Operator

Good day, everyone. Welcome to the Ceragon Networks Limited Fourth Quarter and Full Year 2018 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 relating to the concentration of Ceragon's business in certain geographic regions and particularly in India; risks associated with a decline in demand from the single market segment on which we focus; risk relating to certain guarantees granted by Ceragon on behalf of Orocom to FITEL, in the framework of the FITEL project; risks associated with any failure to effectively compete with other wireless equipment providers; risks associated with a change in our gross margin as a result of changes in the geographic mix of revenue; risks related to the fact that our operating results may vary significantly from quarter to quarter and from our expectations for any specific period; risks related to our ability to meet the supply demands of our customers in a timely manner due to the high volatility in their supply needs; risks associated with difficulties in obtaining market acceptance of newly introduced product; risks associated with technical difficulties that may be discovered in newly developed products; 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. We had a great fourth quarter, and 2018 was an excellent year . . . and we're targeting a fifth year of growth in net income in 2019. We are looking forward to sharing the details with you.

With me on the call is Doron Arazi. As most of you are aware, Doron's is Deputy CEO and Chief Financial Officer, which means that Doron has two separate time-consuming roles. This morning, we announced that Ran Vered has joined Ceragon to assume the CFO role and he is here with us on the call today.

Both Doron and I will continue to do what we've been doing, which is make sure that, between the two of us, we are maintaining -- at the executive level -- key customer, channel and supply chain relationships. With Ran as CFO, we'll both be able to bring more focus to our work, so we are very pleased that he has joined us. Welcome, Ran!

Turning to our results, we had a very strong finish to the year. The fourth quarter exceeded our expectations for revenue, gross margin *and* net income. We also had a book-to-bill above 1 in Q4.

The strong finish contributed to 2018 being an excellent year in several respects. In addition to achieving our primary goal of net income growth, our revenue increased about 4%, which was ahead of our original expectation. We were successful in gradually increasing our market share in Latin America, Africa, Asia and some vertical markets in North America.. Gross margin improved, and we kept operating expenses within our target range. We also generated close to $10 million in positive cash flow in 2018, which enabled us to end the year with an even stronger balance sheet. On balance, the organization executed very well and we continue to believe our strategy of managing to the bottom line is the right one for our business. Therefore, we are aiming for 2019 to be the fifth consecutive year of growth in net income.

We have not seen any significant changes in demand or overall deployment activity anywhere in the world. We are expecting operators to be moving along the path to 5G this year before increasing the pace of ordering next year and beyond. Within this very positive overall picture of our business, we need to mention one caveat: lack of linearity. Those of you who have followed our business for some time are aware that it is typical for Tier 1 operators to pause orders temporarily during a major deployment. Usually, the reason is to bring site acquisition, installation capabilities and equipment inventory into full alignment . . . and it often means, when they do resume, the orders are even larger than they would have been without the pause. As a result, we tend to see lumpy order and revenue recognition patterns as well. Lack of linearity is “normal” in our business and we need to keep this in mind as we think about each region, the timing of orders, and how they combine into the overall picture.

Also, it’s worth noting that we also have some potentially large projects in the pipeline. These could provide some upside to the picture we are going to describe for you today.

Turning to the regional update, we’ll discuss India first.

There seems to be some confusion about our expectations in this region, so we'll try to be as clear as possible. Revenues from India were very high in 2018 – in fact, the same high level as 2017, which we did not expect. We expected a pause in orders during the first half of 2018 that didn't happen. If it had, 2018 would have been somewhat lower than 2017, having nothing to do with demand, or deployments plans, or anything else except the timing of orders and revenue recognition. With India sustaining such a blistering pace in 2018, it seemed even *more* likely that we would soon see a pause in the order pattern, which is why we put a lot of emphasis on the potential lumpiness on our last call.

Sure enough, orders from India in Q4 were lower. We expect another large batch of orders during the first half, but we don't know the exact timing, which creates the possibility that Q1 revenues from India could drop temporarily. The important thing to emphasize is that we expect the overall strength of the Indian market to continue for at least the next several years. We are only talking about the timing of orders and how they cause revenues to be recorded in various reporting periods.

You are probably wondering how Vodafone/Idea fits into our expectations for the market in India. Nothing has been finalized yet, but we have very strong indications that we are a preferred vendor from the technology standpoint. However, we won't necessarily be able to reach a satisfactory agreement on other aspects such as price or payment terms. There are considerable challenges in this regard before we have a deal that will meet our criteria. If eventually we are able to overcome these challenges this could generate significantly higher business and revenue from India than our current expectations.

After increasing our market share in APAC during 2018, we expect this region to remain generally strong in terms of ongoing business during 2019. There is a major bidding process going on for a large project in the APAC region where the service provider is preparing for 5G. This is factored into our projections in small numbers and could generate higher revenue than we currently expect toward late 2019 and into next year.

Africa began to pick up in 2018, and this business looks likely to remain strong this year. Our major customer in Africa, along with new customers we brought on board continue to invest in building out 4G in various regions of the continent.

Meanwhile, Europe seems likely to remain flat during 2019. 4G technology has been widely deployed across Western Europe, and there are no apparent “disruptors” among the European operators that seem likely to make an aggressive move on 5G that would force the others to follow.

In Latin America, we are expecting a very good year that will certainly represent growth over 2018 due to the large project we won in Peru, which is aimed at bridging the digital divide in large rural areas of the country. In Q4, we began shipping to this Orocom project. We also believe our customers in the South Cone will continue to invest as 4G penetration in several countries gradually increases.

We saw a pickup in revenues from North America in Q4 and we expect to sustain these higher levels during 2019.

