RADCOM Ltd.
Conference Call
November 10, 2022

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Radcom Ltd. Results Conference Call for the Third Quarter of 2022. All participants are present in a listen-only mode. Following Management's formal presentation, instructions for the question-and-answer session will be given. For operator assistance during the conference, please press star-zero. As a reminder, this conference is being recorded, and will be available for a replay on the company's website at www.radcom.com later today. On the call are Eyal Harari, Radcom's CEO, and Hadar Rahav, Radcom's CFO. Please note that Management has prepared a presentation for your reference that will be used during the call. If you still need to download it yet, you may do so through the link in the Investors section of Radcom's website at www.radcom.com/investor-relations. Before we begin, I would like to review the Safe Harbor provision. Forward-looking statements in the conference call involve several risks and uncertainties, including but not limited to the company's statements about its full year 2022 revenue guidance, visibility expected growth in 2023 and beyond, expectations regarding the enterprise market for telecom operators, including trends in the market and effect of general economic conditions, continued investment in and benefits from research and development, its expectation to gain further interest from operators and play an important role in facilitating the transition to 5G, its expectations about its pipeline and momentum, further demand for its products and growth, levels of expenses and keeping them below revenues, the potential for additional multiyear contracts, engagements and expansion of opportunities, the company's expectations with respect to its relationships with Rakuten, and potential grants from the Israeli Innovation Authority. 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 filing. 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 helpful in assessing Radcom's core operating performance, and evaluating and comparing the results of operations consistently 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, included in the quarter's earnings release available on our website. Now I would like to turn over the call to Eyal. Please go ahead.

