Q4 and FY 2022 – Management Remarks and Q&A – Transcript

February 8, 2023

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Radcom Ltd. Results Conference Call for the Fourth Quarter and Full Year 2022. All participants are present 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 star-zero. As a reminder, this conference is being recorded, and will be available for replay on the company's website at www.radcom.com 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 have not downloaded it yet, you may do so through the link in the Investor 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 the 5G market and industry trends, the role the company is expected to play in the 5G transformation, sales opportunities, sales cycles, visibility, leads, pipeline and backlog, the expected impact of currency rates, the company's market position, cash position, potential and expected growth, including scalable and profitable growth, and momentum in 2023 and thereafter, levels of recurring revenues and gross profit from such activity, its expectations with respect to research and development and sales and marketing expenses, as well as grants from the Israel Innovation Authority, company's expectations with respect to its relationships with Rakuten and AT&T, its ability to handle future growth and meet demand, its expectation to continue enhancing its software solutions, and demand for its solutions, deployment of its 5G solutions in cloud environments and the potential benefits of its clients, its ability to capitalize on the emerging 5G opportunities and win more market share with new and existing customers, the potential of the company's vision and the use of artificial intelligence in its products, and its revenue guidance. 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 refer 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 the call over to Eyal. Please go ahead.

Eyal Harari: Thanks, Operator. Good morning, everyone, and thank you for joining us for our fourth quarter and full year 2022 earnings call. The fourth quarter was a solid finish to a record year, as we expanded our install base with multiple top-tier mobile operators. During 2022, we deliver record revenue each quarter, representing a third successive year of growth. Fourth quarter revenue were 12.3 million dollars and full year revenues were 46.1 million dollars, a 14% year-over-year growth, and we reached an inflection point for the Company, delivering a profitable year on a non-GAAP basis while generating a positive cash flow of 7 million dollars, ending the year with a record level of cash and a non-GAAP basis, a net income of 2.9 million dollars. We also had an encouraging start to 2023 by announcing that we had secured another North American contract for our solutions. This exciting news continues the positive momentum since the beginning of 2022. These additional wins bring us over 50 million dollars in new contracts over the last 12-months period. The new multi-year contracts secured during 2022 on top of our current agreements provide good visibility and strong backlog for 2023 and beyond. As business grows, we carefully manage our expenses and believe we can maintain scalable, profitable growth. We delivered a record-breaking year despite the current economic headwind. We believe this positive momentum will continue into 2023, and expect an even more robust growth year in 2023. Based on our current visibility, we are providing full-year 2023 revenue guide of 50 to 53 million dollars. Turning to our customer activities. In 2022, we announced the renewal of our contracts with AT&T and Rakuten. These are important milestones as they remain key strategic accounts with whom we have a strong relationship and partnership. We continue to innovate and provide software enhancements to ensure excellent customer experience and offer an advanced assurance solution that provide intelligence insight in a cloud-native solution. We also announced in 2022 that Rakuten Symphony selected our cloud assurance technology as its service assurance solution that will be globally available in their Symworld marketplace. The integration of Radcom ACE into Rakuten Symphony streamlines network operations and helps teams understand what is happening in their network and where are the customer-affecting issues. It also provides built-in workflows and unified data analytics to enable more operators to deploy and roll out 5G rapidly. Being part of this could open significant opportunities for Radcom in the future. Turning to the new contracts. In 2022 we secured multiple new contracts, including DISH in the US and a European mobile operator. Thanks to solid execution by our teams, we have made good progress in these accounts, which began to reflect in fourth-quarter revenues. Most revenues will be recognized during 2023 and beyond. As these network advance, we believe there could be further opportunities to expand with these operators. For example, DISH has previously stated that the enterprise could generate significant new revenue streams. This is where our cloud assurance technology can help. DISH can offer enterprise customers our assurance solution to monitor these private networks to ensure service quality and certify SLAs. The operators can sell premium services