's not a secret.

Alex Henderson:

Right. But we still have to forecast that tomorrow –

Yaron Ravkaie:

Yeah, I would just –

Alex Henderson:

It's just using the same amount?

Yaron Ravkaie:

Yeah.

Alex Henderson:

Okay. And then, just going back to the programs that you've announced here. It sounds like a large program in Lat Am. Can you, kind of, give us a sense of what the structure of that is, and similarly for the Pac Rim. Is it starting now, going to roll out over the next couple of quarters? Is it starting in '18? When does that show up in – those two contracts show up as revenues?

Yaron Ravkaie:

Latam and APAC?

Alex Henderson:

Yeah. The Latam expansion and the APAC project.

Yaron Ravkaie:

The – APAC –

Alex Henderson:

You made two announcements, of two contracts. On the call, you just talked about a deal in Latam and a deal in APAC.

Yaron Ravkaie:

Yeah.

Alex Henderson:

When do we expect those revenues to accrue? Is it going to be smooth, is it going to be – starting this year, is it going to be next year? Can you give us some – some, revenue recognition?

Yaron Ravkaie:

Both of them are going to start to impact us positively this year.

Alex Henderson:

So a little bit in '17 and the majority in '18? Or – partly? 50-50, or 75-25? Any – any sense of the cadence between the two years?

Ran Vered:

The majority will be in 2017, and the remainders in 2018.

Alex Henderson:

Okay. And then, we have talked about a number of projects, nine or so companies that are talking about doing field trials, three or four that were in field trials. Can you give us an update where we are on those projects? Is there any progress in bringing down some of these larger deals that you've been talking about and chasing after?

Yaron Ravkaie:

Yeah. So, first of all, you know, we were disclosing here that we were close to a project on one of them. So I think that's very positive news for all of us. The remainder of the trials basically continue. Some have finished the evaluation, the technical evaluation stage, now they're in – they're more like coupling the decision around us, and exactly what type of project to do, together with how their transformation to NFV looks like. This is why, you know, when I refer to many of the comments in the scripted portion, I try to give color on some of these carriers as they make decisions. I'm expecting some of them to continue to evaluate how we fit into their plans, and this can potentially turn into deals in 2018, I would say, maybe with some early surprises this year. So – but the one that we disclose, we expect it to materialize this year.

Alex Henderson:

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

Operator:

The next question is from Dmitry Netis of William Blair. Please go ahead.

Dmitry Netis:

Thanks very much. Congrats on the good quarter, guys.

Yaron Ravkaie:

Thank you.

Dmitry Netis:

Okay. So, I just want to make sure you've addressed Alex's question, and that we've captioned this correctly. I think what you had said was, the two deals were the expansion deals in APAC and Lat Am. And then, on top of it, this is separate, you won an NFV with a fairly large tier-1 operator, which is an NFV project. The other two I think are kind of a continuation of your existing relationship. Is that correct?

Yaron Ravkaie:

Yes, that's correct. I would – it starts by being excited from our tier-1 win, and then the – if you recall that I mentioned – I think I touched on it last quarter – that the company did a very good job in doing work with our existing installed base. The result of the expansion in Latin America and the expansion in Asia Pacific is the result of that work.

Dmitry Netis:

Okay. And then, let's focus on –

Yaron Ravkaie:

Which –

Dmitry Netis:

Thank you, Yaron. Thank you for that clarification. Let's focus on the NFV project in hand. Can you tell us the geography you won that customer, and, you know, roughly, the size. Is that similar to the size of AT&T? Smaller? I mean, I can't imagine anybody being bigger than AT&T at this point. But, just give us a little color around this project, and – just want to make sure you will expect to see revenue in the back half of this year. That's basically what you said. But just, kind of, correlating to the size of this project, vis-à-vis the AT&T project you currently have.

Yaron Ravkaie:

Okay. So, I'm going to disappoint you, Dmitry. I need to stay quiet on this for the time being. And I do promise that when I can disclose, I will. It's a sensitive time with, you know, reaching the signature phase, and – with this customer.

Dmitry Netis:

Okay. But do we know, like, the size? Is it a fairly material operator? As big as AT&T? Can you comment on that? Or is that not possible at this point, as well?

