Operator

Good day, everyone. Welcome to the Ceragon Networks Limited Third Quarter 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 associated with a decline in revenues due to our focus on a single market segment; risks relating to the concentration of Ceragon's business in certain geographic regions such as India, and in other developing nations; risk relating to certain guarantees granted by Ceragon on behalf of Orocom to FITEL, in the framework of the FITEL project; political, economic and regulatory risks from doing business in developing regions, including potential currency restrictions and fluctuations; risks related to our ability to meet the demand for our products due to shortages in raw materials, including certain passive components; risks associated with a change in Ceragon's gross margin as a result of changes in the geographic mix of revenues and/or as a result of increase in costs of raw materials, including certain passive components; risks associated with the loss of a single customer or customer group, which represents a significant portion of Ceragon's revenues; risks associated with Ceragon's failure to effectively compete with other wireless equipment providers; 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 Doron Arazi, our CFO.

We are very pleased to report an excellent third quarter, which was above the top end of our quarterly revenue run rate . . . with net income growing both sequentially and year-over-year. We also generated very strong cash flow during the quarter. In addition, we are on track to meet our goal of attaining an increase in non-GAAP net income in 2018 compared to 2017. Based on the current outlook, we believe we are able to extend our goal of net income growth to 2019 as well.

We are benefitting from the early stages of the migration of networks from 4G to 5G technology . . . and, as noted on past calls, this is a long multi-year global process, not an event that happens everywhere at once. Operators around the world are planning their path to 5G, but they are at different stages as a starting point. Some are still building out 4G to bridge the digital divide and bring broadband access to more of their population, while others are expanding capacity and densifying 4G networks in preparation to launch 5G. The common denominator for all of them is that they are looking for wireless backhaul solutions that combine the benefits of flexibility, enabling rapid site acquisition, quick roll out, and conserving resources such as spectrum and power. As a result of offering a full suite of solutions, we are seeing many positive developments worldwide and our book to bill in Q3 was above 1:1, excluding India – which tends to be lumpy. Furthermore, we saw an increase in bookings during Q3 in most regions around the world.

To discuss some details of the current situation and the outlook in each region, we will begin with India.

In this hyper-competitive market, our IP-20 all-outdoor solution enables very rapid network roll-out with the most efficient use of resources and maximum future flexibility. These characteristics have enabled us to achieve a very strong market share in India already.

We expect operators in the region to continue to spend on significant expansion and densification of their networks as the Indian broadband data boom continues. For example, Vodafone India plans to make vendor selections soon, and we are working hard to get our share of that business. Therefore, we expect continued spending on wireless backhaul capacity in India for the next couple of years. We know from past experience that spending decisions tend to be made at the last minute, which makes order patterns lumpy and delivery expectations short. This means continued quarter-to-quarter fluctuations in bookings and revenue from India . . . but with sustainable overall strength from this region.

We are very pleased with what we see in Latin America. In general, we see acceleration of the rollout of 4G networks in several countries in the region . . . to add capacity and densify the networks already in place, with a growing demand for all-outdoor wireless backhaul solutions to enable simple expansion and densification of networks. This is leading to growing demand for our IP-20 platform in Latin America. We expect this trend to continue.

Another example of 4G/5G migration is happening in Africa, this region is continuing to grow from a low base since the beginning of the year. Until recently, migration to 4G wasn’t happening because of spectrum availability. That has changed and the largest Pan-African operator, as well as other large operators, have resumed investing, with other smaller ones returning as well. In one project, we recently displaced a competitor, so we see continued gradual improvement both as a result of returning demand and from gaining market share in this region.

The picture in Asia continues to be a good one and we believe we will continue to gradually gain market share. In Southeast Asia we continue to roll out 4G networks expansion with our wireless backhaul solutions and services at scale - using our unique all-outdoor solutions - allowing quick service expansion for our mobile operator customers in the region. Currently, we see a funnel of interesting opportunities throughout the APAC regions and we are well-positioned to participate in 4G & 5G projects that are reaching the RFP stage in this region where we bring significant value in our technology and services. Within an overall positive trend toward taking market share, we retain a little bit of caution because we see a lot of potential competition and operators in this region tend to do a lot of bundled deals.

Meanwhile, in Europe we aren’t seeing any major changes and recent bookings indicate that business is likely to remain steady in the near term. Our pipeline of potential new business in this region indicates some prospect for a pick-up next year from the level of the past few quarters.

