Ceragon Networks Q1 FY 2023 Earnings Call Script

May 1, 2023

Operator

Welcome to Ceragon Networks First Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation.

[OPERATOR INSTRUCTIONS]

As a reminder, this call is being recorded. It is now my pleasure to introduce your host, Maya Lustig, you may begin.

Maya Lustig

Thank you, operator, and good morning, everyone. Hosting today's call is Doron Arazi, Ceragon's Chief Executive Officer and Ronen Stein, Chief Financial Officer.

Before we start, I would like to note that certain statements made on this call, including projected financial information and other results and the company's future initiatives, future events, business outlook, development efforts and their potential outcome, anticipated progress and plans, results and timelines and other financial and accounting-related matters, constitute "forward-looking statements" within the meaning of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended, and the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995.

Ceragon intends forward-looking terminology, such as believes, expects, may, will, should, anticipates, plans or similar expressions to identify forward-looking statements. Such statements reflect only current beliefs, expectations, and assumptions of Ceragon's management, but actual results, performance, or achievements of Ceragon may differ materially, as they are subject to certain risks and uncertainties, which could cause Ceragon's actual results to differ materially from those projected in such forward-looking statements. Such risks and uncertainties include, but are not limited to, those that are described in Ceragon's most recent Annual Report on Form 20-F and as may be supplemented from time to time in Ceragon's other filings with the SEC, including today's earlier filing of the earnings PR, all of which are expressly incorporated herein by reference. Forward-looking statements relate to the date initially made, do not purport to be predictions of future events or results, and there can be no assurance that they will prove to be accurate, and Ceragon undertakes no obligation to update them.

Ceragon's public filings are available on the Securities and Exchange Commission's website at www.sec.gov, and may also 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 Doron. Please go ahead.

Doron Arazi

Thank you, Maya, and good morning, everyone.

Ceragon Networks delivered double-digit revenue growth and solid profitability in the first quarter, with $83.4 million in revenue, 4 cents in non-GAAP earnings per share, and importantly a book-to-bill above one. These results, our booking levels, and the demand we are seeing are encouraging data points for us. And the trends, especially when looking at trailing 12-month revenue and bookings, confirm the positive momentum we are experiencing. To be clear, we have **not** seen the slowdown in spending, softness or pressures that others across the telecom industry have reported. In fact, demand for our solutions has continued to be strong and our sales execution in key regions has improved all while our access to supply chain continues to normalize. The trends we are seeing are encouraging. We are cognizant of the macro environment and recognize that others in the telecom industry are speaking to softness – softness we have not experienced – and volatility in customer buying patterns. With that in mind, we want to validate the customer trends we have experienced to date before we consider raising our full year outlook. Doing so will give us more touchpoints to confirm that the demand we are experiencing is as it seems, and not being pulled forward from a future period.

Beyond the revenue line, our results demonstrate the improving earnings power of our organization. Our gross margins continue to expand, reflecting our improved execution in key markets, higher revenues from North America, as well as reductions in supply chain costs. We delivered $3.6 million in non-GAAP net income in the first quarter. Barring any unexpected developments, we continue to believe that we will deliver positive non-GAAP net income during 2023. With a profitable business model, a solid backlog, a booking to revenue ratio that exceeds 1, and solutions, that address key capex and OPEX goals for customers around the world, we believe we are well-positioned for sustained success.

Importantly, there were no significant impacts from supply chain disruption in the quarter, and while we continue to carefully manage the supply chain, component availability has been improving.

Our geographic diversification continues to benefit our revenue. In the first quarter, we generated sequential and year-over-year revenue growth in APAC, Europe, and North America, and year-over-year growth in India, where we generated our fourth-consecutive quarter of revenue over $20 million. In North America, we generated revenue of $26.4 million, up from $17.2 million in the fourth quarter and from $13.3 million in the first quarter last year. In Europe, we believe we have room for improvement even considering the modest improvement in our revenues. We recently installed a seasoned region head to lead our business in Europe, and we expect further improvements as this transition advances.

Our first quarter revenues reflect approximately $5 million in revenue that shifted out of the fourth quarter of 2022 and into the first quarter of 2023, that we noted on our last quarterly call. With that shift, we would expect some normalization in the revenue cadence going forward. This is primarily impacting North America. The fourth quarter had lower than expected revenue from North America, with some revenue shifting into the first quarter, and therefore the normalized run rate in this region is probably somewhere in between these two data points going forward.

The trend for our gross margins is also encouraging. We delivered non-GAAP margins of 34.0% in the quarter, driving $5.9 million in non-GAAP operating income, a positive swing of $6.5 million. This improvement reflects higher revenues from North America coupled with better operational execution, especially in the supply chain.