Yaron Ravkaie:

I would say that – it's not possible, but I would say, it's a very important milestone for the project, and I think you can – you know, you can, like, understand the importance, also, from the fact that you see the level of investment that we're preparing for it. And as this thing gets clear and fully secured, we will make an attempt to disclose more, of course without violating anything that we're not allowed to violate.

Dmitry Netis:

Okay. Fair enough. I'll leave that be. Let's then, maybe, focus on AT&T this quarter. What was the rough contribution of AT&T in the quarter?

Ran Vered:

Hi, Dmitry. So, AT&T contributed roughly 47% to the revenue this quarter.

Dmitry Netis:

47. Okay. And, when you guys said you expanded the relationship with AT&T, what do you mean by that? Was there additional – you know, this is like a licensed – and a pretty defined schedule. So are you winning new applications at AT&T is what you mean? Or do you have additional maintenance that's flowing in the model right now? Can you give us a little – color on what's going on with AT&T?

Yaron Ravkaie:

Just one second, Dmitry. [pause] So, we – we're working with the – we're on an ongoing basis, working with AT&T. And we're receiving additional work that was not contracted in the original contract. What we can say is that we now forecast the – till the end of the year to be at around 55% revenue coming from AT&T, which is, I think, higher than the 50, if I recall, what we forecasted before.

Dmitry Netis:

Okay, great. And –

Yaron Ravkaie:

Just take into consideration, some of this is also impacting next year, the relationship. It's – to summarize AT&T, it's a positive relationship, we continue to deliver on the ground, it's an active implementation at the cutting edge. And we focus on the things that we contracted to do. And once in a while we're asked to do additional things, due to the positive nature of the relationship. And it's going very well.

Dmitry Netis:

Okay. Very good. So, just to summarize – I mean, whatever the run rate business you had, which was a three-year contract, so if I took that number, split it in three, next year, that number is going to be higher by that additional contracted work that you won during the quarter. Is that fair?

Yaron Ravkaie:

Some of it might also impact this year. So – we still don't know exactly, you know, there's a lot of accounting math and project math involved. So we'll see some of it this year, and some of it next year. And there are still stuff –

Dmitry Netis:

Okay.

Yaron Ravkaie:

Also from the previous things that were signed that still impact the coming quarters, and also impact next year. So –

Dmitry Netis:

All right. Okay. Very good. And – on the OpEx side, I just – that's my last question. You said you were increasing the R&D levels. You did about five million, excluding the OCS grant, including the 4.7 million of R&D – are you – So, what you're saying, basically, is that's the projection for the remainder of the year? September-December, we should be thinking about, kind of, roughly, five million in R&D? Just, kind of, verify if that's the case. And then, what are you investing, as far as Sales & Marketing goes, to support new projects? If you can give us additional personnel you're hiring, what that number is, in support of this new project, that would be super-helpful.

Yaron Ravkaie:

I think what we're saying is the overall profitability in the second half will be similar to the first half. Now, when you model, you see that the revenue projections for the second half are higher, which means that the costs are going to be higher. A lot of them are going to go into the R&D. We – we're now – because of the nature of the – of this new tier-1, and the fact that some of the exact scope and the things that I can't disclose, either because some of it I don't fully know yet – how it impacted the year, and how it impact our resource plan, we're actually going through this exercise in the coming weeks. So – but at the high level, this is what we're modeling, what I just mentioned – an increase in the R&D, an increase – not so much an increase in Sales & Marketing, maybe there will be some increase there. And to maintain an overall profitability that we maintained in the first half.

Dmitry Netis:

Okay. Yeah. Yeah, I apologize. I should have mentioned profitability. I was looking at, sort of – I understand as your revenue would go up, you – you would have –

Yaron Ravkaie:

So the head count will go up, basically.

Dmitry Netis:

Understood. Okay. Understood. So – okay. And then, how are we thinking about next year? I mean, what should we be thinking, right now – you know, the models are sort of touching, kind of, the 9-10% operating margin, so we – so what should we be thinking, as far as operating margin, coming into next year? How – any guidance, if you will, or is it too early?

Yaron Ravkaie:

No, I think it's a little bit too early for us to accurately model next year. If you use some top-down approaches, is – it's – if we generate, you know, around the range that we're gravitating in the models for next year, then we're going to see already higher profitability next year than this year. But we don't have anything, I think, smarter to say than what's currently modeled. And I think, as we go into the second half of this year, and the clarity with this new tier-1, and more the ability to forecast, of course, you know, we'll give the coloring there, make sure that you guys modeled it as accurate as we can.

