Operator

Good day, everyone. Welcome to the Ceragon Networks Limited First Quarter 2019 Results conference call.

Today's call is being recorded and will be hosted by Mr. Ira Palti, President and CEO of Ceragon Networks.

Today's call will include statements concerning Ceragon's future prospects that are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on the current beliefs, expectations and assumptions of Ceragon's management. For examples of forward-looking statements, please refer to the forward-looking statements paragraph in our press release that was published earlier today. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially, including risks relating to the concentration of a significant portion of Ceragon's business in certain geographic regions and particularly in India; risks associated with a decline in demand from the single market segment on which we focus; risks associated with any failure to effectively compete with other wireless equipment providers; risk relating to certain guarantees granted by Ceragon on behalf of Orocom to FITEL, in the framework of the FITEL project; and other risks and uncertainties detailed from time to time in Ceragon's Annual Report on Form 20-F and Ceragon's other filings with the Securities and Exchange Commission, that represent our views only as of the date they are made and should not be relied upon as representing our views as of any subsequent date. We do not assume any obligation to update any forward-looking statements.

Ceragon's public filings are available from the Securities and Exchange Commission's website at www.sec.gov or may be obtained from Ceragon's website at www.ceragon.com.

Also today's call will include certain Non-GAAP numbers. For a reconciliation between GAAP and Non-GAAP results please see the table attached to the press release that was issued earlier today.

I will now turn the call over to Mr. Ira Palti, President and CEO of Ceragon. Please go ahead, sir.

Ira Palti
President and CEO

Thank you for joining us today. With me on the call is Ran Vered, Chief Financial Officer. This is his first call with Ceragon, so welcome on board.

I want to summarize our current business situation before we get into a discussion of the details of the quarter. The "headline" is: Business conditions continue to be very good . . . no significant change anywhere in the world since the last call, and we have some very positive progress to report in several areas. Meanwhile, first quarter results were skewed by the lumpiness and timing of orders from customers in India. This was not a surprise and we indicated this could happen during our last call. There has been no fundamental change in the backhaul market in India, nor do we expect to see one in the foreseeable future.

We'll get into the details regarding the regions in a moment, but the key takeaway from this call is that overall demand remains steady or picking up in all regions compared to the end of last year and we continue to expect 2019 revenue to be similar to 2018 and we continue to target non-GAAP net income growth for the 5th consecutive year, based on improving gross margins and lower financial expense.

As noted in previous calls, we are benefitting from the ongoing deployment of 4G as well as initial 5G initiatives by various operators to upgrade and densify their wireless backhaul networks in preparation for launching 5G services. We are at the beginning of the first phase of a network evolution that is expected to last several years, with acceleration in overall demand as the transition progresses. We are very well-positioned to participate as a wireless backhaul vendor of choice for most operators due to our superior technology and services capabilities. In fact, our leadership was validated recently when we announced the 5G-related development agreement with NEC, one of the other large players in this market. This work will build on the R&D work we've done so far on next generation technologies to be embedded in our new 5G future chipset.

So, within the context of continuing strong business as our main message, we'll discuss Q1 results and business developments in more detail.

On the last call we alerted investors to the possibility that the timing of orders from India might cause Q1 be lower beyond what one would expect from typical seasonality. For those of you who didn't hear the call, in response to a question about whether Q1 could drop below the low end of our current revenue run rate, Doron said it could. He also mentioned similar patterns of lumpiness in orders from India during Q1 of 2016 when we reported $60M and Q1 of 2017 when we reported $76M in revenue. Doron indicated that we could be somewhere in between those two levels in Q1 – which proved to be the case. The reason is simple – Q4 bookings in India were low and, in Q1, we did not receive the next batch of orders. We continue to expect to receive a large batch of orders before the end of the first half, as we said on the last call.

The remainder of our business during Q1 showed typical seasonality and all other regions were in line with, or ahead of, our expectations. Excluding India, bookings in Q1 were quite good with a book-to-bill above 1:1, and bookings in most regions were better than expected with Latin America continuing to be strong even after a very good Q4. Despite the sequential decline in revenue, gross margin was very good, reflecting the more favorable geographic mix. So, everything was in line with expectations and what we anticipated on our last call.

Turning to the regional update, we'll discuss India first. As a primary wireless backhaul vendor to two of the major Indian operators, we have been in close contact with them and we have gained a better understanding of the timing issues. We have confirmed that all the vendors are in the same situation – no one has been receiving large orders. The explanation for the pause is related to multiple factors including the complexity of the budgeting process for the new fiscal year beginning April 1st, as well as company-specific projects such as internal reorganizations and capital raising events that also have been affecting the timing. Most of those factors are behind, or very close to being complete.