Eyal Harari: Thanks, Operator. Good morning, everyone, and thank you for joining us for our third quarter 2022 earnings call. We achieved record revenues in the third quarter, reaching 12 million dollars, representing the thirteenth consecutive quarter of year-over-year growth, double digit growth of 17% compared to the third quarter of 2021. At the same time, we manage our expenses while investing in the business strategically and efficiently, resulting in a non-GAAP net income for the quarter of 1 million … *[glitch 03:57]* We are proud of our best-in-class cloud assurance portfolio that enables operator to manage their networks with advanced AI-driven analytics, that provides automated actionable insight to save engineering manual labor, and help quickly resolve network degradations to assure great customer experience. We have built a resilient software-centric business, with strong business model, that delivers high gross margin in over 70% recurring revenue from the beginning of the year, while offering our customers forecastable long-term pricing structure and great value. Our multiyear contract wins have improved a strong backlog, driving consistent result and giving us good visibility into 2023 and beyond. Turning to the pipeline. We continue to see strong demand for our advanced cloud assurance technology, reflected in our healthy pipeline of opportunities as we manage multiple customer engagements, at different stages of the sales cycle, with healthy mix of new logos and the current installed base, with most opportunities focused on 5G. We see good momentum for the 5G market, and believe it will be a catalyst for growth as the market ramps up, creating more sales engagements that can lead to additional multiyear contracts and increase market share. Recently, we have been hearing concerns from technology companies regarding the macro economy's negative impact on the market. We believe the telecom market is robust, as we saw during the more difficult periods of the COVID pandemic. We continue to monitor the situation closely, and will adapt as necessary. We believe our position as a best-in-class assurance provider for cloud native 5G networks, and our cloud expertise and knowledge, will continue to drive positive returns. We are glad to report that the demand looks strong, and we have a solid pipeline of opportunities that has the potential to increase our market share. With the positive market trends and our healthy pipeline, we are confident in the growth outlook of our business. As a software focused company, we are very agile and can handle future growth prospects scale and meet more demand while continuing to deliver on our current customer commitments. We are happy that the new customers are enjoying our Radcom ACE software, as we deploy it in their networks, and operator teams utilize its capabilities to smartly monitor service quality. We are progressing positively and we continue integrating our software into the cloud environment. As a 5G and cloud assurance leader, we are happy to be engaged with the teams, work closely with them, and offer our expertise to help them as they roll out 5G. With our existing teams, our software can scale seamlessly to many customers, which drives our financial performance and operational efficiencies, while at the same time delivering on the customer's expectations and requirements. We are receiving positive feedback, and are proud of our employees, who are dedicated and committed to delivering on our customers' success, as we can continue to deploy our solutions, and deliver new cutting-edge software releases. Legacy assurance solutions are limited and not flexible. While competitor takes weeks or months to deploy, we implement our cloud based solutions in days or hours. Our software is a critical source of truth for engineers who needs to make quick data-driven decisions affecting billions of subscribers across their entire network stack, and all service offering. We can adapt quickly and deliver features to customers. As we move forward and deploy our software to new customers, like DISH, we see the value of our analytics through all stages of deployment, to assure a smooth network rollout and deliver great customer experiences. Turning to Rakuten in Japan, and Rakuten Symphony. During the third quarter, we announced the renewal of our initial contract with Rakuten Mobile. With this agreement, we continue our successful partnership with this innovative operator, providing advanced cloud native assurance solutions for their network in Japan. At the beginning of the quarter, we announced that Rakuten Symphony made Radcom ACE available in the Symworld marketplace. This integration of Radcom ACE into Rakuten Symphony streamlines network operations and help teams understand what is happening in their network and where there are customers-affecting issues. It is also provides built-in workflows and unified data analytics to enable more operators to rapidly deploy and roll out 5G with the Symphony platform. Being part of this cloud opens significant opportunities for Radcom in the future. Turning to our product innovation. We continue our commitment to deliver best-in-class solutions as we enhance our software with more automation and intelligence AI-based capabilities to bring value and expand use cases for our customers as 5G technologies move forward. I am excited to announce that we recently received industry recognition as two of our products were named finalists in the Telecom Focus Award programs that recognize the industry's top companies for their outstanding achievements in the next generation communication technology, strategies and innovation. The AI/ML based solution announced last year for automatic detection of network anomalies in automation in network operation teams was named finalist in the Outstanding Use case in the Service Provider AI category in the Leading Light 2022 Awards. In addition, Radcom ACE named as a finalist in the Most Innovative Cloud Offering category in the Glotel 2022 Awards program. We invest strategically in R&D to enhance our solutions, increase our 5G capabilities, expands our AI driven insight, and seamlessly integrate our solution into the cloud. All these capabilities align with the market needs, and have already bear fruits, as reflected by our recent wins. To summarize, I am happy with our performance in the third quarter and across the first nine months of 2022. Revenue are up year over year by double digits, and we significantly improved our bottom line. We have built a software-centric company with a strong business model that delivers high gross margins. Our team has a proven ability to provide best-in-class solutions to some of the most innovative operators in the world. We are working hard to deliver on our customers' commitments, while continue to invest strategically in our innovative software to boost features and capabilities. With these new wins and our ongoing sales engagements, we have good visibility, which led us to increase the revenue guidance twice during the year's first nine months. To conclude, we are optimistic about our ability to deliver a third consecutive growth year in 2022, and continue this trajectory into 2023. Accordingly, we are reiterating our 2022 revenue guidance of 45 million to 48 million dollars. With that, I would like to turn the call over to Hadar Rahav, our CFO, who will discuss the financial results in detail.