and value-added packages, including service assurance that run over their 5G cloud across multiple market verticals. For the new North America contract we announce last month, we provide real-time insight into the network as the operator maintain its 4G network while expanding 5G coverage nationwide. With our recent win and positive customer feedback, we remain confident that our product offering align with market needs, are best-in-class, and will increase our market share by winning opportunities as the 5G transformation continues. In 2022, our multi-year contracts provided recurring revenue that accounted for approximately 70% of our revenue. Our software-centric business offers a robust business model that delivers high gross margin and significant recurring revenue while providing customers with great value and predictable long-term pricing. Our team executed exceptionally well in 2022. Even though we extended our customer install base, our customer support headcount remain approximately the same throughout the year. This is a testament to the professionalism of our employees and the scalability of our innovative software. Our solutions can be quickly deployed in the operator's cloud network and rapidly roll out new customer features. The agility and operational efficiency drove our financial performance this year while simultaneously delivering on the customer's expectations and requirement. As a software-focused company, we maintained a high gross margin this year, 73%. This helps our operational efficiency and improve our profitability KPIs. I'm incredibly proud of the management team and our employees, and I thank everyone for their continued hard work and dedication. In 2023, we plan on gradually increasing our sales and marketing teams to take advantage of the strong demand for cloud assurance technology reflected in our pipeline. Operators continue to roll out 5G and invest in their networks, and we believe that 5G market remains strong while still only being at the early stages. The complexity of these networks requires automated assurance solution to optimize performance and provide a cornerstone to building networks with extensive automation. With the uncertainty around the macroeconomy, some operators may take longer to roll out their 5G network than others. Still, the market direction is clear, and we believe our position as best-in-class assurance provider for 5G will continue to drive positive returns. With this transition to 5G and the cloud, operators want to become more efficient and reduce their CapEx and OpEx spending. This is also an opportunity for us, as I will elaborate on later. Our long-term vision is to help telecom operators become more autonomous. To achieve this goal, networks must be software-driven, more intelligent, and more automated. This is what our solution enable through AI and automation, making the operator's network more intelligent, and automated through AI-powered analytics. Our solution analyzes massive amounts of network data and provide insight that drive automated network operation. I mentioned that operators are under pressure to reduce CapEx and OpEx spending. This is another area where our innovative software and advance AI can help. Our solution enables operator to save costs by automating their network operations and automatically finding places to optimize that prevent revenue leakage and customer churn. In addition, as we have a cloud-based solution, operators reduce CapEx spending on assurance hardware. In other words, our solution empower operators to do more with less and improve their services. These benefits can help operator navigate the current economic headwind. So, although there is uncertainty around the macroeconomy, we are well-positioned to win more business through our ability to help operator save costs and optimize. Our solutions were born in the cloud and designed for telecom operators. This help us remain focused as we enhance our solution, increase our 5G capabilities, and expand our AI-driven insights. AI has been in the news recently, with ChatGPT going mainstream. This type of AI is called generative AI, which creates new content, such as images, text, and videos. Generative AI has three models of working. One of those model is called GAN for short. This AI model generates synthetic data as an alternative to real network data. We use this AI technology to train and improve our solutions for advanced 5G use cases, develop our AI models, and offer our customers new use cases. Later this month, we will showcase our latest product innovation, AI capabilities, and exciting new use case at the Mobile World Congress in Barcelona, Spain, the leading telecom industry event. We will hold many meeting with customers, top-tier operators, and partners. The event is expected to draw around 80 thousand visitors as … after a couple of years of being primarily virtual event due to COVID limitations. Turning to the pipeline. We continue to see strong demand for our advanced cloud assurance technology reflected in our sales pipeline as we manage multiple customer engagement at different stages of the sales cycle, with a healthy mix of new logos and a current installed base, with most opportunities focused on 5G. We see good momentum for the 5G market and