Dmitry Netis:

Okay. All right. And, Yaron, can you give us a sense of how many people you need to support this additional NFV win? Either R&D or Sales, either way?

Yaron Ravkaie:

We're probably going to only be able to give it next quarter, or – probably next quarter. This is exactly what we are doing now. But –

Dmitry Netis:

Okay.

Yaron Ravkaie:

You can do – if you do – you can roughly do the math, right? Because we've disclosed most of the pieces of the equation.

Dmitry Netis:

Right. Okay. All right.

Yaron Ravkaie:

An accurate number, and exactly what goes to R&D, what's cost of Sales, things like that, that's what we're working now on.

Dmitry Netis:

Okay. I appreciate it. Ran, Yaron, thank you guys very much. I'll take the rest offline. Thank you.

Yaron Ravkaie:

Thank you.

Ran Vered:

Thanks, Dmitry.

Operator:

The next question is from Mike Arnold. Please go ahead.

Mike Arnold:

Hi, Yaron. Thanks for taking my question. If you can say, I'm just curious, is – was this deal, the tier-1, I guess, the top carrier one that we're talking about here – was that a sort of direct-to-customer sort of sale, or trial, or was it something you would go to market with a partner on that one?

Yaron Ravkaie:

The – you came across a little garbled, so you're going to need to repeat.

Mike Arnold:

Oh, I'm sorry. Yeah, I'm curious, on the top-tier customer that we're talking about on the call today – was that a direct-to-carrier sale, or did you go to market with a partner?

Yaron Ravkaie:

Direct.

Mike Arnold:

Okay. And, I'm curious also, in terms of your partnerships – Amdocs, on their call last week, they talked about – a couple ONAP deals that they apparently had won on their earnings transcripts, with Bell, Orange and Comcast. Should we still assume sort of a high probability that Radcom will go along for some of those deals? Or how do you guys, sort of, slot into that scenario?

Yaron Ravkaie:

First of all, as – there is the Amdocs angle, and the ONAP angle – sometimes they align, but they are not – they don't overlap, not always overlap. So both of them are – can have the potential of driving business. I would say that the company's focus today is more on the mobile networks, this is where we see the big demand for customer experience. You need less customer experience in wireline and cable operators, although we're checking these markets to see what type of customer experience needs do they have. And we'll take it from there. So the – the answer, I think, is, as we see mobile operators go to ONAP, there's a – there should be a direct correlation with our ability to generate business there. You know, of course, you need to work with these operators, not only – not every – not – it's not automatic that they choose ONAP that, you know, that we get a deal. Okay? So, we need to work on that. And on the – when it's not a mobile operator, it's yet to be seen. So, the need for customer experience or core-based assurances is still under definition, and we're working on it. And we'll share this when it becomes more mature. We start to engage them. Some of them.

Mike Arnold:

Okay. Okay, very good. And then I – do have one more question regarding the competition. Your big incumbent competitor is sort of out there talking to analysts and investors that – they still feel like they're at the front of the line, at all the CSPs around the world for a service assurance deal. I guess I'd just ask how you'd respond to those comments, in terms of being first in line as it relates to the pure service assurance NFV deals, going forward?

Yaron Ravkaie:

How David respond to Goliath? [pause] It's a biblical question.

Mike Arnold:

Yeah, I know.

Yaron Ravkaie:

So –

[laughter]

Mike Arnold:

Okay.

Yaron Ravkaie:

You know, with a big – with a rock between the eyes. So I – it's not a – though they – I don't – I can't control what they comment. What we – we see NetScout in some of the – as a legacy provider in some of the installed base that we address that are moving to NFV. We see a lot of positive feedback from all the customers on what they are seeing from us. And with clear feedback that we have the differentiating technology. So you can do the math of what they have. You know, I don't sit in their R&D labs. But feedback from the customer is usually the most valuable one. And I think the progress that we are making, and, you know, I disclose what I can on this and more to come, as we say, is, I think, evident of the progress that we are making. I – you know, they do have a huge install base. So I do expect once in a while that they will announce a deal here and there that's exactly like I announce here, an extension of APAC, or it's an extension of Latin America. They will have – they continue to do business, they're not out of business. So – we will – I'm assuming that we will see some of that as well.

