

Operator

Good day, everyone. Welcome to the Ceragon Networks Limited Second 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 the risks relating to the concentration of a significant portion of Ceragon's expected business in certain geographic regions and particularly in India, where a small number of customers are expected to represent a significant portion of our revenues, including the risks of deviations from our expectations of timing and size of orders from these customers; the risk that the current slowdown in revenue from India could extend for a longer period than anticipated; risks associated with any failure to effectively compete with other wireless equipment providers; the risk that the rollout of 5G services could take longer than anticipated; 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.

Our second quarter results were consistent with our revised expectations as indicated in our July 2nd press release. Actual Q2 revenue was toward the upper end of the range we gave, at \$73 million, with a small GAAP profit of a penny a share, or \$0.03 on a non-GAAP basis.

Taking a broader look at the entire first half of 2019, both the positive and the negative factors had more impact than we expected at the beginning of the year. Let's look at the good news first:

- Aside from India, revenue from all regions of the world showed improvement over the first half of last year. The improvement was led by Africa, North America, and Latin America, which were each up substantially year-over-year versus the first half of 2018.

- Europe, North America, Latin America and APAC, also grew in the first six months of 2019 compared to the second half of 2018, and Africa was quite similar.
- So, aside from India, we had a very good first half . . . which puts us on track for a much stronger year in most regions in 2019 versus 2018.
- Also, in our discussion of each region, we will highlight some recent developments that we believe will support a continuation of these positive trends for next year as well. These developments mainly relate to multiple new design wins for 5G.

Now, we'll turn to the challenging region during the first half – India. At the beginning of this year, we expected some tapering off after the extremely strong pace of 2018, when India accounted for over \$130 million of revenue for the year. Order patterns from India have always been lumpy. Therefore, when we saw bookings slow down during the second half of 2018, it appeared to be the usual pattern that operators tend to follow. It's not uncommon for operators to reduce or even pause their

ordering – especially after a very aggressive period of deployment. But we certainly didn't expect the next large batch of orders to be delayed until Q3 of this year. To put the impact into perspective, revenue from India was \$80 million in the first half of 2018, but only \$18 million in the first half of 2019.

Initially, the delay seemed related to customer-specific issues. Some operators were raising capital, others were reorganizing internally, and all have generally complicated procurement processes. In addition, the budget year in India began in April. More recently, since our July 2nd announcement, we have identified other factors indicating that, somewhere along the line, the delay has morphed into an actual slowdown in activity that could persist into next year.

Specifically, Reliance Jio, the disruptor in the market, recently stated their intent to spend at a less aggressive pace. We believe this may relate to the fact that the Indian government set minimum prices for 5G spectrum in the upcoming auction that operators believe are too high. Media report indicate that Bharti and Vodafone Idea have

said they won't participate in the auction. The reports say Reliance will participate, but it's hard to imagine an auction with only one bidder. In any case, if Reliance is easing up on spending, Bharti is likely to feel less pressure to spend . . . and Vodafone Idea continues to struggle financially, which would suggest they prefer a slower pace as well.

We believe we are getting our typical major share of the business from our customers in India . . . but we now see a risk that we are looking at a decline in revenue from India that could continue for several quarters.

Earlier in the year, we understood from our customers in India that they planned to deploy as rapidly as possible once the process issues causing the delay had been resolved. Now, the picture seems to indicate a deliberate slowdown in the pace of expanding and densifying India's 4G networks . . . with more focus on the timing of the 5G spectrum auction and on urging the government to lower minimum bid prices for 5G spectrum.

The tangible evidence of an actual slowdown was evident

when we finally received a large group of orders from India a couple of weeks ago. The total value of these orders, which was \$19 million, was considerably less than we expected at the beginning of the year. At the same time, we were given an indication that we will receive another group of orders, before the end of the year.

Apparently, the second group of orders will total a similar amount as the first batch. So, depending on both the actual size and timing of the second group of orders, we see greater risk that the revenue decline from India in 2019 will be larger than the \$20 million push out from 2019 to 2020 we mentioned on our July 2nd call.

Given the pattern of lumpiness, we could also see the opposite – meaning that we could see the second group of orders coming early in the second half, which potentially could enable us to recognize enough revenue in Q4 to reduce the shortfall for 2019 to slightly below the \$20 million we spoke about in July.