believe it will stimulate growth as it ramps up, creating more sales engagement that can lead to additional multi-year contracts and increase market share. Our solid financial result and new contracts demonstrate our strategy's effectiveness, and the unique market position in supporting telecom operators as they roll out 5G. Also, our recent wins provide a growing stream of recurring revenue and improve our already strong backlog, providing us with long-term visibility into 2023 and beyond. We believe this solid footing will drive consistent financial result in the future and continued improvements to the bottom line. Despite the economic headwinds, we also believe that the 5G market will drive additional demand for our solutions, increase our business and lead to further wins in the future. As a result, all the foundations are in place for a strong 2023, and a fourth consecutive year of revenue growth. Based on our current visibility, our 2023 revenue guidance is 50 million to 53 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. Please turn to slide 8 for our financial highlights. While the slides contain GAAP and non-GAAP results, I will refer mainly to non-GAAP numbers, excluding share-based compensation. We ended the fourth quarter of 2022 with 12.3 million dollars in revenue and a new record quarter, an increase from 11.2 million dollars in the fourth quarter of 2021. Our gross margin in the fourth quarter of 2022 on a non-GAAP basis was 73%. Please note that our gross margin can fluctuate depending on the revenue mix. Our gross R&D expenses for the fourth quarter of 2022 on a non-GAAP basis were 4.7 million dollars, a decrease of 60 thousand dollars compared to the fourth quarter of 2021. We received a grant of 160 thousand dollars from the Israel Innovation Authority during the quarter, compared to a grant of 194 thousand dollars in the fourth quarter of last year. Our net R&D expenses for the fourth quarter of 2022 on a non-GAAP basis were 4.5 million dollars, similar to the fourth quarter of 2021. Sales and marketing expenses for the fourth quarter of 2022 were 2.9 million dollars on a non-GAAP basis, an increase of 347 thousand dollars compared to the fourth quarter of 2021. G&A expenses for the fourth quarter of 2022 on a non-GAAP basis were 942 thousand dollars, an increase of 105 thousand dollars compared to the fourth quarter of 2021. Operating income on a non-GAAP basis for the fourth quarter of 2022 was 608 thousand dollars compared to an operating loss of 158 thousand dollars for the fourth quarter of 2021. Net income for the fourth quarter of 2022 on a non-GAAP basis was 1 million 320 thousand dollars or a net income of 9 cents per diluted share compared to a net loss of 237 thousand dollars or a net loss of 2 cents per diluted share for the fourth quarter of 2021. On a GAAP basis, as you can see on slide 7, our net loss for the fourth quarter of 2022 was 0.03 million dollars, or a net loss of 0 cents per diluted share, compared to a net loss of 1.4 million dollars, or a net loss of 10 cents per diluted share for the fourth quarter of 2021. At the end of the fourth quarter of 2022, our headcount was 284. Now let's turn to the full year results. We ended 2022 with revenue of 46.1 million dollars, an increase of 14% from 40.3 million dollars in 2021. On a non-GAAP basis, our gross margin was 73% in 2022 compared to 72% in 2021. Our gross R&D expenses for 2022 on a non-GAAP basis were 19.0 million dollars, which was approximately the same in 2021. In 2023, we plan on investing in R&D at approximately the same level as in 2022. We received a cumulative grant from the Israel Innovation Authority for 762 thousand dollars during the year. In 2023, we expect grants from the Israel Innovation Authority to be lower by 50% compared to 2022. Sales and marketing expenses for 2022 were 10.9 million dollars on a non-GAAP basis compared to 9.5 million dollars in 2021. In 2023, we expect a gradual increase in sales and marketing to support an increasing pipeline of opportunities. G&A expenses for 2022 on a non-GAAP basis were 3.6 million dollars, an increase of 301 thousand dollars compared to the entire year of 2021. Operating income on a non-GAAP basis for 2022 was 1.1 million dollars, compared to an operating loss of 2.1 million for 2021. Net income for 2022 on a non-GAAP basis was 2.9 million dollars or a net income of 19 cents per diluted share, compared to a net loss of 1.9 million dollars, or a net loss of 13 cents per diluted share for 2021. On a GAAP basis, as you can see on slide 7, our net loss for 2022 was 2.3 million dollars or a net loss of 16 cents per diluted share, compared to a net loss of 5.3 million dollars or a net loss of 37 cents per diluted share for 2021. The increased share-based compensation expenses negatively impacted GAAP net loss in 2022 compared to 2021. In 2023, we believe that the dollar-shekel ratio will stabilize at the current levels and will not require hedging. Turning to the balance sheet. As you can see on slide 11, our cash, cash equivalents, and short-term bank deposits as of December 31, 2022, were 77.7 million dollars. That ends our prepared remarks. I will 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 Alex Henderson of Needham and Company. Please go ahead.

