Q1-18 Financial Results Conference Call

Management's Prepared Remarks and Q&A

May 22, 2018

Ladies and gentlemen, thank you for standing by. Welcome to the Radcom Ltd. first quarter 2018 results conference call. All participants are currently in listen only mode. Following management's formal presentation, instructions will be given for the question and answer session. For operator assistance during the conference please press *0. As a reminder this conference is being recorded and will be available for replay on the company's website, at www.radcom.com from May 23rd, 2018.

On the call today is Yaron Ravkaie, RADCOM's CEO and Ran Vered, RADCOM's CFO. By now we assume you've 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/investors-relations. If you have any trouble, please send Mark Rolston an email 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, levels of growth of revenues in the second half of 2018 and levels of expenses and investments in infrastructure, momentum, sufficiency of capital resources and plans to expand the company's workforce, receipt of additional grants, strategy, launching new products and potential sales of such products, size of pipeline, success of trials and translation thereof into actual sales, market share and market share growth, expansion into new countries and extension of its leadership position, additional transition to NFV, AT&T's continuance as an important customer and key reference, and its plans to virtualize its network over the long term. Favorable industry trends and their effect on the company, and project sales cycles, orders, engagements and relationships with top tier carriers and entering into new contracts with additional operators. 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 users' overall understanding of the company's financial performance. By excluding certain non-GAAP 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 the 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 would like to repeat the information about the presentation.

If you have not downloaded it yet, you may do so on a link through the investors' section on RADCOM's website, at www.radcom.com/investors-relations. If you have any trouble, send

Mark an email at Markr@radcom.com and he will send it to you directly. Now I would like to turn the call to Yaron. Please go ahead.

Yaron Ravkaie:

Thank you, operator, and thank you all for joining us today. We are very pleased with our first quarter results in which we delivered another record quarter. We executed on a number of deployments with existing customers and executed on the new major customer deployment we announced in late 2017.

As we highlighted last quarter, one of NFV pilots that we have been delivering on produced a very successful result, with RADCOM being selected by a top tier galaxy operator. We are currently working with this operator on schedule, project, scope and contract. We expect this planning phase to be finalized soon and implementation to start at the second half of the year.

During the quarter we also deployed our NFV solution in the world leading top tier operator that we announced in late 2017. We are happy with the progress being made and continue to work with them on their NFV journey.

We continue our strong relationship with AT&T, delivering cutting edge cloud-native software releases for AT&T's NFV transformation. AT&T's innovation and its industry leadership in NFV transformation, both through our product and real-life implementation knowledge and ensures a product leadership in the NFV market. AT&T has constantly highlighted the importance of NFV to their operational efficiency, in particular, AT&T stated on their most recent earnings call that it exceeded its goal of virtualizing 55% of their network as of the end of 2017 and expects to have 65% virtualized by the end of 2018. We expect our long-term relationship to continue. The progress we are making in 2018 is excellent. We are seeing significant momentum with our existing customers which we already delivered against during the quarter. We also have a healthy pipeline for the remainder of the year. Furthermore, we expect an additional tier one opportunity to come to fruition in the second half of the year.

In February we attended Mobile World Congress, which is a reminder is the leading event in the telecom industry. We believe it was a very successful event for RADCOM as interest by leading operator in our cloud native technology and broad portfolio of network visibility solutions including our new RADCOM Network Visibility solution that was launched at the event, has generated lots of attention and open up a more substantial pipeline for our market leading solutions.

Our focus for the remain of 2018 will be execution with our top tier customers together with the implementation of new opportunity wins as already mentioned. Also, we expect to engage in additional pilots that are now being scoped out and planned for with other leading top tier operators. As we continue to demonstrate our advanced technology with top tier operators in the NFV workshops and proof of concepts we've seen more and more operators moving forward with their NFV transformation plans. And these potential customers are eager to learn from our telco virtualization expertise and gain our insights and knowhow on integrating cloud native assurance into their networks.

In our leadership position we continue to work hard to provide operators various flavors of cloud implementations. We recently collaborated with Redhat to provide top tier operators a fully virtualized network visibility solution running on a hardened Redhat OpenStack platform. We announced this partnership just before Mobile World Congress. This collaboration enables the operators that need support in setting up their cloud infrastructure to accelerate their ability to adopt our cloud native solutions, while benefiting from Redhat's OpenStack proficiency.