Turning to North America, in another recent announcement, we reported improving traction because North America is the region where the migration from 4G to 5G is the most advanced. Currently, most of pickup in orders is coming from one of our long-standing mobile operator customers using their low-band spectrum to expand 4G coverage in preparation to light up 5G.

We are also seeing a trend toward larger orders from one of our important customers in the Caribbean and we are getting additional orders from Canada contributing to higher revenue from North America as well.

Looking a bit farther out, the T-Mobile/Sprint combination, if approved, will certainly give a boost to our revenue in the region once their plans for 4G and 5G are refined and begin to be fully implemented. Since we have no way of knowing the time frame in which this will happen, we are not building large numbers into our forecasts and we think investors should view this as upside potential, but not something to bake into expectations at this point.

So, to summarize the regional picture for mobile operators . . . we see signs of some pickup in regions such as North

America, Latin America and Africa that can create a favorable shift in the geographic mix

In addition, we continue to target a gradual improvement in our market share in various vertical markets including public safety in the U.S. as well as oil and gas, utilities, maritime and digital divide projects around the world. For example, we recently won a very large deal in Peru, aimed at bridging the digital divide in the rural parts of the country. This was a bit different than our typical deal because it involved “program selling” in which we took on a much larger role than just a wireless backhaul equipment vendor. We are working closely with a consortium that includes a fiber vendor and telecommunications license holder to cover all the requirements of the transport and broadband access network for which we are the wireless network provider. This consortium owns a new operator called Orocom, which was awarded three of the six regions by the Peruvian government (FITEL) in connection with an RFP in late 2017. We expect to begin recognizing significant revenue from this project in Q4 this year and most of the $26 million in revenue from this project is expected to be recognized in the next two years . . . and total revenue from the project could eventually be as much as $36 million. We also played a major role in helping the consortium win the project by providing advisory services and the initial planning of the wireless networks for this project. This project takes advantage of our extensive past experience in deploying high-capacity wireless backbones in Peru and in other regions. These government-sponsored digital divide projects represent a key theme of broadband access deployments. But, the timing of these projects is difficult to predict and we can’t count on the revenue to be steady from quarter-to-quarter. This revenue can be somewhat lumpy as well.

Looking ahead in a strategic sense, what we do is becoming more vital to operators all the time. As operators look toward a time when they must increase capacity and densify at scale in order to support new 5G service models and use cases that connect literally billions of individual sessions and end points, they are concluding that backhaul is very strategic to their future. There is no possibility that fiber will be available everywhere they need it, so wireless backhaul will be critical to the rollout of 5G at scale, more than it already is with 4G networks. In a very competitive environment, with no guarantee of what their ARPU will be, operators will be keeping a tight rein on budgets and will only spend where they can increase network availability and capacity with rapid site acquisition, quick network roll-out, flexibility, and cost savings. This is the value proposition we offer through our IP-20 platform – and in particular with our all-outdoor solution, which requires no shelter, no air-conditioning, no security fence or cameras. This simplifies site acquisition and speeds network deployment when the operator needs only to bring power to the site.

So, translating this into a financial perspective, near-term we feel confident that we can remain toward the upper end of our range for quarterly revenue run rate. We also remind you that we are managing to the bottom line, not the top line – so, we are encouraged to see some rotation toward a more favorable geographic mix which looks likely to continue . . . with some additional positive impact on gross margin as some of the component shortages beginning to abate. Meanwhile, we continue to spend aggressively but carefully on our next generation solutions in order to maintain our technological leadership. This means intentionally staying at the upper end of our target opex level, at least during the near term. With the positive trends I just mentioned, we believe we can continue to target gradual improvement in net income with the usual quarter-to-quarter fluctuations due to timing of orders and revenue mix.

Now I'll turn the call over to Doron for some detailed remarks on our financials.   Doron?

Doron Arazi

Chief Financial Officer

Thank you, Ira**.**

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

Our strong third quarter revenue continued to be driven by the high level of activity in India combined with higher sequential revenue from most other regions. As we've explained previously, orders from India tend to be lumpy and, therefore, revenues can be as well, and there is no real significance to the change in revenue in Q3 versus Q2. Except for our seasonally-affected first quarter, we've been around the high end or above our expected quarterly run rate for several quarters.

