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PRESENTATION

Operator

Welcome to the Radware conference call discussing fourth quarter and full year 2023 results, and thank you all for holding. As a reminder, this conference is being recorded February 7, 2024.

I would now like to turn this call over to Yisca Erez, Director, Investor Relations at Radware. Please go ahead.

Yisca Erez - *Radware Ltd. - Director of IR*

Thank you, Ian. Good morning, everyone, and welcome to Radware's Fourth Quarter and Full Year 2023 Earnings Conference Call. Joining me today are Roy Zisapel, President and Chief Executive Officer; and Guy Avidan, Chief Financial Officer.

A copy of today's press release and financial statements as well as the investor kit for the fourth quarter and full year are available in the Investor Relations section of our website. During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. These forward-looking statements are subject to various risks and uncertainties, and actual results could differ materially from Radware's current forecast and estimates. Factors that could cause or contribute to such differences include, but are not limited to, impact from changing or severe global economic conditions, the COVID-19 pandemic, general business conditions and our ability to address changes in our industry, changes in demand for products, the timing and the amount of orders and other risks, difference from time to time in Radware's filings.

We refer you to the documents that the company files and furnishes from time to time with the SEC, specifically the company's last annual report on Form 20-F as filed on March 30, 2023. We undertake no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date of such statement is made.

I will now turn the call to Roy Zisapel.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Thank you, Yisca, and thank you all for joining us today. We ended the fourth quarter of 2023 with revenue of $65 million, and non-GAAP diluted earnings per share of $0.13. In the fourth quarter of 2023, total adjusted ARR, as discussed in our last earnings call, grew to $211 million, a 7% increase compared to the same period in 2022.

The ARR growth is driving recurring revenues, which accounted for 77% of total revenue in 2023. This is a 900-basis point increase compared to last year. The total ARR growth was fueled by cloud ARR growth of 22%, once again exceeding 20% year-over-year growth and reaching $65 million.

Subscription revenue that is comprised of cloud and product subscriptions accounted for 44% of total revenue in the fourth quarter as well as for the full year, reaching $115 million for 2023. With that, we are making strong and steady progress to a cloud-security-as-a-service company.

Looking forward, we are cautiously optimistic about 2024.

First, we witnessed a better business environment in the fourth quarter. In addition to growth in our cloud and subscription business, we saw early signs of recovery in closing large CapEx deals, specifically across Europe and Asia Pacific. The recovery is also reflected in the pipeline and the progress we made in moving existing projects forward.

Second, the demand in the market for cyber protection solutions continue to be solid as attacks intensify. According to our full year 2023 Global Threat Intelligence Report, the number of DDoS attacks per customer grew by 94% compared to 2022. In addition, we observed a surge in malicious web application and API attacks which rose 171% last year.

A significant part of this increased activity was driven by Layer-7 web application attacks or web DDoS attacks, a trend that has not slowed down. We believe the frequency, complexity, and sophistication of cyberattacks would intensify throughout 2024. Organizations, regardless of geography or industry, are facing increased cyber threats driven by major geopolitical tensions and conflicts. This plays directly to our value proposition, real-time protection against application and data center attacks.

Third, we are confident we have the right solutions in place to address the emerging trends in the marketplace. To stay ahead of the attackers, we are continuously enhancing our offering with new algorithms and capabilities. One example is the web DDoS attacks. These Layer-7 attacks emerged last year and caught companies that rely on preexisting signatures or rate-based detection off-guard. Our cloud web DDoS protection continues to be unmatched in its ability to mitigate web DDoS attacks based on a battery of algorithms we added last year.

In the fourth quarter, we announced an on-premise version of our web DDoS protection with DefensePro X. This solution offers companies comprehensive protection against these attacks without decrypting incoming traffic or adding latency. We believe this significant capability will strengthen the traction for DefensePro X in the market, boosting our appliance business.

Another example is the recent expansion of our Bot Manager module in our cloud application security offering. We recently enhanced our solution to detect and mitigate the latest generation of bot threats, those that are developed with the help of generative AI tools. These new enhancements enable organizations to defend against attackers who try to evade detection by exploiting vulnerabilities, rotating IP addresses (corrected by company after the call), manipulating HTTP (added by company after the call) headers, using CAPTCHA farms and more.