We also announced yesterday that RADCOM has been certified to run on Telefonica's UNICA platform enabling us to participate in Telefonica's global NFV rollout that has started to take place. We continue to invest in our product portfolio to extend our leadership position and in February announced the general availability of RADCOM network visibility. This cloud native solution is explicitly designed to help operators gain full network visibility, while smartly managing and load-bouncing the virtual traffic for their NFV transformations. We expect this solution to enhance our portfolio and provide additional value to operators as they migrate their networks to NFV.

Although this solution was recently, was only recently introduced we are seeing significant interest from our customers and receiving positive feedback regarding RADCOM Network Visibility. Given our strong and growing pipeline of opportunities, our deployment with top tier operators, and our expected upcoming deployment by a top tier galaxy operator, we have scaled the company focusing on R&D and professional services.

We are confident that our investment in infrastructure will continue to pay off allowing us to capture additional opportunities. Also, our strong balance sheet will allow us to execute on our strategy of increasing sales by leveraging our leadership and innovation around NFV and cloud-based solutions. By taking advantage of the experience gained from our current deployments and by maintaining our technical advantage over competitors by investing in our differentiated NFV and cloud-based solutions.

Now moving on to the results for the first quarter. We are very pleased with our first quarter results. As you can see on slide 5, revenues for the quarter increased by 36% year over year to 10.9 million dollars. Our GAAP net income was 322,000 dollars, or 2 cents per share. We achieved a non-GAAP net income of nearly 1 million dollars or 7 cents per diluted share.

So, to summarize we are very pleased with our execution during the first quarter. Given that Radcom remains the go to NFV vendor for virtual pro-based services assurance and customer experience management we are well positioned to maintain the momentum. With that I will stop and turn over the call to Ran Vered, our CFO to discuss the financial results. Ran, please.

Ran Vered:

Thank you Yaron. Please turn on slide number 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 was 10.1 million dollars up 36% over the year. Our gross margin for the quarter was 73.9% on a non-GAAP basis in line with our expectations. As a reminder we expect gross margin to continue to fluctuate depending on the mix of each quarter revenues. Our gross R&D for the quarter on a non-GAAP basis increased to 3.5 million dollars from 2.4 million dollars in the first quarter of 2017, which was in line with our ramp up plan and highlights our strategy of investing to support future growth. Additionally, we did not receive any grants from the Israeli Innovation Authority during the period so R&D for the quarter was the same as the gross amount.

We want to point out that in the second quarter of 2018 the Israeli Innovation Authority approved an annual grant of approximately 1.7 million dollars. We expect the gross R&D expenses in the coming few quarters to be roughly the same level, or slightly higher. Sales and marketing expenses for the quarter increased to 3 million dollars on non-GAAP basis, up from 2.8 million dollars in the first quarter of 2017.

G&A expenses for the quarter on a non-GAAP basis, total 799,000 dollars compared to 724,000 dollars in the first quarter of 2017. Operating income on a non-GAAP basis for the quarter was 707,000 dollars, compared with 193,000 dollars for the first quarter of 2017. Net income for the quarter on a non-GAAP basis was just under 1 million dollars or 7 cents per diluted share compared with 284,000 dollars or 2 cents per diluted share during the first quarter of 2017.

On a GAAP basis as you can see on slide 5 we reported net income of 322,000 dollars or 2 cents per diluted share, compared to a net loss of 336,000 dollars or 3 cents per diluted share during the first quarter of 2017. At the end of Q1 2018 our headcount was 219 employees. We expect some slight growth in the second quarter.

Turning to balance sheet. As you can see in slide 9, our cash, cash equivalents and short-term bank deposits, as of the end of the quarter were 74.5 million dollars. We believe that our strong cash balance places the company on a solid footing for addressing top tier operator opportunities.

Now turning into guidance. We started the year with good momentum and we remain in position to increase market share and extend our technology leadership. As a result, we are reiterating our fiscal 2018 guidance range of 43 to 47 million dollars in revenue. This guidance also assumes ongoing interaction with AT&T, our new world leading top tier operator as well the addition of new customers from our strong pipeline including the new top tier galaxy operator. Regarding profitability, while we don't plan to provide specific EPS guidance, similar to past years, we plan to continue to invest in our infrastructure to support growth. As a reminder we view and continue to manage our business on an annual basis, because our quarterly results can fluctuate due to the timing of implementation milestones. That ends our prepared remarks. Yaron and I will turn the call back to the operator, so that we can take questions.