Hadar Rahav: Thank you, Eyal, and good morning, everyone. To help you understand the results, I will refer mainly to non-GAAP numbers, which exclude share-based compensation. Now please turn to slide 8 for our financial highlights. We achieved record revenue in the third quarter which in 12 million dollars, representing a third and consecutive quarter of year over year revenue growth, and an increase from 10.2 million dollars in the third quarter of 2021, double digit growth of 17%. This resulted in non-GAAP net income for the quarter of 1 million, a four-year high. At the same time, we continue to manage our expenses while investing in the business strategically and efficiently. Our gross margin in the third quarter of 2022 on a non-GAAP basis was 73%. Please note that our gross margin can fluctuate depending on the revenue mix. We expect that Q4 will remain at a similar level. Our gross R&D expenses for the third quarter of 2022 on a non-GAAP basis were 4.6 million dollars, an increase of 150 thousand dollars compared to the third quarter of 2021. We received a grant of 187 thousand dollars from the Israel Innovation Authority during the quarter, compared to 205 thousand dollars in the third quarter of last year. As a result, our net R&D expenses for the third quarter of 2022 on a non-GAAP basis were 4.5 million dollars compared to 4.3 million dollars in the third quarter of 2021. We expect the Israel Innovation Authority grant in the fourth quarter to be a similar level as in the third quarter. Sales and marketing expenses for the third quarter of 2022 were 2.8 million dollars on a non-GAAP basis, an increase of 596 thousand dollars compared to the third quarter of 2021. The increase in sales and marketing was align with the growth in backlog and the good progress we made delivering on our customer commitment. We expect sales and marketing to remain at a similar level in the fourth quarter. G&A expenses for the third quarter of 2022 were 958 thousand dollars on a non-GAAP basis, an increase of 181 thousand dollars compared to the third quarter of 2021. Operating income on a non-GAAP basis for the third quarter of 2022 was 545 thousand dollars compared to an operating loss of 200 thousand dollars for the third quarter of 2021. Net income for the third quarter of 2022 on a non-GAAP basis was 963 thousand dollars or a net income of 6 cents per diluted share compared to a net loss of 333 thousand dollars or a net loss of 2 cents per diluted share for the third quarter of 2021. The positive net income was due to the increase in revenue and the favorable impact of changes in foreign exchange rates. On a GAAP basis, as you can see on slide 7, our net loss for the third quarter of 2022 was 389 thousand dollars or a net loss of 3 cents per diluted share. This compares to a net loss of 1 million 69 thousand dollars or a net loss of 8 cents per diluted share for the third quarter of 2021. At the end of the third quarter of 2022, our head count was 289. Turning to the balance sheet. As you can see on slide 11, our cash, cash equivalents and short-term bank deposits as of September 30, 2022, were 70.8 million dollars. That ends our prepared remarks. I will now turn the call back to the Operator for your questions.

Operator: *[pause]* 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 Arjun Bhatia of William Blair. Please go ahead.

Arjun Bhatia: Perfect. Thank you, and congrats, guys, on a good quarter. Eyal, I wanted to start with you. It starts like – it sounds like, you know, you're adding a lot more features and capabilities into the offering. Telcos are still building up 5G. You're clearly seeing good growth, and customers are seeing the ROI. How do you think about pricing power, going forward, in the model, both with, you know, some of the newer rollouts, and, you know, with your existing customer base as well?

Eyal Harari: Good morning. Yes. So, we are continue to invest in our Radcom ACE 5G platform. We release our 5G solution couple of years ago, and since we are continuing enhancing our product. Last year we added our AI based anomaly detection capabilities, which are very important to support customers in their 5G journey. We are mainly focus now on making sure we are creating additional value added capabilities and use cases, in order to make sure that our customers are successful in their journey, as they are going to the – to implement their 5G networks. We know that it's not simple, and it's required them not only to deal with the 5G as new telephone technology, but also with the migration to cloud. So we are primarily focused on making sure their transformation will be as smooth as possible and as efficient as possible. Those additional new capabilities are added, and they are – some of them are used as differentiators, when we are going and competing with new opportunities, and some are becoming a possible upsell on existing customers that do not have those included. So overall, we are looking to continue to invest in our R&D, continue to create a lot of innovation, and we feel very comfortable with our offering to the market.

Arjun Bhatia: Okay, understood. Very helpful. And then, for Hadar, the margin that you generated this quarter, you know, that was great to see. When you look out ahead over the next several quarters, where do you see the most opportunity for leverage and offering expenses going forward. Like, is this a good run rate of operating expenses that you did in Q3? Or could we see, you know, could we see more increases as a percentage of revenue, in some areas, like R&D for example?

Hadar Rahav: We – hi, good morning. So, in the last two years, we saw that our gross margin was around 72, 73%. Our operating expenses are around 8 million dollar per quarter. We believe that we will keep a similar level of operating expenses, with a slight increase in sales and marketing. *[pause]* Bhatia?

Operator: *[pause]* We didn't hear you for a moment. Please continue.

Hadar Rahav: Okay. I said that we believe that we will, you know, excluding any impact of the shekel-dollar ratio, we believe that we will keep a similar level of operating expenses, around 8 million per quarter, with some incremental increase in sales and marketing expenses.

