Q4-18 Financial results conference call

Management's prepared remarks and Q&A

February 12, 2019

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the RADCOM Ltd. Fourth Quarter and Calendar Year 2018 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 February 13th, 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 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 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 and status of negotiations, pipeline, 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 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 Investor section of RADCOM's website at www.radcom.com/investor-relations. If you have any trouble, send Mark Rolston 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. Earlier this morning, we issued a press release stating our results for the fourth quarter and full year 2018. As you may have seen, total revenues were 4 million dollars for the fourth quarter of 2018, bringing our total revenues for the year to 34.1 million dollars, an 8% decrease from 2017.

The results for the fourth quarter and the year-over-year decrease reflect the slower than expected pace of NFV transformation that we have seen and previously discussed and that we continue to see. We believe that these delays in operators' decision-making towards the adoption of NFV are due, at least in part, to uncertainty regarding the timing of 5G deployments and the operators' desire to lay out their road maps before making investments. As a result of these factors, it is still uncertain when exactly operators will make the decision to transition to NFV and 5G. Taking all this into account, we are currently providing revenue guidance for 2019 for 28 to 32 million dollars.

While our guidance for now does not forecast growth, we believe that the pace of NFV transformations will be positively impacted by 5G rollout and as a result, we remain confident about the important role NFV will play and remain confident in our business and technology strategies. We continue to work on new sales opportunities. We continue to invest in advancing our technology and positioning our solutions as the go-to NFV and 5G service assurance and network visibility solutions.

During the fourth quarter, we continued to make progress on our deployments with existing customers, while enhancing our product capabilities to accommodate new cases requested by operators. We are working very closely with AT&T to maintain their technological edge in software-defined networking. We are in advanced discussions with AT&T regarding their roadmap and our commercial engagements with them for 2019 and beyond. AT&T remains on track with their goal to transition 75% of their network functions to NFV by 2020. We maintain sales and marketing efforts with new operators and are in the process of performing several proofs of concept demonstrations with top-tier operators in Asia, Europe, North America and Latin America, that are thinking ahead about their technology needs, particularly as it relates to the 5G rollout and the future use cases enabled by 5G.

We also continue to invest in research and development to maintain and extend our technological leadership within the service assurance and network visibility space. We are constantly working to ensure that we maintain a cutting-edge NFV 5G portfolio. We are investing in the development of new use cases and applications, which enhance the capabilities of our solutions and will meet our customers' needs today and in the future.

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 strategy of targeting top tier operators transitioning to NFV, even when facing longer sales cycles and lumpiness in our revenues. Looking beyond the current guidance, it is important to keep in mind that RADCOM remains the leading NFV vendor for virtual probe-based service assurance and customer experience management.

Our solutions provide operators operational flexibility and cost efficiency by reducing CAPEX, and operational costs and by offering long-term upgradability through our cloud-native technology. We believe we are well positioned to take advantage of the move to NFV and 5G once operators move forward with their plans. We continue to see interest in our solutions and have gained industry-wide recognition as a provider of NFV service assurance. Our portfolio maturity and experience gained through the AT&T transformation is second to none and is in demand.

We also see ongoing activity around NFV and increased activity around 5G, where we believe our NFV solutions are needed prerequisites given the complexity of 5G technology. As a result, we remain confident and focused on our business strategy, the future of NFV, the superiority of our NFV offerings and the role RADCOM expects to play in the NFV transformation to come.

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.

Revenue for the quarter were 4 million, down by 62% year-over-year. As we have previously discussed, we continue to expect lumpiness in our revenues going forward. Our gross margin for the quarter was 64% on non-GAAP basis. Gross margins were affected by the level of revenues and the product mix. As a reminder, we expect gross margin to continue to fluctuate depending upon level of revenues and mix of each quarter revenues.

Our gross R&D for the quarter on a non-GAAP basis increased to 3.9 million from 2.9 million in the fourth quarter of 2017. Although during the fourth quarter, we received 366 thousand dollars from the Israel Innovation Authority, compared to one million 132 thousand dollars in the fourth quarters of last year. As a result, our net R&D for the quarter were 3.5 million, an increase from 1.8 million in the comparative period last year.

Sales and marketing expenses for the quarter were 2.6 million on a non-GAAP basis, slight decrease from 2.7 million in the fourth quarter of 2017. G&A expenses for the quarter on a non-GAAP basis totaled 643 thousand dollars compared to 846 thousand dollars in the fourth quarter of 2017. *[pause]*

Operating loss on a non-GAAP basis for the four – for the quarter was 4.2 million compared with an operating profit of 2.7 million for the fourth quarter of 2017. Net loss for the quarter on a non-GAAP basis was 3.7 million or a loss per share of 27 cents per diluted share. On a GAAP basis, as you can see on Slide 5, we reported net loss for the quarter of 4.1 million or loss per share of 30 cents per diluted share.

I will now highlight our results for full year 2018. Total revenue was three – 34.1 million, decrease of 8% compared to full year of 2017. During the year, AT&T accounted for 47.8% of total revenues. During the full year 2018, the non-GAAP gross margin was 74%. Non-GAAP operation – operating loss was 1.4 million and non-GAAP net loss per share was two cents for the year base – two cents. For the year base of – on 13.6 million diluted shares.