At this point, based on recent experience, our bias is toward the first scenario where the year-over-year decline in revenue from India in 2019 versus 2018 might

approach 50%, rather than the moderate decline from India we anticipated at the beginning of the year. Before we all become overly preoccupied with this apparent slowdown in India, there are important points to be made regarding the long term:

- India began deploying 4G later than most developed countries and the operators are not finished with what they have to do in order to have a smooth path to 5G.
- Operator in India acknowledge that they must continue to spend billions. Our strong relationships and value proposition mean we will continue to get a large share of the backhaul business. For example, one operator's CEO who spoke at the ET Telecom 5G Congress in New Delhi recently was quoted in the media recently as saying:
- "5G in India, as with everywhere else in the world, is going to launch on a non-standalone basis, which means it will be built on top of our existing 4G framework. This is an absolute imperative to get the 4G story right. It means we have to spread 4G networks right across the country and make sure that they are robust enough to deal with

enormous volumes of traffic.” He went on to say that the biggest issue in evolving from 4G to 5G would be the backhaul.

- It’s interesting that the executive quoted happened to be the CEO of Vodafone Idea because we are still in discussions with them. As you may recall, we are the preferred vendor from a technology standpoint. We have not given up on finding a mutually satisfactory way to deal with the financial terms of their project. Although we aren’t assuming new orders from Vodafone Idea in our forecasts, this remains as potential upside for next year.

Turning to Africa, we continue to support 4G rollouts in several countries. These projects are aimed at bringing mobile broadband service to an increasing number of subscribers. We also have a large new deal; we are re-engaging with an operator in Africa we haven’t done business with for a while. . . although the timing of the related orders is not 100% certain. Nevertheless, we expect growth in revenue from Africa for the full year compared to 2018 and we think revenue from Africa will continue to grow moderately next year as well.

Looking at Latin America, we continue to expect good growth in 2019 compared to 2018, owing in part to the multi-year Orocom project in Peru. This project has been moving well, but a little bit slower than expected. Meanwhile, our only 10% customer this quarter was an operator in Argentina continuing to aggressively invest in expanding and densifying their 4G wireless backhaul network. We think Latin America is likely to pick up a little more in the second half and continue to grow next year as well.

The APAC region also continues to grow, with several customer contributing to the revenue increase. As mentioned on the last call, in Southeast Asia we are continuing to support large-scale network expansions as the primary vendor to one of the region's mobile operators.

We are very pleased to report that we were successful in winning the business from the RFP in the Pacific region we've mentioned previously, where the operator is preparing for 5G with a major upgrade of the backhaul infrastructure. Winning this business will help ensure that

revenue from the APAC region continues to grow next year, on top of the excellent year we are having in 2019.

We are even more encouraged about Europe which has remained relatively flat for the past several quarters. We expect revenue from Europe to pick up toward the end of this year and also continue to grow next year. We expect the growth next year to be driven by new business for large global operators in Europe. For example, there is an RFP issued by Vodafone in Europe in anticipation of their 5G rollout. As you will recall, we became an approved vendor to Vodafone some time back and this gives us what we refer to as a “hunting license” to be able to address projects in various parts of the world as they come along.

Finally, the report on North America is quite positive . . . but with a certain amount of short-term risk remaining. As we discussed last quarter, our primary U.S. customer is continuing to expand services with our microwave and millimeter-wave backhaul solutions in preparation for 5G.

Most of you are familiar with the long saga of their efforts to merge with another carrier that we also serve. We continue

to be confident in the long-term – regardless of the outcome . . . but we can't rule out a short-term pause related to corporate initiatives. The really exciting news is that we have been chosen by an additional Tier 1 operator in the U.S. we haven't worked with previously. This is the one we mentioned on the last call with a strong interest in our IP-50 disaggregated wireless backhaul solutions. We expect this new customer to begin contributing to revenue only toward the middle of next year, but this development reinforces our technology leadership and the value we bring to customers with our solutions. We continue to expect revenue from North America to grow moderately in 2019 compared to 2018 . . . and we are looking for strong growth in North America next year, particularly in the second half.

So, to summarize and put recent developments into some context we should look at it from this perspective:

- The 4G buildout in most regions of the developed world peaked several *years* ago and, since then, we have benefitted from steady revenue growth in India from very aggressive deployment of 4G. Simply put, for the past several years, India has been going up as other

regions have been going down at a varying rate. The peak in revenue from India came in Q2 of 2018, with over \$40 million in that one quarter.

- Meanwhile, revenue from other regions stopped trending down or staying flat at various points during the last year and began increasing. So, we entered 2019 viewing the year as a transition period in which revenue from India would remain at a relatively high level, but not as high as in 2018 . . . and revenue from several other regions would begin to increase in preparation to launch 5G services . . . with the net effect of generally flat revenue in 2019, but with improving profitability from a more favorable geographic mix.
- Now we see something different – signs of a change in attitude from operators in India that points to an actual slowdown. Therefore, the transition between less aggressive spending in India and the pick-up in spending in other regions seems unlikely to be as smooth as previously expected.

