Ceragon Networks - Q4 2020 Conference Call Script

February 8, 2021

Welcome - Operator

Greetings and welcome to Ceragon Networks Limited Fourth Quarter and Full Year 2020 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 conference is being recorded. It is now my pleasure to introduce your host, Maya Lustig, Head of Investor Relations of Ceragon. Thank you, you may begin.

Safe Harbor - Maya

Thank you, operator, and good morning everyone. I am joined by Ira Palti, Ceragon's President & Chief Executive Officer, and Ran Vered, Ceragon's Chief Financial Officer.

Before we start, I would like to note that this call includes information that constitutes "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. Although we believe that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, we can give no assurance that our expectations will be obtained or that any deviations therefrom will not be material. Such statements involve risks and uncertainties that may cause future results to differ materially from those anticipated. These risks and uncertainties include, but are not limited to, such risks, uncertainties and other factors that could affect our results as detailed in our press release that was published earlier today and as further detailed in Ceragon's most recent Annual Report on Form 20-F and in Ceragon's other filings with the Securities and Exchange Commission.

Such forward-looking statements 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. Such forward-looking statements do not purport to be predictions of future events or results, and there can be no assurance that they will prove to be accurate. Ceragon may elect to update these forward-looking statements at some point in the future, but it specifically disclaims any obligation to do so.

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 Ira. Please go ahead.

Overview Commentary - Ira

Thank you Maya, and good morning everyone.

In the fourth quarter of 2020 as well as almost the entire year, the macro environment remained challenging. Fast-forward to the present, the vaccine roll-out in Israel is inspiring, setting a world record and an example to other nations. I got my second shot already and I'm happy to share with you that I'm feeling perfectly fine.

For Ceragon, the fourth quarter was a relatively good end to a volatile year, with revenues and business activities returning to their normal run rate. Ran will give you the details later in the call.

I'd like to take the opportunity to say a few words about our most recent technology focus, the evolving market, and our emerging roadmap. 2020 was a unique year for business – and as an economist once said, a crisis is a terrible thing to waste. A big opportunity for us this past year was to be a key player in moving the 5G evolution from hype to reality.

As you would agree, 2020 created a deep cultural change in our global society. Due to all the lockdowns, limited face-to-face interactions, and reduced travel, online services became the lifeline. We all adopted new ways of communicating, doing business, shopping, entertaining ourselves, and more. This has generated massive traffic and complexity that strain existing networks, creating an urgent need for more network capacity.

To keep pace, operators are pushing 5G from initial trials into the field – and this is what we have been waiting for and are very excited about.

We believe we are poised to provide operators with the technology, expertise, and services they need to make this transition happen. And we foresee a significant opportunity to grow and take market share.

At Ceragon, we have a history of benefitting from the transition between wireless generations.

As 5G services and networks build momentum, we believe that once again we will do what we do best – leverage this transition and continue our successful company story in 2021 and beyond.

When we look back, we see that the three main technological breakthroughs that empowered us to become a true global player were Wireless SDH, Wireless IP, and compact multi-core All-Outdoor wireless backhaul solutions. And more than that: we became present in all corners of the world, positioned to benefit from the wave when it occurs, where it occurs which is something our best-of breed competitors cannot boast.

Our first big revenue jump was a decade and a half ago, when our wireless SDH solutions drove the transition from 2G to 3G. This almost tripled our revenues at the time, from $55 million to above $160 million per year. We were the first to introduce wireless SDH technologies – a game changer that opened a world of possibilities for operators to bring the internet to mobile devices.

Our next big step was over the next 10 years, when we were the first to introduce wireless IP hauling, compact all-outdoor solutions, dual-core chipsets which allowed us to ride the 4G wave globally, and took us from $160 million to a yearly revenue run-rate of about $300 million.

And that's exactly the position we're in today. We expect to continue to be a key enabler of the exciting 5G evolution.

I'd now like to spend just a few minutes to explain why. Especially for those of you who are new to Ceragon, it might help to break down the elements that contribute to our 5G positioning.

5G networks require massive capacity, density, and flexibility with extremely low latency, and we believe our differentiated solutions lead the market in all of these areas.

We enable operators to utilize a much wider range of spectrum, and our open-networks architecture supports more flexible and operationally efficient network roll-outs and quicker time-to-revenues.

We are one of the only players that develops all network components in-house. We believe this gives our customers' networks a performance advantage along with a several-years' lead in network capacity and network resources management, such as spectrum, energy and site-acquisition. Thanks to all this we believe our customers succeed more often and more efficiently in today's competitive markets.

I'd now like to speak a bit more about our leadership in the BEST-OF-BREED portion of the wireless hauling market. We were at the forefront, leading a change that created more possibilities for operators to build and manage higher performance and more operationally efficient networks by integrating the best solution for every network domain. This is what made us the #1 wireless hauling specialist, first in the 3G days with wireless SDH and then in the 4G days with wireless IP and multi-core all-outdoor solutions.

