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George Notter Jefferies - Analyst

Chris Reimer Barclays - Analyst

Ryan Koontz Needham & Company - Analyst

PRESENTATION

Operator

Welcome to the Radware Conference Call Discussing Third-Quarter, 2024 Results and thank you all for holding. As a reminder, this conference is being recorded, October 31, 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 Investor Relations

Thank you, Operator. Good morning, everyone and welcome to Radware third quarter, 2024 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 third quarter 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.

The forward looking statements are subject to various risks and uncertainties and actual results could differ materially from current forecast and estimates. Factors that could cause or contribute to such differences include but are not limited to impact from the changing or severe global economic conditions, general business conditions and our ability to address changes in our industry, changes in demand for products, the timing in the amount of orders and other risks detailed from time to time in Radware's filings.

We refer you to the documents, the company files and furnishes from time to time in the SEC specifically, the company's last annual report on form 20-F as filed on March 18, 2024. 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 - President, Chief Executive Officer, Co-Founder, Director

Thank you Yisca and thank you all for joining us today. I'm pleased to report another solid quarter which exceeded our guidance. We achieved 13% revenue growth while successfully managing our operating expense.

Given the strong leverage in our business model, we recorded substantial increase in non-GAAP EPS in the quarter, delivering earnings of \$0.23 per share more than triple the EPS recorded in the third quarter of 2023.

These results underscore the significant progress we are making in executing against our strategy, despite the challenging economic environment and cautious spending behavior of our customers. We continue to see strong traction across multiple areas of our business. To start, our cloud security business continues to grow. During the third quarter we added a record number of new cloud customers contributing to 15% year of the

real growth in cloud ARR. Our cloud security business represents a significant long term market opportunity and a key growth driver. We are focused on accelerating growth by expanding our channel, expanding our global cloud security network, further broadening our cloud security suite and aligning our organization to support these efforts.

One of our key cloud wings is a multi million dollar cloud deals, deal with a major US communication provider, replacing their incumbent vendor. A few years ago after suffering a costly DDoS attack, the customer has turned to a different provider but face service issues and limited traffic blocking granularity. This led them to initially implement an on premise DDoS mitigation with Radware. Last quarter, we expanded the relationship to include cloud DDoS services, consolidating the infrastructure under Radware. In addition to cloud ARR, total subscription revenue also grew double digits and now account for 47% of our total revenue. As a reminder, our subscription revenue is comprised of product subscriptions and cloud subscriptions.

During the third quarter, we saw significant strength in our security product subscription. This momentum was driven by our DefensePro X refresh which carries more content of software subscriptions. The third quarter was also marked by a strong performance among our OEM partners. Both Cisco and Checkpoint are setting records for total bookings and are on track to achieve record yearly results.

In addition, our cloud application security was added to the Cisco Enterprise Agreement. The expanded agreement will streamline purchasing and licensing for Cisco customers and unlock future growth opportunities for us.

One example of our collaboration with Cisco is a significant deal with a major railway company. Following DDoS attack that bypassed the customer incumbent provider, we demonstrated the superiority of our solutions and secured the cloud security suite deal. This includes DefensePro X for on premise, application and network protection, cloud DDoS service, web DDoS or layer-7 applications, firewall as-a-service and network analytics. This deal demonstrates the breadth and effectiveness of our platform reinforcing the value and stickiness of our solution.

We continue to see more customers upgrading the security posture with DefensePro X. Our AI powered solution stands out in detecting and blocking web deals attacks while ensuring legitimate traffic flows uninterrupted. With less than 20% of our installed base already migrated to DefensePro X, the growth potential of this product cycle is substantial, not to mention additional opportunities with new customers and cross-sell prospects.

In the third quarter, we closed several significant DefensePro X deals including a multi million dollar agreement with a leading financial group, building on a successful cloud expansion in the first quarter. Similarly, we secured the DefensePro X and web application firewall deal with a major internet and telephony provider in EMEA, demonstrating our technical leadership.