Operator:

Thank you. Ladies and gentlemen, at this time we'll begin the question and answer session. If you have a question, please press *1. If you wish to cancel your request, please press *2. If you are using speaker equipment, kindly lift the handset before pressing the numbers. Your questions will be polled in the order they are received. Please stand by while we poll your questions. First question is from Dmitry Netis of William Blair. Please go ahead.

Dmitry Netis:

Ok, great. Thank you, guys, very much. I'd like to touch on, you know, the three NFV customers, you know, one by one, if I may. So just to be clear, the galaxy operator you guys are talking about and the ones you mentioned last quarter, this is not Telefonica UNICA? So, I just want be clear on that and then if you could give us a sense of you know whether you've gotten any POs from this galaxy operator yet or not. That would be great. And if not when do you expect to get it. I think you've mentioned second half but I, you know just a little bit clarity of what's happening. What potential size of those POs may be, anything you can talk about that would be great.

Yaron Ravkaie:

Ok, hi Dmitri. So first of all, we didn't disclose the operator, so you know basically respecting you know their privacy rules etc. So, we can't comment on anything that has to do with that. And once we can disclose it, we will disclose it very clearly so there won't be a guessing game. It's a top tier galaxy operator. Everybody will be impressed once we are going to disclose it. As for the actual plan and scope. We were selected by this operator. Ok? For multiple projects within their galaxy. Exactly the scope of this project and timelines in which PO will be first and which company will be first, and which of their assets we will be implementing, this is exactly what we've been working with them in the last you know weeks and that's the plan also for the coming weeks. So once we finish that, we can add more color into how we see that impacting revenue for the year, and you know, and we have the understanding of how it'll impact next year etc.

Operator:

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

Dan Park:

Good morning, this is Dan Park on for Alex. So just looking at the competitive landscape, can you just talk about whether you're seeing any competitors making inroads in terms of penetrating into ONAP and becoming a viable competitor to your virtualized products?

Yaron Ravkaie:

Sure. First of all, as I been saying, for the last several years, we're in no, from everything that we understand, and we see we're probably a couple of years ahead of any competition. This advantage is primarily led by At&T on the fact that they're several years ahead of any other carrier in the migration of NFV, working with them is making sure you know that our product and our roadmap and that we've been investing in and will invest is cutting edge. It has real world expertise very deep and this is very valuable to the carriers.

Continuing that, we expand our expertise even on top of that and the product portfolio each time we add an operator and that is true also for that operator, that major operator we added back in the second half of 2017 which we talked also now. And that from our internal you know, vantage point, view point. Now, when I look at what competitors are doing, they are not announcing any big products or anything like that. They are trying to announce here and there some announcements which is exactly what I would expect to be, to see 2.5 years after we are into AT&T and major transformations.

So, this is a good sign. It means that the industry is picking up, the other competitors see you know that they need to make an investment, we still see that we're you know, years ahead of competition.

Dan Park:

Ok, great and so it's seems like gross margins were real strong this quarter and you did mention that it's primarily based on the mix of business closed around the quarter. What's the best way to think about this, at least directionally as we most throughout the year.

Ran Vered:

Hi, this is Ran. So yeah, so we had a very strong quarter in terms of gross margin, we do expect it to be in the range of any, we can't really expect the exact number, but it's really depend on the mix of the revenue, but we do expect it to be in this high percentage. Anything between 70 to 75% is something that we are planning for.

Dan Park:

Ok, great. Thank you for that. And you also touched upon the partnership with Redhat during your prepared remarks, so I was just wondering if you could provide some additional color on this and if you expect any material revenues from this moving forward.

Yaron Ravkaie:

Sure. So Redhat I think is, as a lot of you know, is one of the leading if not the leading company that works around the OpenStack which is the operating system that all this cloud technology for network runs on and what they do is they take the open source version and they provide services in a hardened version so carriers with their huge scale can scale easier and not need, you know, to be worried about bugs in the operating system and things like that.