We continue to advance the productization of our new system-on-chip technology. To date, our efforts are advancing according to plan and while there is much work to be done, we remain on track to launch our new product line in 2024. We believe we have first mover position and a 2 to 3 year time to market advantage over our competitors. With this, we believe our SoC powered products will drive significant demand and have a transformative impact on the industry and on our market share.

I'd now like to overview our Q1 highlights by region. Noting that on today's call and future quarterly calls we will focus primarily on activities in North America and India, the two regions that have, and we expect will continue to have, the greatest impact on our quarterly results.

In North America the 5G build continues to be strong. We have continued to receive orders from major carriers, with one customer driving a significant portion of our volume. We are also participating in multiple RFPs for the critical infrastructure sector, and pursuing new rural broadband initiatives as well as other opportunities we are seeing in this region. Those are driven by Federal and State funding plans as well as the demand for faster networks rollouts which can be accommodated by wireless transport technology. These initiatives remain a critical area of incremental opportunity and diversification for our business. Rural broadband initiatives represent government priorities in the United States in general, and in specific states in particular. The process for rural broadband expansion takes time as the various Federal plans take shape, but we believe we are increasingly well-positioned to capitalize when these opportunities mature.

In **India** operators are increasingly turning to up-selling and cross-selling to improve customer experience and drive engagement. Indian telcos continue to invest in 4G technology while beginning to deploy 5G in certain regions. We are working with operators in the market for 4G rollout and enhancement in selected regions, as well as deploy 5G equipment in urban areas. Indian telcos augment their network capacity with additional fiber and wireless E-band & multiband to meet the demand for high-speed, though government has not concluded the E-band fees yet. Coupled with the growing affordability and availability of 5G smartphones, we expect these developments to fuel consumer adoption of 5G in 2023 and beyond.

In Q1 2023, we continued to deliver our products for 4G networks as well as delivering our E-band/multiband solution for 5G networks in an increased pace. We ended the quarter with approximately $30 million in follow on orders from Tier 1 Operators that we expect to deploy mainly over the next two quarters. These orders include both products and services focused on upgrading existing network capabilities to 5G, expanding capacity, improving rural connectivity, and providing customers with reliable uninterrupted high-speed experiences. We expect this trend to continue throughout 2023.

Looking at the rest of the world:

In Europe, we had another good quarter, benefiting from strong Q4 bookings, even as we navigate a significant organizational change and despite the ongoing macroeconomic challenges. We believe there is a significant opportunity for us here with near-term room for improvement under the new leadership.

In **APAC,** we had a good quarter in terms of booking, primarily from Australia and Indonesia. We see opportunities in this region as 5G deployment is unfolding at a different pace in different parts of the region in the Telcom and also in the private network domain.

In Africa, we had a significant booking from a private networks business this quarter, although the market is still soft.

To summarize, conditions have been improving, both on the macro and micro levels. Demand for our solutions is strong, execution is improving, and supply chain availability has been getting better. Quarter-to-quarter variability in our financials is always a reality, but we believe the trailing twelve months trends for our business are solid and improving, both from a revenue and a profitability standpoint. Given the positive business traction, our significant backlog and a book-to-bill that is above 1 in the first quarter, we expect our growth trajectory, over time, to continue. Importantly, we also believe that we can be profitable, on a non-GAAP basis, for the 2023 full-year.

Ronen, over to you?

Ronen Stein

Thank you Doron, and good morning, everyone.

Before I review the quarterly results, I would like to call attention to a disclosure that was included in our annual report on a form 20-F that was filed earlier this morning. This disclosure is specifically related to a debt from a single customer which was discussed on our Q4 earnings conference call that was held in February. Recently, there were changes in the circumstances which reduced the probability to collect the outstanding debt in the near term or in full, and, as a result, we found it appropriate to record a credit loss provision for this customer's outstanding debt in Q4 of 2022.

As a result, our audited results for 2022 differ from the preliminary unaudited results previously announced and our operating loss on a GAAP basis is now $(10.9) million, a decrease of $12.3 million from the preliminary unaudited results previously announced with a corresponding reduction in our accounts receivables. We would like to emphasize that we continue to take vigorous measures towards collecting the debt. Note this matter has no impact on our guidance for 2023.

I'd like to note, on today's call, when discussing our quarterly results, that for the purpose of sequential comparisons our Q4 2022 G&A, Operating profit, Net income and earnings per share will INCLUDE the impact of the $12.3 million credit loss provision.

With that said, I would like to shift to my review of the Q1 results. As Doron outlined, this was a strong quarter for Ceragon. Though, it's important to keep in mind that we are a project driven business and as such there is inherent variability in results from quarter to quarter. Because of this we analyze our bookings, revenue, and gross margin, as well as other key performance indicators over a 12-month period, a duration which we believe better reflects the underlying business trends.