[pause] Headcount. *[pause]* At the end of 2017, our headcount was two hundred – 233. We expect our headcount to remain steady with some increase in R&D investment, as we continue to invest in our cutting-edge technology.

Turning to balance sheet. As you can see on Slide 9, our cash and cash equivalents at the end of the quarter were thirty – 62 million dollars. We believe that our strong balance sheet place us on a solid footing to execute on opportunities in front of us.

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]* The first question is from Bhavan Suri of William Blair. Please go ahead.

Bhavan Suri:

Hey guys, thanks for taking my question. I guess, I just – I wanted to start maybe a little bit, when – touching on AT&T. As you look at AT&T in terms of the NFV rollout, how far along are they, and how do you view the remaining business opportunity there for RADCOM? Maybe start there, and then I'll jump into sort of some of the renewals that you're expecting to see this year.

Yaron Ravkaie:

So, AT&T, are making their plans public and they said that by 2020, 75% of their network will be virtualized, and they are on track for that virtualization. From our perspective, at the end of 2018, we've finished the original three-year contract that we announced in the beginning of 2016. And, as I mentioned in the prepared remarks, we're in constant discussions on shaping 2019 and beyond with them. We don't have yet the numbers to report. But if everybody will be a little bit patient, the moment that everything is signed and sealed, we will be able – we will be able to probably report it.

Bhavan Suri:

Got it, got it. But when you look at the broader CAPEX spend environment, I guess, you know, when you think about sort of what , you know, Verizon and others have said about a flattish CAPEX spend – how does that, sort of, impact your plans, or is that sort of what you're building into guidance, as you think about their CAPEX spending?

Yaron Ravkaie:

The – at the end of the day, each operator, whether it's an existing client/customer of ours or a prospect, they have their own CAPEX plans. What – you know, with AT&T specifically, you know, I'm not going to remark on their CAPEX plans.

We are – and I think, you know, they make a lot of that information public – what we are doing is working very closely with them on our specific plans, and then they allocate the right budget. As it pertains to the overall situation in the market, as I mentioned, you know, first of all, you know, operators and carriers are very conscious. They have been conscious. They – I believe they will continue to be conscious of their CAPEX plans.

It's not – the – life in the telecommunication world is not a simple life. As we've talked, I think, many times in the past, ARPUs are declining for them, and they're looking for more ways to save on budget so they can make ends meet and they can live in a world where they need to roll out new technologies like 5G, make the investments in a world that we're consuming as much data that we can consume, but we're not paying more than that. And – basically, if you look around the globe, we're paying less for that. So, that's where NFV comes in, their ability to virtualize the network is giving them CAPEX savings and OPEX savings.

AT&T jumped first in the water, and I think they made it public that they're already getting the benefits of their virtualization. Others are a little slow to follow. But as they need to now make investments into 5G, it's our belief that they will – it will accelerate their deployments of NFV and 5G, because 5G is primarily coming available on virtual technology. Now they can live in some hybrid world, they can postpone it a little bit and there will be ones that are, you know, rolling out 5G earlier and they are more aggressive on NFV and 5G, and there will be ones that are waiting.

Overall, you know, it's – it's about to happen. So, to predict exactly who will be the ones that are moving faster than others, they are more sitting on the bench waiting and putting their, you know, plans in place. I think the good news for us, in a lot of cases, they're engaged with us. So, the moment that some of these plans move forward, we hope to say that cement into POs for us.

Bhavan Suri:

Got it. Got it. Got it. One follow up for Amir, maybe. You mentioned in the past you had a number of, like, three sort of big renewals coming up in '19. As you look at sort of this guidance that you've given, for top line here, I guess I'd just like to understand, how much of that have you included in the renewals? Sort of, how you're thinking about those? Have you, sort of, thought those will renew sort of evenly and you feel good about that? And that's built into guidance? Or you've taken a haircut to guidance to maybe give yourselves a little room, as those come into renewal? Just some sense of how you guys have thought about that in the guidance. Thank you.

Yaron Ravkaie:

So the – so, it's Yaron. Primarily the one impacting where we're at and how we're guiding is AT&T. Others are not up for renewal. So, they're not so much, I think, impacting the guidance. When we look at everything into consideration, we felt that this is the right guidance for us. Of course, you know, there are scenarios, if the market will start to move, you know, you will see different numbers.

So, we take all of it into consideration, you know, continue to work hard on everything that we now are finalizing with AT&T, and continue to work hard with our other customers, and with the prospects executing pacts, doing a lot of sessions and things like that. And as the – they allocate budgets and move – look, at the end of the day, they're going to deploy 5G. Some sooner, some later. So, that should help the trend and help it move along. And the slowness that we've experienced is baked into the guidance. Once we see things pick up, and if, you know, we're going to be positively impacting our numbers, you know, we'll of course update the guidance.

Bhavan Suri:

Got it, got it, it's helpful. Thank you, gentlemen. Thanks for taking my questions.

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

[End of conference call]