During the third quarter our solution continued to earn us recognition by industry analysts. For the fourth consecutive year Quadrant Knowledge Solutions named a technology leader in the SPARK Matrix analysis for the web application firewall market. We received the highest rating in technology excellence.

Additionally, we were named a leader in the 2024 SPARK Matrix for bot management, ranking strongest in both technology excellence and customer impact. On the product front one of our strategic initiatives is to continue to broaden our cloud security platform. In the last quarter, we introduced a new cloud service, the Threat Intelligence Service. With this new service, we are opening the door for customers to access the high value attack data lake that we use internally. SOC teams can use the real time intelligence and preemptive warning about potential attacks and attack sources to make more informed decisions about application and data center threats.

Additionally, we're launching our AI SOC expert for DDoS services following last quarter EPIC-AI release, which integrates advanced AI and generative AI algorithms in our cloud security stack. The new AI SOC expert automatically detects unmitigated attacks and creates the remediation and mitigation plans significantly reducing response time. We're excited about the opportunities this framework presents to us and our customers and the impact it will bring going forward.

In summary, we are pleased with our third quarter results, continue the ARR growth and double digit revenue gains despite the current business environment. Our cloud security business remains robust and the strong momentum behind DefensePro X with its high subscription component

continues to drive double digit growth in subscription revenue, now nearly 50% of total revenues. As we close out the year, we remain focused on executing our strategy to sustain growth and position ourselves for long term success. With that, I will turn the call over to Guy.

Guy Avidan - Radware Ltd - Chief Financial Officer

Thank you Roy and good day everyone. I'm pleased to provide the analysis of our financial results and business performance for the third quarter of 2024 as well as our outlook for the fourth 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 to non-GAAP basis is available in the earning press release issued earlier today and on the Investor section of our website. Revenue for the third quarter of 2024 reached \$69.5 million up from \$61.6 million in the same period last year, representing 13% year-over-year growth. This growth was driven primarily by the expansion of our cloud security business, the DefensePro X refresh and increase revenue from OEM Partnership. Total ARR increased by 9% year-over-year to \$223.6 million. The cloud ARR rising 15% to \$71.6 million. This growth boosted recurring revenue to 83% up from 79% in Q3 of last year. On a regional breakdown revenue in the America in the third quarter of 2024 grew 11% year-over-year to \$27.7 million and accounted for 40% of total revenue. On a 12-month trailing basis, America's revenue decreased 1% year over year.

EMEA revenue in the third quarter of 2024 increased 30% year over year to \$25.2 million and accounted for 36% of total revenue. On a 12-month trailing basis EMEA revenue was flat year-over-year.

APAC revenue in the third quarter of 2024 was \$16.6 million which represent a decrease of 5% year-over-year and accounted for 24% of total revenue. On a 12-month trailing basis APAC revenue decreased 3% year over year.

I'll now discuss profits and expenses. Gross margin in Q3, 2024 was 82.3%, an expansion of 120 basis points from Q3, 2023. Operating income reached \$7.2 million compared to operating loss of \$0.5 million we had in the same period last year. we successfully grew our revenue while keeping operating expenses just below \$50 million.

We were pleased with our progress in leveraging our existing assets and resources to accelerate top line growth and enhance profitability. We remain committed to this approach, selectively increasing R&D investment to strengthen our offering and drive further growth in cloud security.

We tend to increase our go to market investment to capitalize on new opportunities in the cyber security market. By strengthening our sales and marketing capabilities, expanding our partner ecosystem and enhancing customer engagement, we believe that we are positioning ourselves to accelerate growth and extend our market reach. This strategic investment will enable us to better serve existing customers and we expect to capture market share in high growth areas.

Radware's adjusted EBIDA for the third quarter, increased to \$9.2 million or \$11.9 million excluding the Hawk's business, compared to \$1.6 million or \$4.2 million excluding the Hawk's business in the same period of last year.

Financial income was \$4.9 million in the third quarter and tax rate for the third quarter of 2024 was 15.5% compared to 14.8% in the same period of last year. We expect the tax rate to remain approximately the same next quarter. Net income in the third quarter, more than tripled to \$10.2 million as compared to \$2.9 million in the same period last year. Diluted earning per share for Q3 2024 increased to \$0.23 compared to \$0.07 we had in Q3 2023.