The fourth reason, we are cautiously optimistic about 2024 is the sustained growth of our cloud business. The cloud security ARR continues to grow over 20% year-over-year. We believe we can maintain this growth rate throughout 2024. We are diligently expanding and enhancing our cloud offering, creating more opportunities to cross-sell and upsell within our customer base. We are also expanding our geographic footprint in the market, working with our MSSP and OEM channels. The cloud security market is large and growing with opportunities that we intend to capitalize on.

Finally, our optimistic outlook is strengthened by the positive momentum behind our OEM relationships. During 2023, we expanded our business with Check Point and in particular, with Cisco. Our inclusion in Cisco Enterprise Agreement has created many opportunities that we will build upon in 2024.

Before I conclude my prepared remarks, I would like to share with you some of the notable deals that we closed in the fourth quarter of 2023. For example, with positive momentum beginning to return behind large CapEx deals, we expanded our long-term relationship with one of the top 5 carriers in the world. In a multimillion dollar deal, the customer has extended the DDoS protection for its data centers.

We also closed a multimillion dollar deal with a leading telecom company in Asia Pacific. After winning its MSSP business in the second quarter, we successfully cross-sold our on-premise DDoS and cloud application security solutions in the fourth quarter, replacing two different incumbents. This deal highlights the strength and breadth of our solutions.

In another customer expansion, we closed a large deal with a government agency in Asia Pacific. The customer launched a series of data centers to accommodate their growing customer base. We sold our entire product portfolio to them, including an upsell of our Alteon application delivery controller and our DDoS and cloud DDoS protection. This is another win that showcased the success we have, capitalizing on our full portfolio.

In summary, we closed 2023 on a positive note. During the fourth quarter, we made important progress on our strategic initiatives. We continue to successfully grow our cloud security business, staking our claim as a cloud-security-as-a-service company. With strong cloud security opportunities ahead of us, positive signals in overall customer spending and continued cost discipline, we remain cautiously optimistic about 2024. We look forward to a return to top line growth and improved profitability.

With that, I would like to thank our employees around the world for their continued efforts and turn the call over to Guy.

Guy Avidan - *Radware Ltd. - CFO*

Thank you, Roy, and good day, everyone. I'm pleased to provide the analysis of our financial results and business performance for the fourth quarter and full year of 2023 as well as our outlook for the first quarter of 2024.

Before beginning the financial overview, I would like to remind you that unless otherwise indicated, all financial results are non-GAAP. A full reconciliation of our results on a GAAP and non-GAAP basis is available in the earnings press release issued earlier today and on the Investors section of our website.

Revenue for the fourth quarter 2023 was $65 million compared to $74.1 million in the same period of last year. Revenue for the full year 2023 was $261.3 million compared to $293.4 million in 2022. The decline in revenue is attributed to delays in closing large deals due to greater budget constraints by customers, primarily in the Americas. However, as Roy highlighted, we do see encouraging signs of improvement in macro headwinds and, as a result, in customer spending. These positive signs are reflected in increased RPO at year-end and more traction to our solutions.

In the fourth quarter, the cloud security business, which is the growth engine of the company, continued to excel, producing cloud ARR growth of 22.5% year-over-year, reaching $64.9 million compared to $53 million, taking us another step towards becoming a cloud-security-as-a-service company. Our security business portion accounts for the large majority of the total business of Radware.

On a regional breakdown, revenue in the Americas in the fourth quarter of 2023 was $24.6 million compared to $31.9 million in the same period last year, representing a 23% decrease year-over-year. Revenue in the Americas for the full year of 2023 declined 17% year-over-year to $103.4 million compared to $123.9 million in the same period last year.

EMEA revenue in the fourth quarter of 2023 increased 2% year-over-year to $24.9 million. EMEA revenue for the full year 2023 was $96.5 million compared to $104.2 million in 2022, a 7% decline year-over-year.