Alexander Henderson: Great, thanks so much. And congratulations on the great and consistent execution. You guys really are be – are delivering the right mechanics in your business and it's good to see. I was hoping we could talk a little bit about the commentary around sales and marketing – what do you think your OpEx investment will look like over the course of 2023? I assume your gross margins will stay pretty much where they are, but I also would assume … that a little bit more aggressively on the sales… give some guidance there?

Eyal Harari: So, thank you Alex. And yes, we are finishing a great year with improvements on all of our KPIs. As pointed out, we are looking to keep our operation expense in similar levels in – in general as we are seeing our ability to be efficient and continue to deliver on – with our current team, even though we are growing with our customer base. We are keeping our R&D expense and technical staff in similar expense compared to 2022, and we are looking to gradually increase our sales and marketing, as we see there is additional opportunities and we want to have better reach to more accounts as 5G is progressing.

Alex Henderson: Just so that I can understand, I mean I would think that you have at least some wage inflation to deal with, you know. Is the – is it the shekel that's offsetting, you know, the weakness in the shekel over the last year, offsetting the wage inflation? Is that how you're delivering stable OpEx? Because that seems like a pretty…

Eyal Harari: So yes, we do have some weakening of the shekel as compared to the dollar, which allow us to optimize a bit our cost, as our R&D main cost is in Israel and in shekels. We did also some optimization and cost saving activities to adjust our operational expense. And this is why we are able to maintain similar levels, despite also the inflation and some salary adaptions we need to do.

Alex Henderson: One of the other variables, it's a little bit challenging for us to analyze externally, is the change in cash generation in the company over the course of the year has raised your cash balances, and the interest rate on your cash balances are going up. So, can you give us some sense of, you know, where we ought to be in terms of the interest income over the course of 2023? It was up quite sharply quarter-to-quarter, and I don't know whether that's a function of something unusual in the numbers, you know, a translation … just the rise of interest rates on your balances.

Eyal Harari: Hadar, can you take this?

Hadar Rahav: Yes, sure. So, we ended the last two years with consistent cash flow and believe that with the transition to profitability together with strong collection from our large customers and the expected interest on bank deposits, of course based on the current way, we will continue to generate cash during 2023.

Alex Henderson: Well, yeah, I would assume so. But, I guess my question is, in the interest income line, should we be using 500K a quarter, to roughly 2 million for the year, similar to what you earned in 2022? Or is there something in there that – in 2022 – that overstated that, that it should be down a little bit, or that would … interest income to go up? Can you give us some guidance on the interest line for '23?

Hadar Rahav: Yeah. I feel between 2 to 3 million interest on bank deposits during 2023.

Alex Henderson: Okay, so are there any offsets to that? Or is that just the, you know, what we should be using?

Hadar Rahav: No, this is the significant portion of our financial income.

Alex Henderson: And the other two lines that we could use a little guidance on is the NRE line. Is that going to be, as you're now getting a little larger, is that NRE line from the government subsidies going to start coming down? We're assuming it's going to come down 150K for the year. Is that right? Or is it going up? Or, any thoughts on that?

Hadar Rahav: Sorry, Alex, can you repeat this?

Alex Henderson: Yeah, the NR – you know, the subsidies you get from the government, the NRE line.

Hadar Rahav: Okay.

Alex Henderson: Any cha– any sense of whether that's going to go up, down, sideways, for '23?

Hadar Rahav: So, currently the Innovation Authority is concentrating small companies and the startup. And we believe and expect that the IAA grant during 2023 will be lower by 50% compared to 2022, and it will be recognized during the first half of the year.

Alex Henderson: And then, tax line, any … guidance on tax?

Hadar Rahav: Sorry?

Alex Henderson: The tax line, any guidance on the tax line?