Turning to the cash flow statement and the balance sheet. Cash flow from operations in Q3 2024 reached \$14.7 million compared to the negative cash flow of \$9.8 million in the same period last year. Year-to-date cash flow from operation now totalled \$58.9 million and free cash flow was \$54.6 million.

We ended the third quarter with approximately \$412 million in cash, cash equivalent, bank deposits and marketable securities.

I'll conclude my remarks with guidance. We expect total revenue for the fourth quarter of 2024 to be in the range of \$71 million to \$72 million. We expect Q4 2024 non-GAAP operating expenses to be between \$50.5 million to \$51.5 million. We expect Q4 2024 non-GAAP diluted net earning per share to be between \$0.23 and \$0.24.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

George Notter, Jefferies.

George Notter - Jefferies - Analyst

Hi, guys. Thanks very much. Nice to see the good results here. I guess I was curious about kind of the DefensePro X upgrade. You mentioned that only 20% of the installed base of DefensePro has been upgraded. Could you tell us a bit more about current shipments? I'm just curious about what mix you're currently shipping in terms of DefensePro versus DefensePro X.

And then also, I was just curious about kind of looking forward in the transition, is there a date out in the future when you guys would end of sale or end of life the DefensePro platform? I would imagine that would be a leverage point in terms of driving DefensePro X adoption. Thanks a lot.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Thanks, George. So we are -- we don't have any shortage of shipment, if that was what you alluded to, but it's a process, especially with the large customers, this migration to the new platform in production and so on. DefensePro X brings with it significant advantages in terms of security. First, we've added a lot of new algorithms against most current attacks like the web DDoS or the Layer 7 application attacks, the DNS sophisticated attacks. So a lot of AI and machine learning, additional algorithms that needs stronger platforms, stronger CPUs. That's what we have in DefensePro X.

In addition, it's our next-generation FPGA that's built into the platform. We've completely revamped that layer, giving us between 3x to 5x performance across many, many different performance metrics in security. So very significant host power capabilities. And we rounded it up with a new generation of the management, analytics and automation system, which we call cyber controller. And that's why we have way more, what I said, subscription content with it. So it's important to note that, that for the same \$100 of sales of a product with, let's say, content of one year, the DPX comes with more subscriptions.

Now regarding your second question about the end of sale, I think roughly 60% to 70% of the current DefensePro line was announced end of sale in the last, I would say, 90 to 180 days. We still have some platforms on the DefensePro line that will go end of sale, probably Q1, Q2 next year.

But we definitely saw the impact once we announced end of sale in the last two quarters, there's a significant ramp in the move to DPX. And I think also our view for this quarter is strong regarding that.

George Notter - Jefferies - Analyst

Got it. So would you say it's more than half of the hardware sales at this point? Is that, is that fair to say.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Of the lineup of DP, yes.

George Notter - Jefferies - Analyst

Got it. Okay. I guess I was just asking about sales.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Yes. George, also, I want to note that some of the customers without their platform end of sale are upgrading as well because of the security needs and content. So absolutely, end of sale is a trigger. But the biggest trigger, I must tell you is the security coverage and capabilities.

George Notter - Jefferies - Analyst

Got it. Okay. That's great. And then one last one. Obviously, you guys have built out this global cloud services model with scrubbing centers and PoPs. Obviously, I think going back, the installed base of devices in those locations with DefensePros. I mean are you also going back and upgrading those cloud scrubbing centers? And then does that drive incremental revenue for you? Or is that just a straight-up replacement of CapEx costs that you've invested historically?

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Of course, we are upgrading our cloud. Our cloud runs always the latest and greatest algorithms. Sometimes even we have it on AB testing and so on, leveraging the power of the cloud and the flexibility it brings us. So definitely, we are putting all our new generation stuff into those clouds. It's a replacement of our CapEx investments. You're right.