APAC revenue in the fourth quarter of 2023 was $15.5 million, which represents a decrease of 13% year-over-year. For the full year of 2023, APAC revenue decreased by 6% compared to 2022 to $61.4 million.

For the fourth quarter of 2023, Americas and EMEA accounted for 38% of total revenue each, and APAC accounted for the remaining 24% of total revenue. For the full year 2023, Americas accounted for 40% of total revenue, EMEA accounted for 37% and APAC accounted for 23% of total revenue.

I'll now discuss profits and expenses. Gross margin in Q4 2023 was 82% compared to 82.7% in the same period in 2022. The change in gross margin is mainly attributed to the decline in revenue. Gross margin for the full year 2023 was 81.9% compared to 83% in the full year of 2022.

Similar to the last couple of quarters and to align the level of the company operation, we continued to reduce our operating expenses in the fourth quarter to below $50 million. We are minded to our expenses, and we expect to improve our profitability going forward due to continued expense discipline. While we reduced operating expenses, we believe that this expense structure is efficient to operate the business and enable our future growth.

Financial income continued to grow year-over-year and reached $3.8 million in the fourth quarter as a result of higher interest rates in the market.

Tax rate for the fourth quarter and full year of 2023 was 24.3% and 17.7%, respectively, compared to 12.5% and 14.1% in the same period of last year. The increase in our tax rate for the fourth quarter of 2023 is primarily due to a catch-up related to end-of-year updated estimates. The increase in our tax rate for 2023 was primarily due to lower pretax income for this period and expenses derived from our foreign subsidiaries, which are subject to tax based on cost and not profits.

Net income in the fourth quarter was $5.5 million compared to $7.7 million in the same period last year. Net income in the full year of 2023 was $18.9 million compared to $31.3 million in 2022.

Radware's adjusted EBITDA for the fourth quarter was $5.4 million, which includes a negative EBITDA of $2.7 million from the Hawks business. Adjusted EBITDA for the full year of 2023 was $17.6 million, which includes $10.8 million negative EBITDA from the Hawks business.

Diluted earnings per share for Q4 2023 was $0.13 compared to $0.17 in Q4 2022 and $0.43 for the full year of 2023 compared with $0.68 for the same period of last year.

Turning to the cash flow statement and balance sheet. Cash flow from operation in Q4 2023 was $2.7 million compared to $9.6 million in the same period of last year. Cash flow from operations in the full year of 2023 was negative $3.5 million compared to positive cash flow from operations of $32.1 million in 2022. The lower cash flow from operations arised from a lower profitability discussed above.

During the fourth quarter and the full year of 2023, we repurchased shares in the amount of approximately $10 million and $60 million, respectively. As of December 31, 2023, approximately $66 million remained in our share repurchase plan.

We ended the fourth quarter with approximately $364 million in cash, cash equivalents, bank deposits and marketable securities.

I'll conclude my remarks with guidance. We expect total revenue for the first quarter of 2024 to be in the range of $62 million to $64 million. We expect Q1 2024 non-GAAP operating expenses to be in between $49 million to $50.5 million. We expect Q1 2024 non-GAAP diluted net earnings per share to be between $0.12 and $0.14.

I'll now turn the call over to the operator for questions. Operator, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Alex Henderson with Needham.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Just a couple of housekeeping to start off with. Can you talk a little bit about the direction of the interest line? It's hard for us to forecast it externally. And I would assume that interest rates starting to roll over, that the interest rate might be coming down in 2024, and we don't want it to have a bad forecast on that. So can you give us some sense of what you think that's going to do?

Guy Avidan - *Radware Ltd. - CFO*

I think some headwind in terms of reduced interest rate throughout 2024 as well as lower cash balance in 2024 versus 2023. But at the same time, we have a tailwind. We still have or had bonds in 2023 with lower interest because there were long-term bonds. So overall, the $3.8 million we posted in Q4, we expect more or less same level of interest income in 2024, fourth quarter.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Great. And just any guidance on the percentage tax rate that we should be thinking for the year?

Guy Avidan - *Radware Ltd. - CFO*

The way we see for 2024, 15% tax rate will be...