We expect to receive the next batch of orders for the ongoing deployments literally any day now. Meanwhile, the rollout of 4G is far from complete and we are also in extensive discussions with the largest operators in India about their forward network planning. For example, they are looking at rolling out small cells – outdoor deployments at street level for hot zones in certain areas, such as shopping malls and city centers where people congregate, in order to increase speeds and better compete for subscribers. One operator is currently in the process of conducting a large tender for the wireless backhaul portion of small cell deployment. If we are successful, this could become additional revenue next year.

Going back to other parts of the world, in the U.S., our primary customer continues to expand services with recently acquired low-band spectrum using our microwave and millimeter-wave backhaul solutions. They are incorporating more of the all-outdoor configuration to speed rollout, simplify the network and prepare for 5G. In addition, we are continuing our 5G-related discussions with a Tier 1 operator we haven't served in the U.S. previously. They have a strong interest in our newest (IP-50) disaggregated wireless backhaul solutions in a variety of spectrum bands. Some investors have asked about the status of our partnership with Fujitsu so we'll mention that our cooperation in the U.S. is moving well, but slowly.

APAC region continues to show strength. In Southeast Asia we are supporting large-scale network expansions with one of the region's mobile operators as they continue an aggressive push to increase their mobile subscriber base. Over the past year, we have increased our share of this operator's business and have become the primary vendor to this customer. Our success with this operator as well as our advanced solution has opened the door and started business with another large operator in the same region. We have also made significant progress with the major RFP process we mentioned on the last call. It is for a very large project in Pacific part of the region, where the service provider is preparing for 5G with a major upgrade of its backhaul infrastructure.

In Latin America, we continue to expect a very good year that will certainly represent growth over 2018 due in part to Orocom, the large digital divide project we won in Peru, for which we continue to ship, and work on deployment. As expected, our long-time customer in South Cone countries is turning on higher-speed 4G services in dense urban areas with our millimeter-wave solutions as well as expanding 4G services to more remote areas with our high-power, ultra-high capacity wireless backbone solutions. You probably saw our recent PR about these orders.

In Africa, we are continuing to support 4G rollouts in multiple countries, bringing broadband mobile services to more subscribers. Our recent announcement with MUNI is one example of how we excel in this regard. In this complex project, we installed the longest known high-power long-distance wireless backbone link from the capital city on an island to places onshore – a distance of 240 kilometers.

Europe has remained generally flat at a fairly low level . . . but we are seeing positive developments that are encouraging with two of the regional global operators.

The trends we see in the various geographic regions reflect the operators position as they prepare for 5G. Some are farther along than others, but all operators are making decisions with the evolution to 5G technology in mind. Our technology leadership is putting us at the forefront of these discussions as evidenced by our experience at Mobile World Congress this year. It was by far the busiest show we've ever had. We had twice as many full-scale sit-down meetings with customers and prospective customers than the prior year. Traffic in our booth was noticeably greater than some of our competitors. Operators were interested in many things including:

- our IP-50 platform and disaggregation strategy
- our overall capabilities in helping them simplify an increasingly complex network
- better understanding of how a combination of solutions could, for a small premium, provide additional capacity head-room

This is additional evidence of our strength as a wireless backhaul specialist: we thoroughly understand the growing complexities associated with 5G and we help make the network as simple as possible for our customers.

Another example of our strength on the strategic front is our recent collaboration with NEC which is a great achievement for several reasons:

- It is an undisputable recognition by one of our largest competitors in the superiority of our multicore technology and its basis for future cooperation and development
- It opens up an opportunity for cooperation with one of the largest wireless backhaul vendors in other areas
- It allows us to divert significant R&D budgets for other 5G technology requirements and diversification

Said all that, we are continuing to pursue multiple strategic opportunities. We are looking at additional opportunities for technology collaboration, reseller agreements, OEM arrangements or licensing our technology. This is one of the benefits to being in a leadership position. It opens a variety of paths forward. We are also continuing to zero in on our strategy for additional diversification and adding additional capabilities.

To summarize, we continue to expect 2019 revenues to be similar to 2018, and we are targeting a 5th year of non-GAAP net income growth based mainly on a more favorable geographic mix. We believe much of our hard work of the past several years has established the foundation for a return to low single-digit growth beginning next year as the pace of the transition to 5G begins to accelerate. We are entering a once-in-a-decade technology spending cycle from a position of strength and we expect to continue to gain market share in addition to participating in the 5G-driven growth in the market.

Now I would like to turn the call over to Ran to discuss the financials in more detail. Ran?

Ran Vered

Chief Financial Officer

Thank you, Ira**.**

Since you have all seen the press release, I'll just highlight some of the significant items in the report.

Revenue declined sequentially to $69.2 million, below our target quarterly run rate of $80-85 million per quarter. This was a result of typical seasonality as well as substantially lower revenue from India. As Ira described, this was something we anticipated and discussed on the Q4 2018 call. India accounted for only 15% of total revenue in Q1, the lowest level in many quarters. APAC and Europe increased as a percent of total revenue and the other regions remained about the same.