Our third quarter revenue of $86.5 million represented a slight sequential decline from Q2, reflecting the lumpy order and delivery patterns in India. The 13.9% increase over the third quarter of 2017 indicates a generally higher run rate.

We had 2 above 10% customers in the third quarter, both were large customers in India, reflecting a continuation of the intense competition among operators in that region.

India continued to dominate the breakdown of revenues, with the region accounting for a more moderate 34% of total revenue compared to around 46-47% percent during the past couple of quarters. This was a result of revenue from India moderating somewhat from the recent high levels as well as from a sequential increase in revenues from most other regions, most notably North America, APAC, Latin America, and Africa.

Both GAAP and non-GAAP gross margin was 35.0% in Q3, driven by a more favorable geographic revenue mix with a higher proportion of high-margin services as well as beginning to see some relief from the impact of component shortages. The high margin from services is not likely to be a factor going forward. However, based on the booking trends and our pipeline of potential business, we believe the trend toward a more favorable geographic revenue mix will continue. With this trend combined with continued improvement in the component shortage, we believe we can get closer to 34% gross margin in the near term based on expected product mix, and perhaps do even better over the longer term but with the typical fluctuations from quarter to quarter.

Turning to operating expenses, non-GAAP opex of $21.9 million was toward the high end of the expected range as we anticipated. In addition to variable expenses related to volume of business at the upper end of the expected range, we continue to invest in maintaining our technology leadership moving along the path to 5G. We don't expect any significant change in opex near-term. As Ira, noted we expect to continue to spend aggressively, but carefully, on our next generation 5G solutions.

As expected, our financial expenses moderated in Q3, declining from $2.6 million in Q2 to $1.8 million in Q3 on a non-GAAP basis, due to less exchange rate differences and lower bank fees and factoring fees. We continue to expect the trend toward lower financial expenses to continue– probably to $1.0 to $1.5 million in Q4 – assuming no further significant fluctuations in exchange rates.

On a GAAP basis, we reported $6.2 million in net income and non-GAAP net income of $5.7 million. This is a very good result and better than our expectations. It bears repeating that this is the metric we are managing toward when we make business decisions. Although the likely timing and mix of revenues means we expect a slight sequential decline in non-GAAP net income in Q4, we are pleased to say we are on track to report an increase in non-GAAP net income for 2018 compared to 2017 – which was our goal throughout the year. We expect this to be the fourth consecutive year of net income growth.

Turning to the balance sheet at September 30, receivables were $113.2 million, with DSOs of 120 days.

We generated very strong positive cash flow in Q3 of $11.9 million as a result of strong collections during the quarter. In fact, during Q3 we collected close to $1 million from a customer in Venezuela for a receivable that had been written off several years ago due to the impact of the Venezuelan government foreign currency restrictions and the local currency devaluation. This shows up on the P&L as an income item within the overall financial expense category. It is part of the GAAP number and illustrates something we think is important – that we continue pursue collections even when the likelihood of success seems to be low.

Our already-strong balance sheet is getting even stronger. At the end of September, we had cash and cash equivalents of $41.3 million, with a $40 million unused line of credit which gives us ample financial flexibility to handle our working capital needs and to be in a position to use our strong balance sheet to good advantage when we compete for profitable deals that require a bank guarantee – even a large one like the Fitel deal in Peru where we provided a $29 million bank guarantee in return for the advance payment from the government to Orocom.

Looking ahead, we continue to expect to be at the upper end of our quarter run rate of $80 and $85 million for the next several quarters. We are targeting closer to 34% gross margin in the near term, with some prospect for further improvement as we move through next year. We see operating expenses continuing to be at the high end of our $21 to $22 million per quarter range, commensurate with our expected volumes and our ongoing focus on investing in our next generation platform.

So, in spite of maintaining our aggressive spending on R&D, we continue to target an increase in net income in 2018, making it the fourth consecutive year of net income growth.

Looking out beyond the end of this year, we are extending our goal of net income growth to 2019 as well. Our preliminary view continues to be that we can achieve further net income growth through better gross margin due mainly to a more favorable revenue mix, with continued focus on tight control of opex while maintaining an aggressive investment posture. We continue to have confidence in our strategy and our ability to execute within the bounds of what we can control. We believe that wireless backhaul is becoming more strategic and operators' budget priorities will favor what we do best as they add capacity and densify in preparation for a 5G world.

Now we will open the call for questions, operator?