Today, another change is already picking up speed. The industry's move, led by operators, towards open networks – the OpenRAN or "disaggregated" environment – enables operators to integrate specialist solutions for each network domain from different of vendors. The market is becoming more democratized which plays to our favor.

Just a couple of weeks ago, we learned that Europe's Deutsche Telekom, Orange, Telefonica and Vodafone formed a collaboration around the rollout and development of OpenRAN technology in a bid to ensure that Europe keeps up with the US and Japan.

In the Wireless Hauling best-of-breed market segment, we believe the leading provider is Ceragon. We believe we have the most advanced and flexible sets of technologies and solutions, the largest market share, the most comprehensive services and expertise, and the widest geographical coverage.
The transition from 4G to 5G is creating a huge change in the way networks are designed and architected. That's why, often, we help operators achieve an evolutionary approach: we provide a wireless-based backhaul network that is supporting 4G networks, and that can be upgraded cost-effectively to 5G at any point to increase capacity by 10-fold. Along the way, we help them optimize the network performance and the network resources, including re-use of equipment where needed.

This total-support approach is how we have built our extensive customer base world-wide, some of whom are recently acquired. These include major Tier-1 operators in North America, Europe, and South East Asia, as well as Tier 1 and Tier 2 operators across the globe, plus smaller ISPs and regional players. It’s what we believe makes us an essential partner for operators as they evolve to 5G.

So what makes us the technology leader of Wireless Hauling, and even-more-so when it comes to wireless hauling for 5G? The answer is the combination of four elements:

- First of all, we are the only player that builds its own purpose-driven chipsets, giving us the tightest integration in the market functionally and cost wise.

- Second, total vertical integration. We are the only player that does everything in-house, from chipset development for Microwave and Millimeter-wave to complete radio and networking systems.

- Third, we are the only player with leadership in all 3 domains of the disaggregated wireless hauling network: networking software, networking hardware, and radios.

- Finally, we believe we are the “kings” of compact all-outdoor solutions, with nearly 40% market share of the segment, as measured by Sky Light Research firm.

Putting all this together, you see the full extent of our capabilities: solutions and roadmap, 2Gbps to 100Gbps, over a wide range of spectrum going well above 100GHz. This is what is needed to support the capacities and capabilities for any and every possible 5G scenario.

Now that we believe we are perfectly positioned to leverage the 5G evolution, the open question is the timing. We see signs that this evolution will start building at larger scale towards the end of 2021, and then grow through 2022 and 2023. The exact timetable might be impacted by COVID, but we believe this is the general direction.

The US has been deploying 5G since late 2019, and shares leadership of the transition today with China. Network buildouts using wireless hauling for transport across networks have recently begun.

We have increased our 5G design wins to 9 this quarter and we are participating in numerous 5G Proof of Concepts and initial rollouts in the US, Europe, and the Pacific Rim, and plans are being finalized for mass rollouts. We anticipate that the first large-scale networks to make use of wireless hauling in mass are likely to kick off towards the end of 2021, and then to pick up speed, at first gradually, through 2022 and 2023. We expect to benefit from the growth of this market – and also to take market share.

After Japan and Western Europe, we expect to see 5G momentum build in the rest of Europe, APAC and LATAM, followed by Africa 3 years down the road.

In the meantime, we continue to benefit from large, expedited 4G projects to increase network reach. In some of these projects, the operators are already "seeding in" the wireless hauling infrastructure required for 5G.

To conclude, we are moving into a new kind of future, building on a growing collective online mobile presence and global hyper-connectivity whose full ramifications and potential we are yet to witness. In this new context, we believe there are and will be an increasing number of business opportunities for us across the globe, starting already this year. We are working hard to leverage these opportunities and to continue to be a key enabler of the multi-year 5G evolution.

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

Financials - Ran Vered

Thank you, Ira and good morning everyone.

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

During the fourth quarter we made further progress moving back towards "normal operations", continuing the positive trend that began in Q3 2020.

Our revenues returned to a strong level and are at the high end of our projections for the quarter, as well as the high end of our normal quarterly revenue run-rate range pre-COVID. They reflect the return to strong execution of almost all our ongoing activities in an industry that feels a new urgency for network building.

At the same time, COVID has increased our supply chain expenses significantly, reducing our gross margin. This, compounded with a large technology write-off and some year-end expenses recorded in the quarter, gave us a low gross margin and took us into a net loss for the quarter, despite the strong revenues.

Nevertheless, our financial performance in the fourth quarter remained strong, with strong collections, enabling us to generate $9.3 million in cash flow from operating and investing activities and to repay almost $12 million in loans.

In fact, all main balance sheet indicators: DSOs, Inventory, short-term loans and Cash flow, moved in the right direction this quarter, despite the very challenging environment.

Let me now review the actual numbers with you.

Revenues for the fourth quarter were $74 million, up 5% compared with the third quarter 2020, and up 4% compared with Q4 last year.

The revenues varied from region to region in line with the effect that COVID has had on local business operations and network build-out plans.

Europe had its strongest quarter in the last 3 years, reflecting some initial revenues from 5G projects.