Eyal Harari: *[pause]* This answer your question?

Arjun Bhatia: Yup, yeah. And, maybe just last one for me. The – Eyal, you called out the – the telco – the strength in telcos, and you saw that in COVID, and they're still obviously investing in building out. Do you hear any sort of commentary from them, you know, walking back or being more cautious on CapEx spend going forward, just given how much the, you know, it seems the economy has changed, or is changing. Do you see them tightening their belts at all?

Eyal Harari: So, overall, we see telecom industry being robust, and we – we see the 5G investment continues. But of course, the over macroeconomy situation is affecting everyone, and everyone is a bit more cautious and a bit – it can create some delays, as for a large investment. The positive thing is that most of the operators are already committed to the 5G. Many of them are already in a multiyear long term plan that was already initiated and will continue to do so. There might be some slow down, we don't know, we continue to monitor that.

The good thing for us is that we have – we are targeting the tier 1s, the larger and more powerful operators that are looking on their long term strategy, and we see them finding 5G as an important part of their strategy. And we have good visibility with them. So we are monitoring this cautiously, and hoping that there will be no effect on the macroeconomy, but ready in case – in any case for any situation.

Arjun Bhatia: Okay, got it. Very helpful. Thank you for taking the questions.

Operator: *[pause]* The next question is from Alex Henderson of Needham and Company. Please go ahead.

Alex Henderson: Thanks. Let's just continue on that subject, that last question. So clearly, in the 5G deployments, you know, those are multiyear long term plans. But there are all – other companies – companies and customers and companies that you have that are more, call it traditional, still more in the … 4G arena that is in the technology in the older formats. Those seem like they could be more cyclical, and more inclined to cut back . Can you talk to what portion of your business is tied to the 5G at this point, and how much of it is what I would call traditional or legacy customers?

Eyal Harari: So, thank you, Alex. And as I pointed in my prepared remarks, most of our pipeline of opportunities is around 5G. Also, big part of our existing business and the recent wins we get earlier this year is around 5G. What we see is that while there is some, maybe, hesitation, or a delay on the radio side on implementing nationwide coverage on – and investing the large CapEx part, and this you might see from the traditional radio antennas providers, where we play, in the assurance space which is more the core, this is not a heavy CapEx investment. And in many ways they are – they're needing more our tools, as we provide a lot of automation and AI that allow them to do more with less. And as they are adding more technology, they are not going to add more people to their operation, and sometimes they need to optimize, adding tools like ours can help them continue to do what they need in a more efficient way, and it would also drive the need. There might be some operators that didn't start yet their journey for 5G, it might be late, this could happen. But as mentioned, most of dealing providers that are already – are already committed, and continuing with their plans.

Alex Henderson: Well, that's – that's what I thought your answer would be. And so, the – looking at the history of the company, you've had a number of periods where you've had very good margins, up in the 74, 75 range, and some quarters where that's dipped down, you know, considerably lower, towards the 70% level. And my understanding is that the primary difference between the higher margin quarters and the lower margin quarters is the amount of traditional equipment you're selling, that seems to have a lower margin. And so, if the mix is shifting to the higher margin 5G products and more and more towards straight software, and fairly frictionless deploy at that, then, are we now in a period where the expansion and gross margins that occur in '20 to '21 from 71.6 to 72.2? And now on another, call it, 50 to 100 basis points in '20 – in '22, where we can start talking about the longer term gross margins up towards the, you know, 72 to 75 range as opposed to the 70 – the 73 range that I think you've talked about historically.

Eyal Harari: Yes. So, overall we are seeing a trend of improved gross margin, and getting closer to the 75% as we go more and more into 5G and cloud implementations. You are right in saying, part of the revenue mix is it's had some of the clients' base, this was fluctuating a bit down the gross margin. But there is also the – when we implement new customers, there are some one-time costs around third party components or licenses that are adding to the cost, as most of the software and – is very high gross margin. So we sometimes see some fluctuation in the gross margin, but I – what we see is that the overall trend is to have better and better gross margin and getting closer to the 75% range as we continue to scale.