And they can get also implementation support from Redhat. That's what Redhat does. Now, by combining forces with them, and they are very eager to combine forces with the industry leading companies that are at the cutting edge, what we do we give service providers the ability to accelerate their migration to NFV and how does that work? If there's a communication service provider that has just started and they want, they understand they need to make an investment in service assurance because that helps them afterwards deploy all the other VNFs that they need. They can work with us and with Redhat in any commercial, various, I would say, commercial engagement models and deploy a cloud that will serve for the service assurance and then afterwards can serve for other network elements that they want to introduce. That will shorten their time to market of introducing these types of solutions and its sort of a hassle free approach for them.

This I think is going to yield, we see already positive momentum from this, it's already going to yield acceleration of implementation plans which at the end of course leads to revenue and business.

Dan Park:

Ok, great. Thanks for taking my questions I cede the floor.

Yaron Ravkaie:

Sure.

Operator:

We have a follow up question from Dmitry Netis from William Blair. Please go ahead.

Dmitry Netis:

Alright thanks, I'll get back to my line of questioning. For some reason I was cut off. But yeah, going back to I wanted to touch, like I said on all the three NFV wins you've landed so far, so just back to the galaxy operator, and sorry to pound that horse. When do you expect the PO? Is it Q2, Q3, Q4? Is there any visibility when that comes or are you still not quite sure?

Yaron Ravkaie:

No, we, we, we expect it to be you know in the coming months, so we said in the second half of the year, so some of the contracts have already been negotiated with them. It's just ready, it's now focused on the implementation plans and as we close these implementation plans they will be turned into signed POs. Now whether it'll take one month more, two months more or one month less, I don't have this exact visibility, so we are targeting second half of the year. With also the plan to start the work this year and then we will know how it's going to impact the revenue.

Dmitry Netis:

Ok Yaron, thank you for that. And do we know the rough size of this deployment relative to AT&T or the second North America tier 1 that you've landed, I mean, does it sit somewhere in between? Is it on the high end of that? Low end of that? Can you give us some specifics around that?

Yaron Ravkaie:

I would say that it's bigger, it's bigger than the second one that we landed. It's smaller than AT&T at the get go. Based on the nature of the implementation plan and I would say the third thing. It has the potential of a very nice upside there that's already been discussed with them.

Dmitry Netis:

Alright, very good.

Yaron Ravkaie:

There is also a lot of positives in that implementation.

Dmitry Netis:

Sorry and then maybe moving on to UNICA. That was an interesting release as well. My understanding it's a different architecture. You are talking about here Open Source MANO, versus you know ONAP, which is used you know at North American customers. Is it you know, is it a pure NFV? Is it sort of a hybrid? Can you talk about maybe a little about architecture difference here and does it give you any sort of advantage being in this deployment because you could provide, you know a hybrid approach here, or a pure NFV, anything to talk to this particular deployment and how it differentiates you know the North American deployments that you've already won, would be interesting to hear from you.

Yaron Ravkaie:

Ok, so Telefonica is a big group that operates in Latin America and in several properties in Europe. Those are the main operators. We have a long-term relationship already with Telefonica in one of their, I think it's their biggest property in Latin America for Brazil and we work with them already for many years. So, we are familiar with the group and we are familiar with Telefonica.

Now on the UNICA platform, you know, they have their own, there's a lot of public information on it. They have an NFV transformation. They are a big contributor, Telefonica, to an open source effort called OSM and we've been collaborating with them and with this OSM body already for the last couple of years which has yielded very good results and today we see two standards in the industry that are Open Source and then we see some vendor-specific activity. One of them being ONAP which we've talked in the past several times and the other one is OSM which we've also talked about.

What Telefonica is doing with UNICA it's like a pre-version of what they would like to see with OSM so it's a simplified architecture approach but it's one or maybe even more steps toward the very highly automated approach that we do with OSM. Over the course of our engagement with them we've done many, a lot of NFV work with them, we've impressed them with our cloud native technology, and we are able to demonstrate for them an UNICA as well as well on OSM, a lot of automation, and you know, how we can leverage all these investments that we've done in the last several years with our cloud-native technology.

So, this should yield positive results for us as we continue our engagement with Telefonica and you know there's a lot of things that happen on this and you know, as we said in the past, there are also projects that we engaged with them and we've shown last year of how we have relations with Telefonica and projects coming out of there. We expect that relationship to continue and grow.

Dmitry Netis:

So, you are expecting revenue from this deployment even though this was just a certification, you know, who knows, I suppose, when that you know, when the potential orders start coming in. Or do you actually have the visibility that revenue may land sometime this year from, you know this deployment?