But in turn, the additional capabilities, the stronger efficacy I've mentioned here in my notes, some of the customers we've displaced incumbents. For example, the communication provider, I referred to that was a very large cloud contract, probably close to \$1 million ARR. And that was done based on our significant capabilities in blocking VoIP attacks, SIP, UDP, randomized attacks, all of that. And that's squarely based on these algorithms and capabilities.

George Notter - Jefferies - Analyst

Great. Super. Thanks very much. Appreciate it.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Thank you.

Operator

Chris Reimer, Barclays.

Chris Reimer - Barclays - Analyst

Hi. Thanks for taking my questions and congratulations on the strong results. You mentioned the 47% of total revenues being subscriptions. Wondering if that was a quarterly number or if that's a cumulative year-to-date number? Anything on that?

Guy Avidan - Radware Ltd - Chief Financial Officer

Yes. The 46% is a year-to-date number.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

47%, quarter, 46% year-to-date.

Chris Reimer - Barclays - Analyst

47% on the quarter and 46% year-to-date. Got it.

Guy Avidan - Radware Ltd - Chief Financial Officer

Subscription revenue in the last 9 months, that's 46%.

Chris Reimer - Barclays - Analyst

Got it. Okay. And can you talk maybe about what's driving the strong traction in EMEA? You mentioned last quarter, there was a large deal. I'm just wondering what kind of clients you're seeing now and what the behavior is like in that region?

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Yes. I think we're relatively content with our performance in EMEA. We have many of the main markets executing well in a very diversified manner. We do see strong cloud deals there, and I've mentioned some of the key wins in my remarks. We do see very good cooperation with both Cisco and Check Point in the region. So I think it's our best region for that globally. And we do see a lot of also the large on-prem in carrier, government deals as well. So it's really a very healthy mix of our business with strong growth in cloud, strong OEM execution. And I think it shows in the consistent results.

Chris Reimer - Barclays - Analyst

Got it. Yes, that's great color. Thanks. That's it for me.

Operator

Ryan Koontz, Needham & Company.

Ryan Koontz - Needham & Company - Analyst

Thanks. Most of my questions have been answered here, but on the Americas, it looks like that was a little soft. Is that mostly coming from kind of a weaker service provider spending environment, I assume. And any pipeline indications if you think that can inflect to higher growth going forward?

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Yes. So, you're right, service provider was weak in North America. Although we have high expectations, both on the security MSSP and securing their networks and securing 5G deployment. So although this quarter and this year so far was not good, I would not write it off at all. We do have high expectations for the future. North America for us is an area of investment. And I think we are putting a lot of effort. We see huge potential. We have marquee wins there, and we need to scale that. I think that's significant upside to our current performance, and we look forward to report on progress in the coming quarters.

Ryan Koontz - Needham & Company - Analyst

That's great. It sounds like you're optimistic. And in terms of modeling, in terms of OpEx and what you're doing on the go-to-market side, do you think you can continue to grow top line here? And how much investment you need to make on the sales and marketing side to sustain that kind of growth? I know you've done some changes in go-to-market of late. Can you maybe expand on your thoughts on that?

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Yes. So I think it's a mix. I think there's some more leverage and efficiency we can get from the current OpEx, but given the size of opportunities and their global distribution, we are going to make investments also on the go-to-market, specifically as it relates to our cloud security. So I think it's a mix. It's a profitable growth, what we're looking for, continued leverage, but we are at the point that we would like to start investing again for stronger growth.

Guy Avidan - Radware Ltd - Chief Financial Officer

And in terms of number, we said that we are growing. We will continue to grow. We were shy of 50 overall OpEx, and we said it's -- we expect around \$1 million more in Q4, predominantly from sales and marketing and Roy already alluded US.

Ryan Koontz - Needham & Company - Analyst

Right. Great. Thanks for the questions. Appreciate it,

Operator

There are no more questions. I will now turn the conference back over to Roy Zisapel for closing remarks.

Roy Zisapel - Radware Ltd - President, Chief Executive Officer, Co-Founder, Director

Thank you, everyone and have a great day.

Operator

Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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