Mike Arnold:

Okay.

Yaron Ravkaie:

I'm trying to focus, –

Mike Arnold:

All right, thanks.

Yaron Ravkaie:

Big prizes. So, that's where we are focused.

Mike Arnold:

Okay. Thank you, appreciate it. Good luck.

Yaron Ravkaie:

Thank you.

Ran Vered:

Thanks.

Operator:

There is a follow-up question by Alex Henderson. Please go ahead.

Alex Henderson:

Yeah. So, given your guidance here for the back half of the year, with a substantial increase in R&D and a falloff in the NRE, it sounds like you're talking about, roughly, three and a half million plus in quarterly revenue, or quarterly R&D in the fourth quarter. Is that the right ball park that we should be thinking about?

Ran Vered:

So, what you're saying, Alex, is that, you know, on our overall OpEx, or on the other way around on our profitability, on our operating income, which we say that taking the guidance on the revenue and taking the level of OpEx, that the second half of the year in terms of nominal profitability will be the same level as the first half. So –

Alex Henderson:

Yeah, Ran, I heard the guide, and – but I'm just having a hard time making it work. So I'm trying to figure out how it works. And it sounds like you go to a pretty good loss in the third quarter, and a spike in revenues in the fourth quarter. So, you're offsetting the loss but still getting a pretty good sized profit in the fourth quarter. But the fourth quarter exit rate on R&D is important, because I would assume, and the second question is, that that continues at that level as we go into the first half of next year. So I'm just trying to right gauge my expense levels exiting the year. So the R&D line is a critical variable here, and it sounds like three and a half million plus is the exit rate. Is that correct, or am I off?

Yaron Ravkaie:

It makes sense, if it's –

Alex Henderson:

Okay, and then, second question, along the same lines, then. Are we seeing any down draft in the gross margins in the back half? Or are they staying in the 70s?

Yaron Ravkaie:

So – we don't see – currently, our model is to have the gross margin to be in the 70 plus.

Alex Henderson:

Okay. So it's all in the OpEx lines, then, that causes the down draft in the EPS in the back half relative to prior forecast.

Ran Vered:

Yes.

Yaron Ravkaie:

Just, Alex, note that Q3 can be higher than Q2, or slightly lower. We don't know yet where it'll fall. So –

Alex Henderson:

Yeah. But clearly, it's going to produce a loss in either case, given the significant increase in R&D spend.

Yaron Ravkaie:

If it will be higher than Q2, it won't result in a loss.

Alex Henderson:

Well, then, how do you get the spike in the fourth quarter and not end up with a higher profitability than the first half? I mean, the first – the fourth quarter alone ought to be larger than the first half.

Yaron Ravkaie:

No, but then the – if you look at half by half, then – just make sure – it's hard to model per quarter, because we're not giving the – because we don't know exactly what we'll have. And when you calculate,

Alex Henderson:

All that you've given us the third quarter guide and a full year, the fourth quarter's solvable. By definition.

Ran Vered:

But keep in mind that the ramp – we are in the process of ramping up, and some of the ramp-up –

Yaron Ravkaie:

Will happen in Q4.

Ran Vered:

Will happen, or even most of it. This is something that is hard for us to predict, when the ramp-up will be. So, actually, assume that most of the ramp-up will be in the tail end of Q3, in the beginning of Q4.

Alex Henderson:

Right. So, again, three and a half million dollar run rate on R&D, is that the rate that we should be starting the year at 18 at?

Speaker:

It makes sense, Alex. It makes sense.

Alex Henderson:

Okay. And then, could you tell us what the head count was for the second quarter?

Ran Vered:

Yes. So we are currently at 205 people.

Alex Henderson:

And – okay. So, how much of the pressure on margins here is a function of the exchange rate swings that have occurred over the course of the quarter? I mean, clearly, the shekel has moved quite a bit.

Ran Vered:

Yeah, that's a good question. So, actually, comparing to Q1, on a constant currency basis, we actually took a hit of two thousand dollars this quarter.

Yaron Ravkaie:

Two hundred.

Ran Vered:

Two hundred thousand. Yes, sorry.

Alex Henderson:

So, it's costing roughly 600 thousand dollars swing in the numbers over the course of the year?

Ran Vered:

Yeah, exactly.