Yaron Ravkaie:

So, we have many projects going on with Telefonica that are generating revenue. From this specific UNICA project it's a little early to see. I do expect to see some revenue from its coming.

Dmitry Netis:

Ok I appreciate it. Moving on to AT&T, if I may? First of all, how much revenue was realized on Q1 from AT&T and then, if you could also Ran discuss maybe that second tier 1 that you landed. Was there any revenue in Q1 as well from the second tier 1 and if so how much?

Ran Vered:

Hi Dmitry, yes, so good question. So, from AT&T we generated this quarter roughly 20% of our revenue and from this world class tier one that we landed in Q4 17, we actually been able to materialize roughly 37% from our revenue.

Dmitry Netis:

How much? You were breaking up at the moment. I'm sorry. I didn't catch it.

Ran Vered:

So from AT&T it was 20%.

Dmitry Netis:

Ok.

Ran Vered:

From the other that we landed last year, 37% this quarter.

Dmitry Netis:

37% ok.

Ran Vered:

Or 4 million dollars.

Dmitry Netis:

Ok. Excellent, excellent. And then you know if you think about, about AT&T contract coming to the end at the end of this year, you know, what is the going rate that you have high confidence at this point that you will see out of this customer, you know, come 2019 timeframe and beyond? Maybe the best way to ask is what's the worst-case scenario that can land here on an ongoing basis that from AT&T. Once the contract expires.

Yaron Ravkaie:

You know, long term modeling we model I would say double digit revenue from this from AT&T. Where it lands exactly is yet to be seen and how we work with them on the road maps for you know for the coming years. We have already you know, some of the revenues committed beyond this year, maintenance revenue, things like that which is not, not small and it's also an active, a very active I would say customer, so it will be beyond the maintenance revenue.

Dmitry Netis:

Ok and then Yaron, you mentioned that second product that you launched at Mobile World Congress that's already being deployed at AT&T and you there's been sort of nice traction there. Have you been able to win and land any POCs with any other customers on that second product? I would assume it would be a nice source of upsell for you going forward.

Yaron Ravkaie:

Yeah, absolutely so when we mentioned in the prepared remarks that we are scoping out as we speak additional proof of concepts we are able to secure several Proof of Concepts that are focused on that product. Some of it is in addition to you know the full product portfolio. So, we have, you know a very good momentum and we are going to see this product participate in trials.

Dmitry Netis:

And then great, last question if I may. Kind of getting back to that second tier 1, which is would be your third or your fourth if you count Telefonica in there as well. What's the, so with that 37% kind of contribution in Q1. Is there more to come from the original PO that you would need to account for in the P&L? You know, maybe in Q2 Q3 time frame or have you pretty much realized that first purchase order and if so, you know, are there any expansion opportunities there or additional POs that you are expecting you'll have a good visibility for?

Yaron Ravkaie:

You are talking about the contract that we landed last year?

Dmitry Netis:

Yes, correct. The second tier 1.

Yaron Ravkaie:

Yeah so, we are working with them on several active things. The contract is built in a way that there are expansion opportunities for this year and next year and there is also you know things beyond that, so we hope to, we plan to realize some additional revenue from that. And there is you know, it's probably going to happen the second half of the year, did you catch me? Ok. The second and what was the second part of the question?

Dmitry Netis:

Well, the first part was actually whether the original PO was already realized in the P&L in the Q1 time frame and Q4 of last year or if there's more to come. From that original order that you got.

Yaron Ravkaie:

Most of it has been realized but this order is part of bigger agreements that has additional things in it.

Dmitry Netis:

Understood. Ok that's it for me. Thank you very much for all this, being able to answer all these questions. Thank you, guys. Keep up the good work.

Yaron Ravkaie:

Thanks.

Operator:

There are no further questions at this time. Mr. Ravkaie would you like to make your concluding statement?

Yaron Ravkaie:

Sure, thank you operator. As you can see, RADCOM is firing on all pistons. We look forward to the remainder of the year and these exciting times when network transformation to the cloud is taking place and RADCOM is at the forefront of this transition. And thank you all for your participation.

Operator:

Thank you. This concludes the RADCOM Ltd. first quarter 2018 results conference call. Thank you for your participation. You may go ahead and disconnect.