Hadar Rahav: Regarding the tax, we assume a similar cost, as was in 2022, because we believe that our third quarter losses will offset the expected profitability during 2023.

Alex Henderson: Okay, thanks. Can you talk just a little bit about the pipeline? You know, what the likeness of what you are looking at is? Is there a lot of transactions that are being slowed down as a result of the conditions in the marketplace? And to what extent you think that you're going to have some news flow in the first half of the year? Or is it going to be mostly in the back half of the year? Just some sense of timing, of what you're chasing. Thanks.

Eyal Harari: So, our pipeline is solid and we have a good mix of opportunities between our existing customers and new customers. We are monitoring like everyone the news, and we see telecom operators are – are – continue to invest in 5G, but they are also looking on how they need to adapt to the new macroeconomy. It's very hard to predict in telecom, and in Radcom in specific, when exactly these will happen. But I think most importantly is that we are starting 2023 with very good visibility into the year, based on our good performance in 2022, which gives us the confidence that this will be another growth year. Any – we have in our pipeline a mix of opportunities, different stages, definitely some could still happen in the first half of the year, as long as there is no unforeseen delay due to the – to the macroeconomy. But it's very hard to predict.

Alex Henderson: Okay. Thank you so much.

Eyal Harari: Thank you, Alex.

Operator: If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by we poll for more questions. *[pause]* The next question is from Faith Brunner of William Blair. Please go ahead.

Faith Brunner: Hey, guys. It's Faith on for Arjun again. Congrats on the quarter. Just wanted to talk a little bit, now that you've reached that inflection point, what are the levers that you guys have at your disposal, from both the top line perspective as well as margins, that I know you touched on previously, to kind of keep this level trending? As you, kind of, go back towards historic net income numbers?

Eyal Harari: So, thank you, Faith, and good morning. I think to start with, 2022 was a third consecutive year of growth, and as you see our guidance, we are looking to continue growing also in 2023 in double digit levels. The – as a software company with gross margins of 73% in 2022, and we are looking to have a similar levels in 2023, a lot of the top line goes to the bottom line. I mentioned in my prepared remark, and was asked in the previous questions, we are able to maintain our operational expense in a controlled manner and we don't – we didn't see a need to increase our operational teams, despite these goals and additional customers that we work with. This is why we see that a significant part of the – of the top line, is translated to the bottom line. We see this trend in profitability KPI improving along the last three years along with the growth. So, as we are expecting to also grow this year, working and executing with our existing and new customers, we are expecting this to be improving also the – the profitability, and continue to generate cash flow during 2023.

Faith Brunner: Okay, great, thanks. And then, I just want you to talk about Radcom ACE for a second, we've been hearing a lot about it in your recent deals. Can you just talk about, you know, how this solution brings customers to the table, and how it's contributing to the overall pipeline?

Eyal Harari: So, Radcom ACE is a solution that was born in a cloud for telecom operators as they transform into 5G. Unlike many of our competitors who are based on legacy platforms that were built for the 4G networks and appliance days, we are – we build ground up all our technology around virtualization and cloud native architectures. This allow us now to be focus not only on the infrastructure, but we are continuing to add more innovation into the value. If, maybe, some of our other market players are busy today to – to migrate or build a cloud native solutions, this is something we already have for the last two years. And we got endorsement from the recent wins, companies like DISH, that they are very advanced in the cloud, maybe the only operator that is fully cloud native utilizing AWS. So, this – this allow us to direct our R&D investment into creating additional edge. And, as pointed out before, AI technology is amazing. And we are trying to harness these great tools to allow additional value to our customers, as they are required to optimize and save cost. And by levering this technology, they are able to add a lot of machine based applications for automation, and it's align with our long term strategy to help operators become more autonomous. So we are seeing great response from our customers and prospects about the Radcom ACE, and we believe this is probably the best product out there for 5G assurance in the cloud.

Faith Brunner: [pause] Right, awesome. Thanks for the call, and again, congrats on the year.

Eyal Harari: Thank you, Faith.

Operator: This concludes the Radcom Ltd. fourth quarter and full-year 2022 results conference call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call]