Alex Henderson:

All right. And – just going back to – to the 2018 numbers, then. I realize you guys have lots of variables here. But the straight numbers assume a pretty good ramp, and they were predicated on a pretty strong fourth quarter exiting the year. It sounds like what you're guiding towards, that the full year EPS for next year is, on the street, may be quite a bit too high, at least, from the perspective of taking NRE down, but also, probably from the rate of spend in the fourth quarter being annualized over the course of 2018. Sounds like those numbers are too high. Would you give us some general guidance of how we should be thinking about that? I realize you don't want to be too explicit, but, again, the street does have to make forecasts, and the – you know, this is a fairly important determinant.

Ran Vered:

So – I think it's a little bit premature. We are just now including, or start to include our ramp-up plan. But I think it's a fair assumption to assume that the plan to profitability will be a little bit less than the current forecast, from both the NRE perspective that you mention, and due to the ramp-up. How much it will be down, if it's going to be – instead of 14%, if it's going to be 10, or 12, or 8 – it's really a little bit premature to say.

Alex Henderson:

All right. So just to be clear, this is success-based spending as a result of your visibility on new contract wins that you think are likely to drive incremental needs to deliver, both on the Sales & Marketing installation front, as well as on the R&D support front.

Ran Vered:

Exactly. Exactly.

Alex Henderson:

All right. Thank you.

Operator:

The next question is from George Marema. Please go ahead.

George Marema:

Hi, good morning, Yaron.

Yaron Ravkaie:

Hi.

George Marema:

I was wondering, several months ago, you guys showcased the MaveriQ running on OSM. And there are some rather, I'd say, aggressive, tier-1s out there that are sort of warming to the idea of merging OSM into ONAP. I was just curious, with that ecosystem, how Radcom – Radcom's position is.

Yaron Ravkaie:

We're positioned very well for this to happen. So, with the – the key service providers that have been working on OSM, we have – we've – we have an existing relationship with them, and they see the potential. So, I would expect the – the adopt ONAP just to have a magnifying positive impact. To already a positive situation.

George Marema:

And then, back in the summertime, you sort of talked about you were testing in the lab some additional use cases for VPros. And on your website, you have several different products that are listed, in all kinds of areas. You have, like an M2M, analytics products, like a marketing products. Can you give us an update on where those products are, and when you might expect some kind of deployment of such products? Expansions?

Yaron Ravkaie:

First of all, everything that we have on the website is installed with some customer. We didn't put, you know, futuristic modules on the website. I would tell you that the major focus of the company is to do the heavy lifting required for a carrier to move into NFV. Which is basically providing him – them the eyes, the assurance eyes, that their NFV network works. That's where most of the focus of the company is today. And, because we think this is the number one task that the industry is gravitating against. And because of that, as we progress, and continue to progress, we do have additional things that we work on and, you know, we might work on in the future, which will be adjacent to this. If we go and completely go after another addressable market, I'll disclose it, and I'll give the color.

George Marema:

But what it sounds like in general, if we're taking a macro view of this, that Radcom is slowly but surely expanding its addressable markets into – you've had recent announcements of Comcast cable, moving with Amdocs, you have additional use cases we're testing. So, is it fair to say that over time, that Radcom will continue to expand its addressable markets?

Yaron Ravkaie:

The address – maybe I'm missing something in the terminology. But the addressable market for us, or the addressable market, let's say, that we have a significant advantage is where service providers migrate to NFV, we are like the standard assurance, because of everything we've done with AT&T, and now we'll be doing with this additional tier-1 carrier. And that's where the focus is. Now Com – you know, you mentioned Comcast, and Comcast is a cable operator. So, don't have – it's not in our addressable market yet. What I mentioned earlier is that we are looking at the cable … operators, and also operators that launch solution in the fixed line, whether it's business or residential, to see how their assurance needs, or customer exper¬– probate customer experience and assurances is the area – areas that we operate, providing value. Now we believe that there is an angle there that will increase the addressable market, but it's not the main focus of the company as of today. It might be an area that we start to extend into 2018.

George Marema:

Okay. Thank you.

Yaron Ravkaie:

Thank you.

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] There are no further questions at this time. Thank you. This concludes Radcom Ltd. second quarter 2017 results conference call. Thank you for your participation. You may go ahead and disconnect.

(End of conference call)