Alex Henderson: Yeah. So, as we look in the fourth quarter, it looks like, you know, there is some up side to our model on the gross margin. Is it – is the 73 mark that we did in the sec – September quarter the right level for the fourth quarter?

Eyal Harari: Yeah, it's – it's, again, it makes sense. Again, from quarter to quarter, it's always can fluctuate a bit because of the, you know, the exact revenue mix. But this is a good assumption.

Alex Henderson: Yeah. So, if that's the case, then you're really kind of at 73 here, and, you know, we've been modeling 71.3, out to '23, out through '24. Should I be taking that up to 73, and using that as the new benchmark?

Eyal Harari: As I said, it's makes – it's a – makes sense as a good assumption, yes.

Alex Henderson: Okay. Perfect. I just wanted to be clear on it. Can you remind us, you don't hedge the shekel at all, and your sales outside the US are all in dollars. Correct? I mean, outside the – globally …

[speaking together]

Eyal Harari: Correct. We do not add, so we had some up side from that, as the shekel was weakening compared to the dollar. And most of our customers internationally are US dollar based, a big part of revenue is in dollars. So we don't have any significant effect from the foreign exchange.

Alex Henderson: Right. So, the shekel is, you know, pretty much gone to, you know, loans for the year, here right at the end of the, you know, at the end of the quarter. It's down considerably, I think it's, you know, double digit decline. So, at these levels for the full year, that should help you on the OpEx. Are you reinvesting that OpEx? I think the comment was that you're going to increase sales and marketing slightly, but overall, you know, spend in dollars, so it would be fairly flat. So, as we look out to '23, is that, you know, reinvestment in local currency? And therefore, that's why you're able to keep it flat and still get the benefit of some additional investment?

Eyal Harari: So, we are going to keep our R&D flat, flattish. You know, we are still before our end of the year plans. But as a strategic, let's say, plan, in the couple, the last couple of years, as we move forward, we believe we got to the right R&D level. Of course, trying to take advantage of the improved dollar to shekel ratio, to gain some efficiencies, and maybe strengthen some of the area. We do look into increasing in some level the sales and marketing, in order to capture the market opportunity. And part of our work around the work plan as we are doing now is to make sure we have a good coverage where the 5G operators are more advanced. So we do look to increase, on the long run, slightly the operations expense. But as we grow, and as I mentioned, more importantly, we are looking to grow next year, and as our operation expense increase is going to be modest, we look on a better numbers on the bottom line.

Alex Henderson: This question was asked earlier about pricing, but I would like to rephrase that one a little bit. Is there a way that – or is there any motion in the development cycle that would give you an opportunity to start doing some upsell to existing contracts, by adding a bundle of additional features, or some – some additional capabilities, that might not have been covered by the existing contracts that some of your customers – Is there an upsell opportunity, where we might start to see, you know, existing customers buying a larger package or product from you?

Eyal Harari: Definitely. Definitely, we see – as we did it in the past, as opportunities, like a customer enhancing his technology coverage, it enhances the add-on applications he use for additional use cases, or additional product parts that are not necessarily part of what he is doing today. We are spending now our R&D to create additional innovation. And as I mention, it's both in order to add some up side, upsales into our existing installed base, but for sure also to create additional cutting edge capabilities that will allow us to continue and win more contracts, and penetrate into additional carriers.

Alex Henderson: All right. One last question and then I'll cede the floor. So, as we look out into '23, you produced an average of double digit growth over the last three years. You dipped a little bit low in '21, but 14% plus in both '20 and '22. Is it reasonable to think that '23 is another double digit growth rate? I realize that you haven't done your – your forecasting yet, and therefore we're not going to hold you to it. But it seems pretty plausible that, given the momentum that you've got, that it's another double digit year.

Eyal Harari: Yes. As – we are looking – we have good visibility to '23, where many of our customer contracts are multiyear, and we already see that 2023 looks like another growth year. Likely in double digit. Again, it's still early, but we are looking positively to continue in a similar momentum, and hopefully improve.

Alex Henderson: Right. Thank you so much. And congratulations on the – on good execution and visibility.

Eyal Harari: Thank you, Alex.

Operator: *[pause]* This concludes the Radcom Ltd. third quarter 2022 results conference call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call]