Operator

Good day, everyone. Welcome to the Ceragon Networks Limited Third 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; the risk of delays in converting design wins into revenue; 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 third quarter results were disappointing. We had a very strong quarter in APAC, but performance was below our expectations in most other regions for various reasons. At a high level, the main factors impacting Q3 were the slowdown in India and a short-term delay on one large project in Latin America.

I want to emphasize a few key points which aren't apparent from our Q3 results before we get into the regional business details:

1. During the quarter, we made excellent progress with new customers we mentioned as 5G design wins on previous calls, and we added another new 5G design win during Q3 as well. This demonstrates two things:
    - that operators are continuing to move ahead with their 5G plans despite a more cautious

environment, and

- our leadership position is being recognized outside our existing customer base.

2. We expect quarterly revenue in most regions to improve in Q4 and also during 2020, allowing for typical seasonality in Q1. We see general strength, or at least stability, in most regions of the world outside of India. This is an important point because it is not apparent from the results we just reported.

We are subject to the same macro issues that you've been hearing about from other companies in the telecom equipment industry and elsewhere . . . nevertheless, we are targeting overall revenue growth next year. Driving this growth will be both ongoing programs and new 5G design wins which will contribute mainly during the second half of next year. We acknowledge that our growth in 2020 will be from a lower level of revenue in 2019 than previously expected. In the current global telecom environment, being able to see a path to profitable growth next year is a significant positive point –

one which we owe to our leadership position and ongoing commitment to maintaining a global presence. So, we intend to grow and we intend to do it profitably. We have the resilience to deal with these developments without the need to make drastic changes. With that overview in mind, I'd like to discuss developments region by region, beginning with India.

On our Q2 call, we said the picture in **India** seemed to indicate a deliberate slowdown in the pace of expanding and densifying India's 4G networks, with more focus on the 5G spectrum auction and on urging the government to lower minimum bid prices. In Q3, India fell slightly short of our lowered expectations . . . and, after receiving half of the large batch of orders delayed from earlier in the year in July, we were disappointed but not overly surprised that we did not receive the second half of this batch of orders in Q3. We now believe they will come sometime during the first half of 2020. So, the slowdown in India is definitely real and affecting us for more than just a quarter or two.

The lack of profitability and heavy debt burdens among

most of the large operators in India, even after consolidation and restructuring, is becoming a more serious concern due to a recent decision by the Supreme Court in India. This decision, which settled a dispute between the operators and the Indian government over how certain fees should be calculated, is expected to result in an additional $13 *billion* in fees owed to the government by the large operators. This decision represents the biggest development in the region since our last call. The burden of these additional fees will fall disproportionately on the 2 largest incumbents – Bharti and Vodafone-Idea – who are expected to seek some form of government intervention to support the operators and address the financial stress. Meanwhile, the pace of investment will be curtailed pending decisions from the government on the fees and the minimum bid price of 5G spectrum. The only solidly profitable operator in India, Reliance Jio, was not much affected by the court decision, but it had already announced its intentions to spend at a less aggressive pace. Now we better understand their reasoning. With all the major operators

scaling back spending either because they must or because they can afford to strategically, our assumption about annual run-rate for India this year and next is less than half the average run-rate of the 2014 through 2018 . . . more like $50 million per year in 2019 and 2020, versus over $100 million a year in revenue on average for the past several years.

We strongly believe we are retaining our market share in India and we have some positive indications about strengthening our position in the region. Specifically, we believe we will be selling to Vodafone-Idea next year in addition to continuing with Bharti and Reliance Jio. We have been working very hard to find a way to sell to Vodafone in India with an acceptable level of risk . . . and we believe we are closer to finding such a mechanism. This feeds into the reason we now expect business in India to stabilize at around the 2019 level during the transition period between the 4G buildout and the evolution to 5G. Regardless of their financial woes, these operators need to support more coverage in the rural markets, which requires compact, low-cost solutions of

the type we already deliver. Meanwhile, Indian operators will also have to address growing data demand in the urban markets, using high capacity links . . .which is also an area where we excel by providing compact all-outdoor solutions. So, within the context of the typical lumpiness and timing issues in India, we see some potential upside in demand next year, but we prefer to remain cautious and look for a flat year in 2020, given the operators' financial situation, recent developments, and our recent experiences in the region.

In **Africa**, we have also seen more caution from customers recently with the decision cycle taking a bit longer. We expect some improvement in Q4 as we begin to ship to the new African customer we mentioned on the last call . . . but, looking into next year, we are a little more cautious about the near term potential of this region because of the ongoing issues the operators are having with obtaining foreign currency, plus their tendency to pay slowly. We are addressing this risk by negotiating additional upfront payments and other measures.

Latin America continues to be strong overall, due to the

continued expansion of 4G networks. We had a hiccup in Q3 because the project for Orocom, aimed at bridging Peru's digital divide, was delayed due to the after-effect of the election in Peru. However, we believe it was a delay of only one quarter. We have a nice backlog in Latin America, and expect to see further growth in this region next year as well.