- Despite the shift in the near-term outlook, the longer-term picture remains the same. We will continue to benefit from ongoing deployment of 4G, including in India, even if the pace slows more than we anticipated.
- Something that hasn't changed is we are at the very beginning of a multi-year network evolution to upgrade and densify wireless backhaul networks in preparation for launching 5G services. We are benefitting from our technology leadership, already gaining significant traction with multiple design wins for 5G. We continue to expect acceleration in demand as the transition progresses, but vendor selection is happening *now* in several regions. We are well-positioned to participate in every phase of this evolution . . . and to continue to gain market share.

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 increased sequentially to \$73.0 million, which was considerably below our target quarterly run rate of \$80-85 million per quarter.

This was a result of substantially lower-than-expected revenue from India, partially offset by higher-than-expected revenue from several other regions. In Q2, India accounted for only \$7.5 million, or only about 10% of total revenue as a result of the ongoing delay in receiving a large group of orders expected since early Q1. In addition to the further sequential decrease in revenue from India, revenue from Europe decreased slightly from a strong Q1 in that region. Both India and Europe also decreased as a percent of total revenue in Q2. Meanwhile, revenue from both North America and Latin America increased sequentially and also increased as a percent of total

revenue in Q2. Revenue in Q2 from other regions was similar to Q1.

In Q2, we had one above-10% customer in Latin America.

The low level of revenue from India in both Q1 and Q2 has certainly distorted year-over-year revenue comparisons.

Excluding India, revenue for the first half of 2019 increased over 36% compared to the first half of 2018, with all regions other than India contributing to the increase.

Both GAAP and non-GAAP gross margin was 36.1% in Q2, a slight sequential improvement reflecting the further shift in geographic mix with lower revenue from India. Gross margin for the first half of 2019 was 35.9%, over 300 basis points higher than the first half of 2018. Even assuming substantially more revenue from India during the second half, we expect gross margin for all of 2019 to be slightly higher than 2018, but with gross margin in the second half likely to be slightly lower than the first half.

Turning to operating expenses, non-GAAP opex of \$21.5 million in Q2 was in line with our target quarterly range of \$21 to \$22 million per quarter. We continue to expect opex to increase to slightly above \$23 million per quarter during the second half.

Our non-GAAP financial expenses increased sequentially in Q2 to \$1.6 million, compared to \$1.1 million in Q1, due to higher interest expense, bank commissions and exchange rate differences.

Tax expense was slightly higher than Q1 as expected and we continue to expect our tax expense for the second half to be somewhat higher than the first half.

On a GAAP basis, we reported \$763 thousand in net income and non-GAAP net income of \$2.5 million.

This was an improvement sequentially, due to slightly higher revenue and higher gross margin. However, our \$2.5 million in non-GAAP net income was substantially less than \$3.8 million reported in Q2 of 2018, when revenue was above the target quarterly run rate due to over \$40 million in revenue from India in Q2 a year ago.

By comparison, we had only \$7.5M in revenue from India in Q2 this year, causing our revenue to be below the typical run rate.

Turning to the balance sheet at June 30, receivables increased slightly to \$121 million, with DSOs of 141 days. The DSO increase was mainly due to a shift in mix toward customers with more extended payment terms than our average.

The continued sequential increase in inventories was primarily related to our preparations for the fast delivery of the large batch of orders expected from India.

To meet higher working capital requirements during Q2, we added \$5 million of receivables financing as well as \$8.9 million of short-term debt from our revolving line of credit. We had net negative cash flow of \$9.6 million in Q2.

At June 30, we had cash and cash equivalents of \$29.0 million, with \$31 million available from our revolving credit line, which gives us ample financial flexibility.

Our book-to-bill ratio was below 1 for the quarter, also excluding India; however, we expect bookings to increase in Q3 and Q4 in most regions and as a whole.

As Ira mentioned, it is no longer realistic to target an increase in net income for 2019 . . . or even to assume we can reach the 2018 net income level.

In light of recent developments which could affect the transition in regional ordering patterns, we see a wider than normal range of possible revenue scenarios in Q3 and Q4 – each with different gross margin characteristics. Depending on the amount and timing of orders from India, gross margin in 2019 could range from 34% to 35%.

Therefore, with our opex trending up slightly during the second half, and similar or slightly higher financial and tax expense in the second half relative to the first half, we should expect at least a moderate decline in net income for 2019 versus 2018.

Until we see the actual timing and size of the additional orders expected from India during the second half, it is difficult to develop a revised net income goal for 2019 . . . mainly due to the wide range of possible outcomes,

compounded by the number of variables. Meanwhile, in view of the developments we've been discussing, we are looking again, even more closely, at the timing and potential contribution of every project and opportunity . . . and we will continue to work very hard to bring in these orders.

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