We are expecting to receive the large batch of orders from India this quarter and we have been able to plan for them in order to begin shipping as quickly as possible. Therefore, we expect that Q2 and the remaining quarters of 2019 will be at or above our $80 to $85 million quarterly run rate.

Our preparations for the India large batch of orders has impacted and may further impact our inventory and our cash flow. I will give some more color on this impact when discussing our cash flow.

In Q1, we had no above 10% customers or customer groups. GAAP gross margin was 35.6% and non-GAAP gross margin was 35.7% in Q1, a sequential improvement of 100 basis points and nearly 300 basis points higher than the same period in 2018, primarily due to a more favorable geographic mix, with much lower revenue from India. We continue to expect a higher gross margin for the year in 2019 versus 2018, with the typical fluctuations from quarter to quarter depending on geographic and product mix.

Turning to operating expenses, non-GAAP opex of $20.9 million was slightly below our target quarterly range. Our R&D expenses came lower than our initial plan primarily due to impact of the agreement with NEC. In addition, our sales and marketing expenses were slightly lower due to variable compensation expense, primarily related to our lower revenue in Q1. Our G&A expenses increased primarily as a result of activities related to strategic initiatives.

As mentioned by Ira, we expect to divert the R&D budget that freed up, due to our agreement with NEC, to other R&D initiatives. Investment in these initiatives may take some time to implement and result in some slightly lower near-term R&D expense but, at this point we assume the same overall level of operating expenses for 2019 that we stated previously , expecting them to reach toward the upper end of our target range of $21 to $22 million per quarter in Q2, and slightly exceed $23 million per quarter during the second half. We expect to continue to spend aggressively, but carefully, on our next generation 5G solutions and other related initiatives to maintain our technology leadership.

Our financial expenses increased a bit sequentially in Q1, increasing from $872 thousand in Q4 to about $1.1 million on a non-GAAP basis, due mainly to foreign exchange rate differences. We expect quarterly financial expenses to range between $1.0 to $1.5 million this year – assuming no further significant fluctuations in exchange rates. Tax expense was slightly lower than Q4 and is likely to increase gradually during the remainder of the year.

On a GAAP basis, we reported $808 thousand in net income and non-GAAP net income of $2.1 million.
This was obviously much lower than Q4 also, below the same period a year ago. With quarterly revenue for the remaining quarter of 2019 expected to be at or above the $80-$85 million quarterly run rate, we continue to target growth in non-GAAP net income for the full year, based on a more favorable geographic mix and lower financial expenses compared to 2018.

Turning to the balance sheet at March 31, receivables declined to $119.5 million, with DSOs of 132 days.

The DSO increase was mainly attributed to further reduction in factoring activity, as well as change in mix towards customers with more extended payment terms than our average. In Q1, we had negative cash flow of about $5.8 million. This is an opportunity for me to explain some trends we have seen on our balance sheet, that can give more color on our cash flow trends. As you have probably noticed, we have seen a continued increase in our inventories with a similar trend in our Trade Payables. The main reasons for that are our preparations for the fast delivery of the large batch of orders that is expected from India and, to a lesser extent, slight changes we have made to our strategy of components procurement, which is meant to better accommodate fast delivery requirements and purchase price changes. These reasons, together with changes in customers mix towards more extended payment terms, and continued decrease in factoring, have been creating pressure on our cash flow that we expect to continue for a while. We expect this trend to change within 2019 and therefore our cash flow for the full 2019 is expected to be positive.

At March 31, we had cash and cash equivalents of $29.8 million, with a $40 million unused line of credit which gives us ample financial flexibility. As Ira mentioned, excluding India, our book-to-bill ratio was above 1 for the quarter. Including India, it was slightly below 1. As noted, this is primarily due to timing factors related to our business in India. All regions appear to be the same or stronger than

2018 in terms of overall demand and activity, so we continue to expect revenue for 2019 as a whole to be about the same as 2018, but with a more favorable geographic mix due to a lower proportion of revenue from India related to the timing of orders, not to the level of demand. We continue to have potential upside and our revenue in 2019 could be higher if some of the projects that are currently counted in our projections at low amounts or not reflected at all will convert to orders and backlog in time to be recognized as revenues within the current year.

We are targeting approximately 33% non-GAAP gross margin in Q2 mainly due bigger portion of revenue from India, with some improvement during the second half of 2019. Non-GAAP operating expenses are expected to be slightly higher in 2019 versus 2018. So, as Ira indicated, we are aiming to make 2019 our fifth consecutive year of growth in non-GAAP net income based on a similar level of revenue compared to 2018. We expect this additional net income improvement to be driven by a gradual increase in gross margin, tight control of operating expenses and lower financial expense versus 2018. So, as communicated last quarter, we believe Q1 was an unusual quarter that will be offset during the remaining quarters of 2019, so our net income growth objective for the year remains achievable based on the overall strength in our business.

Now, I would like to open the call for questions, operator?