In addition, to help you understand the results, I will be referring primarily to non-GAAP financials. For more information regarding our use of non-GAAP financial measures, including reconciliations of these measures, we refer you to today's press release.

Let me now review the actual results:

Revenues were $83.4 million, an increase of 18.6% compared to $70.3 million in Q1 2022 and 10.4% compared to $75.5 million in Q4 2022. When we take the trailing twelve months' view, our revenue was $308.3 million, an increase compared to last quarter's trailing twelve months revenue of $295.2 million.

Our strongest regions in terms of revenues for the quarter were **North America** and **India** with $26.4 million and $20.0 million, respectively, in line with the continuous strong demand we see in these regions.

Our third strongest region in terms of revenues was **Europe** with $12.0 million.

We had two customers in the first quarter that contributed more than 10% of our revenues.

Gross profit for the first quarter on a non-GAAP basis was $28.4 million, an increase of 45.7% compared to $19.5 million in Q1 2022 and an increase of 13.5% as compared to $25.0 million in Q4 2022. Our non-GAAP gross margin was 34.0% compared to 27.7% in Q1 2022 and 33.1% in Q4 2022.

When we take the trailing twelve months' view, our non-GAAP gross margin was 33.4%, an increase compared to last quarter's trailing twelve months gross margin of 31.8%.
This upward trajectory of our gross margin trend reflects our ability to increase margins when we execute on our strategy and operational efficiencies.

As for our **operating expenses**:

Research & Development expenses for the first quarter on a non-GAAP basis were $7.7 million, up from $6.8 million in Q1 2022, and slightly lower from the $7.9 million in Q4 2022. As a percentage of revenue, our R&D expenses were 9.2% in the first quarter compared to 9.6% in the first quarter last year.

Sales & Marketing expenses for the first quarter on a non-GAAP basis were $9.8 million, up from $8.5 million in Q1 2022 and from $8.6 million in Q4 2022. As a percent of revenue, sales and marketing expenses were 11.8% in the first quarter compared to 12.1% in the first quarter last year.

General and Administrative expenses for the first quarter on a non-GAAP basis were $5.0 million, higher slightly from $4.8 million in Q1 2022 and down from $17.7 million in Q4 2022. As a percent of G&A expenses were 5.9% in the first quarter compared to 6.8% in the first quarter last year.

Operating profit for the first quarter was $5.9 million, up approximately $6.5 million from the operating loss of $(0.6) million in Q1 2022 and up $15.0 million from the operating loss of $9.1 million in Q4 2022.

Financial and Other Expenses for the first quarter on a non-GAAP basis were $1.8 million, slightly less than expected due to more favorable exchange rates, offset by an increase in interest expenses.

Our tax expenses for the first quarter on a non-GAAP basis were $0.4 million.

Net income on a non-GAAP basis for the quarter was $3.6 million, or $0.04 per diluted share, compared to a net loss of $(1.9) million or $(0.02) per share in the first quarter last year. The first quarter net income was up $16.2 million from the net loss of $(12.5) million, or $(0.15) per diluted share in Q4 2022.

As for our **balance sheet**:

Our **cash position** at the end of the first quarter was $26.4 million, and our short-term loans stands at $41.9 million. We believe we have cash and facilities that are sufficient for our operations and working capital needs, and we are not currently contemplating raising equity capital.

Our **inventory** at the end of Q1 2023 was $68.7 million, down from the $72.0 million at the end of December, as we continue to better convert our backlog and monitor inventory levels, taking into consideration the improvements in availability of components.

Our **trade receivables** are at $100.6 million, with no major changes compared to $100.0 million at the end of December.

Our DSO now stands at 119 days.

As for our **cashflow**:

Net cash flow used for operations and investing activities in Q1 2023 was $0.9 million. We expect to generate positive cash from operations for the full-year.

Our 2023 revenue guidance of $325 - $345 million remains unchanged. As Doron shared at the start of today's call, we are encouraged by the strong results we achieved in the first quarter, however, given the macro environment we think it is prudent to monitor the trends we are seeing before reevaluating our full year outlook. As we see supply chain and component shortages challenges dissipate, our confidence in our outlook and ability to drive sustainable and profitable growth will increase.

With that, I now open the call for your questions. Operator?

Doron's Closing Remarks

To close, this was a strong start to the year for us. We delivered strong revenue, and significantly improved profitability. We are well-positioned to achieve self-sustaining cash flows as we execute our growth and diversification strategies . We expect that the new System on Chip based product line to launch in 2024 will give us a durable competitive advantage. We are increasingly excited about Ceragon's opportunities.

I look forward to updating you further on our next call.

Have a good day everyone.