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

So no change in that. Great. You do seem to have a little bit more confidence in the outlook. It does sound like the trajectory is starting to recover. Can you talk a little bit about what the pipeline looks like, what the -- how many -- is there an increase in large deals? Is the closure rate improving? Is the duration of the time to close deals stable or improving? What are the mechanics that give you that confidence?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Okay. So several points on that. So first, we started to see some first large deals closing in Q4. If you look on Q3 or Q2, we had challenges on closing those over $1 million deals.

Second, the pipeline that was there was not moving to its close at the regular rates that we've seen. In Q4 and also since beginning of this year, we're starting to see some of the deals moving forward. It's not completely back to previous levels, but definitely better. And that's why we chose the term, cautiously optimistic. It's definitely better.

It's also better, by the way, in North America. So some of the deals that we had in the pipeline, some other deals are opening up. Customers are more optimistic on their budgets and their ability to leapfrog the security infrastructure going forward. So overall, I would say it's neutral to positive across the world, and hence, we are feeling more positive about it as well.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

So just to be clear, what you're saying there is that the deal closure time had been expanding to take longer to close the deal, and now you're starting to see that improve? Is that what I'm hearing?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Yes. And before, it's not even expanding, they were not closing. They were just pushed from quarter to the other. So now we started to see early signs of close and more concrete discussions in some other opportunities that give us confidence those will be closing probably in the first half of 2024. So definitely, we're seeing good signs there.

By the way, you couple that with the growth that we had during all recent years, including 2023, in cloud security, which we believe we can maintain that momentum. So overall, we obviously feel better. And last but not least, Guy mentioned that our RPO is now at record levels, ARR is at record levels. Obviously, all of that gives us more visibility towards 2024.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Sure. Absolutely. Just one last question on the cost side of the equation. Is it reasonable to think that we should be using that kind of 50 -- $49 million to $50.5 million range for all 4 quarters? Is that kind of the cost structure for the year?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Yes.

Operator

(Operator Instructions) Our next question comes from the line of Chris Reimer with Barclays.

Chris Reimer - *Barclays Bank PLC, Research Division - Analyst*

Congratulations on the strong results. You mentioned the weakness in North America recently and the gradual pickup that you're seeing now. I was wondering if you could talk about any other challenges or headwinds you're seeing maybe playing out through the year aside from that as deals start to close faster and you get a little more momentum.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I think for us, this is by far the largest challenge we see. We are looking, obviously, for a better year in 2024 in North America. But overall, we feel that the results internationally were good as it relates to us. We don't foresee specific unique headwinds to us beyond the regular geopolitical -- China, Russia, the regular geopolitical challenges in the economy for us. But as it relates to us, I think it's North America predominantly.

Chris Reimer - *Barclays Bank PLC, Research Division - Analyst*

Okay. And regarding SkyHawk, could you give us like an overview of the evolution of the business there and when you might think it will start to impact the business?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Yes. So SkyHawk is focused on a new niche market in public cloud security, which is called Cloud Detection and Response, CDR. It's a very new market. There are other startups in that, but it's basically talking or addressing the need in real time to detect intrusion into your public cloud account and block it before the hackers are able to steal the valuable data, identities and so on.

The solution is heavily based on machine learning and AI algorithms that, based on multiple malicious indicators, are able to understand whether what we are seeing, the anomalies we see are actually part of a kill chain or an attack that is actually developing in real-time. I think the solution is very advanced and unique in the market. We are adding there a lot of usage of generative AI to detect new attacks as well as create new sensors and in real-time and improve the product.

But again, it's very early. I would not foresee in 2024 material impact on other revenues. As you see, we do consolidate the losses, although the company is fully funded, and that hurts our EPS. But we are strong believers in the technology, in the positioning. We think there will be a very good opportunity for shareholder value in public cloud security with SkyHawk, and we look forward to their success.

Operator

There are no further questions at this time. I would like to hand the call back over to Roy Zisapel for some closing remarks.

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Thanks a lot. Thank you for joining us, and have a great day.

Operator

This concludes today's conference call. You may now disconnect.

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