APAC was particularly strong in Q3, as we recognized significant revenue from the large-scale network expansion we are supporting in Southeast Asia. You may recall this was the subject of a press release we issued recently. We continue to expect growth next year – on top of the excellent year we are expecting in 2019, as we begin to recognize revenue from a 5G design win in the Pacific region we mentioned on our last call.

Europe remains steady at a somewhat higher run rate than we saw in 2018 . . . and now seems likely to remain steady at a similar run-rate to 2019 through next year as well, even with additional macro uncertainties – again owing to some recent design wins.

In **North America**, the near-term risk we highlighted last quarter was manifested in Q3 with a pause. We believe the pause in Q3 was related to the States' attorneys general filing a lawsuit to block the proposed merger between two of our customers despite the fact that it had received most regulatory approvals. We continue to be confident in the long-term business – regardless of the outcome of the lawsuit – but we are now assuming only modest improvement in Q4 versus Q3. Next year, we expect North America to grow versus 2019 when our new Tier 1 customer in North America begins to contribute to revenue during the second half. Meanwhile, we are tempering our overall expectations for North America a little in view of the additional timing uncertainty due to the lawsuit from several States. On the positive side, as I said at the beginning, we are making good progress toward another significant 5G design win that might provide some additional upside toward the end of next year.

To summarize, the main challenge from now through next year continues to be India. To put it another way, the

basic difference between an assumption of an $80-$85 million quarterly run-rate for 2020 and our new assumption that next year's average quarterly run rate will be closer to $75 million, is India. Since our overall growth next year is coming mainly from new business we won recently or expect to win soon, the timing of the revenue recognition is likely to be skewed more to the second half of the year. So, the first two quarters are apt to be below the average quarterly run-rate for the year, and the final two quarters are apt to be above the average. We expect at least stability, and in some cases revenue growth from most regions, due to ongoing projects, as well as new design wins in APAC, Africa and North America. There is a more cautious environment, but the journey to 5G has not stopped. We are winning 5G business and expect to continue to do so in the coming quarters. Meanwhile, we have a slowdown in India which will continue to affect us until the dynamics in that region improve.

Of course, we recognized the risk associated with geographic concentration as India grew rapidly during the

past several years. One objective of our various strategic initiatives has been to mitigate our geographic concentration. Some aspects of our strategic moves have been effective in reducing our future geographic concentration – for example the relationship with NEC, and design wins in other regions. Other initiatives, aimed at changing the geographic balance more rapidly, did not come to fruition. These initiatives included exploring strategic opportunities for consolidation and/or diversification via external investment. Over the past 2-3 years, we've held a number of serious discussions with various companies in multiple countries – in some cases more than once. In fact, we were so committed to the process that we consciously increased the depth and strength of our management team in order to be well-prepared to manage the integration of either a consolidating or diversifying transaction – or both. We created an organization that would support a larger, more diverse business in the real world – not just on paper. But, in the end, we could not conclude a deal on terms that we and our board could be confident would create

shareholder value in an acceptable length of time, with an acceptable risk profile.

So, the personal objectives of the people who created such a strong management capability are not being realized in the time frame expected. So, predictably, a few of our most senior people will be leaving the company between now and year end to pursue other opportunities. Specifically, Doron Arazi whom most of you know, Yuval Reina, our COO and Nurit, EVP and head of HR will be leaving. The board and the management team recognize the many contributions of these valuable executives, not the least of which was their outstanding succession planning! We wish them all the best in their new endeavors. They are friends as well as colleagues and they will be missed.

On the positive side, I have a great organization that is well-equipped to make a seamless transition. Also, we can now create a flatter organization that can quickly adapt as the business evolves.

As I said at the beginning, on the expense front we aren’t

planning drastic moves. Our plans are not focused on cost-cutting. We will continue to invest in maintaining our technology leadership and design-to-cost advantage, while also exercising very tight control over operating expenses. We will put even more focus on working capital management in order to generate more cash flow, and we intend to repay most or all of the outstanding debt under the revolving credit agreement to give us the financial flexibility to be opportunistic under the right circumstances.

Some strategic initiatives we are working on include:

- moving to more software-based solutions in order to exploit changing market dynamics and
- we may consider more opportunities to become a technology provider . . . in order to create a new source of revenue.

We will continue to look for external strategic opportunities and be financially prepared to move aggressively.

Meanwhile, we believe the primary indicator of future

success to watch, in the near term, is the number of new 5G design wins we can achieve. The time for winning the business is right *now* and onward . . . The time for recognizing the revenue will be as full 5G deployments begin to ramp – mostly in late 2020 and beyond. In our view, this has always been the general time frame – you will recall that we commented several quarters ago that 5G is a journey, not an event.

We've had a couple of challenging developments like the Indian Supreme Court ruling, and the States' challenge to the merger of two U.S. customers. So, the journey has bumps in the road . . . but the journey continues, and we remain well-positioned to capitalize on it.