Our strongest revenues for the quarter were from India, reflecting ongoing deliveries for Bharti.

Revenues in North America were strong, reflecting continued positive momentum with ISPs and smaller carriers.

Africa, too, had a strong quarter, reflecting shipments for the Orange Niger project we announced in August as well as to another customer we won this quarter. This is further proof of our strong 4G success in Africa.

Latin America had the strongest quarter in 2020, reflecting some gradual return to activity in our project in Peru. However, we are still facing frozen CAPEX budgets in the face of COVID-19.

APAC had a relatively weak quarter.

We had 1 above 10% customer in the fourth quarter.

For the year, revenues were almost $263 million, down 8% from 2019. This reflected the weak first half of the year due to COVID, following a much stronger second half.

The **Booking** to revenue ratio for the quarter was slightly below 1. Overall, our annual book-to-bill ratio for 2020 was above 1 while overall bookings were slightly higher than 2019.

Gross profit for the quarter on a non-GAAP basis was $21.4 million, giving us a non-GAAP gross margin of 28.9%, compared with 31.3% for the fourth quarter of 2019.

This reflects few one-time negative effects, some of which are agreements reached with several customers, which we believe will improve our future business with them, as well as a less favorable customer mix.

It also reflects the continued high supply chain costs that we have had to deal with in the COVID environment, with a major increase in air freight costs, higher material costs and more. This is likely to continue to fluctuate over the next few quarters until there is a full recovery.

For the full 2020 year ended, the non-GAAP gross margin was 28.7%, compared to 33.8% in 2019. This is not a level we are pleased with, and we have taken some operational steps to improve it for 2021.

Operating expenses on a Non-GAAP basis for the fourth quarter were $20.8 million, in line with our expectations.

Research & Development expenses for the fourth quarter on a Non-GAAP basis were $7.7 million, a slight increase from Q4 2019, mainly due to our progress with chip development. As planned, these expenses will continue to stay high until we reach tape-out in mid-2021.

Sales & Marketing expenses for the fourth quarter on a Non-GAAP basis were $8.5 million, down from $10 million in Q4 2019, reflecting the reduced travel and variable compensation that have come with COVID.

General and Administrative expenses for the fourth quarter on a Non-GAAP basis were $4.7 million, in line with our expectations and down from $6.8M million in Q4 2019 which was impacted by one-time provision.

Operating expenses on a Non-GAAP basis for the full-year period were $79.9 million, down from $87.6 million in 2019, primarily due to reduced sales and marketing expenses.

For 2021, we expect to have higher R&D expenses during the first half as we complete the new chip, and to gradually increase our sales and marketing expenses throughout the year as markets open post-COVID.

Financial and Other Expenses for the fourth quarter on a Non-GAAP basis were $2.5 million, which is much higher than their normal expected level. We do expect them to return to their regular levels in Q1-2021.

Our tax expenses for the fourth quarter on a Non-GAAP basis were $1.6 million, which were higher than expected. However, when we take a step back and look at the annual 2020 tax expenses, we see that they are in line with our typical annual tax expenses.

During the fourth quarter 2020, we had a $0.5 million equity loss together with a $1.8 million impairment of intangible assets related to the write-off of a technology investment. This was taken in view of our decision to use an alternative solution which we believe is a better fit for our customers and the market.

Net loss on a non-GAAP basis for the quarter was $3.5 million, or $0.04 per diluted share.

On a GAAP basis, net loss was $6.3 million, or $0.08 per diluted share.

As to our **balance sheet**, we continued to improve our stability and working capital, and you can see our success in the following parameters.

We reduced our **inventory** to $50.6 million, down from $62.1 million at the end of 2019.

Our **receivables** are now at $107.4 million, down from $118.5 million at the end of 2019. Our DSOs now stand at 149 days, which is a bit lower than in Q4 2019.

Cash flow from operating activities for the fourth quarter was $11.1 million.
Net cash used this quarter for investing activities was $1.8 million.
This strong cash flow enabled us to repay $11.9 million of our short-term loans.

Looking forward, we continue to expect to see significant operator activities – alongside continued uncertainty. Although the situation remains volatile, we believe that we are maintaining good control, and are well positioned to take full advantage of long-term opportunities.

We are targeting revenue growth in 2021. Although we expect a slow start for the first half of the year, based on a Q4 book-to-bill below 1 plus typical seasonal factors negatively affecting the first half, we continue to expect yearly revenue to be between $275-$295 million. We are aiming to reach Non-GAAP gross margin in the range of 30%-34% in 2021. However, with the continuing COVID impact on supply chain expenses and other cost factors, the gross margin might deviate from that range.

For Q1 2021, we expect our Non-GAAP operating expenses to be in the range of $20-21.5 million, taking into consideration the investment needed in our unique multicore chipset technology.

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

Ira’s closing remarks:

Thank you for joining us today. We believe that we have made great strides towards being a key enabler of the 5G evolution, but we think the real story is how Ceragon, once more, will enable and leverage a wireless generation transition. We appreciate your time today and we look forward to speaking to you again next quarter.

Have a good day everyone.