Now I'd like to turn the call over to Ran to discuss the financial side 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 our third quarter results.

Revenue declined slightly from Q2 to $72.2 million and was substantially below our revenue in Q3 of 2018. As you have already heard, this was primarily a function of:

- the continued effects of the slowdown in India,
- a delay at one customer in Latin America, which was mostly offset by stronger-than-expected revenue from APAC;
- and lower revenue from North America, which was below the run rate of the last several quarters.

Revenue from both Europe and APAC grew sequentially and year-over-year from Q3 of 2018. Revenue from India increased sequentially from the very low level of Q2 as a result of shipping a major portion of the first batch of orders received at the end of July.

In Q3, we had two above-10% customer: one in India and one in APAC.

Both GAAP and non-GAAP gross margin was 32.2% in Q3, a sequential decline, primarily reflecting a less favorable geographic revenue mix. We continue to expect gross margin for all of 2019 to be slightly higher than 2018, 34% or slightly higher depending on the mix of revenue in Q4.

Turning to operating expenses, non-GAAP opex of $20.7 million in Q3 was slightly below our target quarterly range of $21 to $22 million per quarter because of some delay in ramping planned R&D expenses and lower commissions due to the lower level of sales. We expect opex to move back above $21 million per quarter during the next several quarters, but slightly shifting our priorities, we expect to remain in the $21 to $22 million per quarter range – probably through next year, though we haven't finalized budgets at this point. To emphasize what Ira said, we are

not slowing or cutting any major R&D programs and continue to invest to retain and expand our leadership.

Our non-GAAP financial expenses decreased slightly from Q2 to $1.5 million in Q3 due to lower bank fees and exchange rate differences, partially offset by slightly higher interest expense.

Tax expense was slightly lower than Q2. Q4 has a tendency to be higher than other quarters so we are expecting it to increase sequentially by a few hundred thousand dollars.

On a GAAP basis, we reported $186 thousand dollars in net income and non-GAAP net income of $497 thousand dollars.

This was a decline from Q2, due to slightly lower revenue and lower gross margin due to the mix.

Turning to the balance sheet at September 30, receivables increased to $126 million, with DSOs of 154 days.

The increase was mainly due to a further shift in mix

toward customers with more extended payment terms than our average and two customers paid at the beginning of October which also affected our net cash flow.

Inventories decreased from Q2 by approximately $6 million to $67.7 million. Inventories had been unusually high due to our preparations for the fast delivery of the large batch of orders expected from India. Given the current outlook in India, we are focusing on bringing down inventories as quickly as possible and on aggressive working capital management, including collection efforts.

To meet working capital requirements during Q3, we increased our borrowing under our revolving line of credit by $8.5 million to $17.4 million. We had negative cash flow from operations of $14.4 million in Q3, with cash and cash equivalents at the end of September totaling $20.5 million. We expect cash flow to turn around in Q4. Since we expect to generate strong positive cash flow next quarter, we are aiming to pay most of the outstanding balance under our revolving credit agreement. This means we would end the year with minimal debt and close to the maximum of $40 million of unused credit.

Turning to the near-term outlook, with a book-to-bill ratio which was above 1:1 for the quarter, we believe we can target a run rate of $70-$75 million in the near term. To repeat what Ira said, we expect to grow in 2020 compared to 2019, with most of the strength likely to come in the second half of the year. It's too soon to have enough visibility to set a specific target, but our current assumptions about 2020 include an average quarterly run-rate somewhere around $75 million with gross margin and opex fairly similar to 2019. These assumptions do not lead to the profit growth we have been targeting – certainly not in the short term. In fact, with some year-end items, such as expenses related to departing executives, we are probably looking at reporting a small loss in Q4, along with the positive cash flow from higher collections and strong working capital management. As Ira said, despite recent developments, we are taking the long view and continuing to invest in major programs because our future roadmap is an important aspect of adding new design wins that will turn to revenue next year and beyond. We are the

strongest company in wireless backhaul and we expect to maintain that position throughout the transition to 5G and beyond.

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

Recap by Ira after Q&A:

Like other companies in our industry, we have found it necessary to adjust our short-term view to take into account growing macro uncertainties such as trade and global economic trends, as well as the specific challenges many customers are facing with the migration to 5G.

We believe that working in our favor is the fact that we offer solutions that effectively address many of our customers pain points, as well as services to help them sort through the complexities inherent process. During the 4G investment cycle, it has become more obvious that the cheapest solution often not the most cost-effective one, and the magnitude of the investment required for 5G will continue to drive home that point. Our product road map is an excellent match with every phase of the migration to

5G, near-term, intermediate- and long-term, which increases our confidence that we will continue adding new 5G design wins. This will be our focus – having the best solution, winning the business for the right reasons, being financially strong and prepared to be opportunistic when the circumstances are right – regardless of short-term macro issues or regional dynamics.