The temporary government shutdown may have had some effect on the T-Mobile/Sprint process, but they are still targeting a closing during the first half. Any further acceleration of orders from these customers is part of the potential upside we referred to earlier, but we're not building it into the forecast until we have a better sense of the post-closing plans and the timing. Meanwhile, we continue to target gradual gains in market share in various vertical markets and among smaller operators until we see a 5G-related pickup, which we don't expect until next year.

The trends we see in most geographic regions reflect the various stages service providers are in as they prepare for 5G. So, we should talk about how we see 5G affecting wireless backhaul. From a technology and market perspective, it means:

- orders of magnitude more complexity -- to plan a network, to build or densify a network, and to operate a network.
- It means more sites – perhaps 5 times more sites
- It means more capacity to all the sites – it could be

100 times more capacity

- It means service providers must plan for new and more varied service offerings, or what we call "use cases". For example, gigabit mobile broadband to support activities like mobile on-line gaming, connecting billions of "things" from vending machines to parking meters, and more mission-critical applications requiring very low latency such as self-driving cars, real-time inspection of critical infrastructure and real-time collaborative robotics .

What 5G does NOT mean is orders of magnitude larger capex budgets . . . so we have to help our customers meet these challenges in ways that are not only simple and fast but also conserve valuable spectrum assets, minimize expensive real estate for mounting equipment, reduce power consumption as so on. So, doing all these things at scale requires innovation in deployment and professional services.

It's also important to remember that not every network will suddenly need 100 times more capacity all at once.

Different operators and service providers have different needs and are beginning the transition to 5G from different places. So, we have to be prepared to meet customers where they are today and give them solutions that will take them where they need to go at the pace they need to get there in a future-proof way.

Yesterday, we announced our new IP-50 platform that represents a premium solution providing certain additional capabilities which will command a premium in the market. The IP-50 platform is *not* a replacement for the IP-20. It is incremental and complementary to our IP-20 offering because not all networks require the particular capabilities of the IP-50 platform now or in the foreseeable future.

Our IP-20 platform is helping customers move along the path from 4G to 5G by providing multiple types of radios, each with multicore capabilities delivering high capacity in a variety of configurations including all-outdoor, split mount, and all indoor, depending on the specific needs of the operator. So, we will continue to develop the IP-20 platform, offering new releases with higher speeds and more functionality while we also make the IP-50 premium products available.

We believe the IP-50 platform is unique in that it offers certain advantages that are based on the concept of disaggregation – which in its simplest form means separating the path of innovation among radio technology, networking software and hardware to increase flexibility and available options. The IP-50 leverages software and hardware disaggregation to create an ultra-scalable platform that enables the customer to add capacity and interfaces by simply moving to a larger hardware variant while keeping all the software functionality intact. Without getting into all the technical details, in addition to offering multicore technology like the IP-20, the IP-50 offers additional capabilities that include a single radio for all deployment scenarios and routing software capabilities that are separated from the hardware, to enable simpler, faster deployments with lowest possible total cost of ownership. Our first IP-50 products will be showcased at Mobile World Congress next week and we expect to start recognize significant revenue from the IP-50 products beginning next year.

To summarize, we're looking forward to an excellent year in 2019 because we expect higher revenue from North America, Latin America and Africa to compensate for the impact of a temporary pause in India at the beginning of the year. So, currently, we are expecting overall revenues to be about the same in 2019 as in 2018 . . . and, with a more favorable geographic mix, we are again setting a goal of growing net income for the fifth straight year and again generating positive cash flow. . . . and we intend to do both while also continuing to invest aggressively in our next generation technology. The next generation of our Multicore technology, known as Octacore, will enable service providers to address the challenges of a full 5G world.

2019 promises to be a busy, exciting and profitable year that will provide an excellent transition to 2020 when we hope to see 5G deployments start to make an impact. ow, I'll turn the call over to 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 in the report.

The fourth quarter was a strong finish to the year, and we achieved our primary goal for 2018, which was improving net income. Our primary benchmark, non-GAAP net income, was up 14.8% to $17.5 million.

As Ira noted, revenues grew about 4% for the year, which was likely more related to timing of orders and revenue recognition factors, although we do believe we are gradually increasing our market share.

For those of you on the call who might be new to our story, we manage to the bottom line, not the top line. We look at each deal according to the amount of incremental gross profit it can bring and we keep stringent control of our operating expenses. We increased our (GAAP) gross profit by 8.2% in 2018, and our gross margin improved to

33.8%, which was inline with our expectations, despite some higher component costs. Our (GAAP) operating expenses for the year were also in line with our expectations, and higher than 2017, mainly due to foreign currency headwinds, increased R&D investment to continue our technology leadership, and performance-related compensation expenses. Our (GAAP) EPS in 2018 was $0.28 per diluted share, compared to $0.19 per diluted share in 2017. I will further elaborate on the big jump in the GAAP EPS in 2018 when reviewing the Q4 results shortly.

Turning to the details of our fourth quarter, revenues were better than expected and about even with both the third quarter and the fourth quarter of 2017. We saw strength in virtually all regions except India, which was below the very high level of recent quarters, as we ate through the backlog from the large orders received earlier in the year and in Q4 of last year. Even Europe picked up a little in Q4 compared with the last few quarters.

We had 3 above 10% customers or customer groups in the fourth quarter – one customer in India, a customer group with presence in India and Africa and a customer group in Latin America.

India continued to dominate the breakdown of revenues, but with a more moderate 25% of the total. Aside from India there were no major changes in the geographic breakdown.

GAAP gross margin was 34.4% and non-GAAP gross margin was 34.7% in Q4, similar to Q3 and an improvement from the same period in 2017, primarily due to a more favorable geographic mix. We believe the trend toward a more favorable geographic revenue mix will continue which we expect to result in slightly higher gross margin in 2019, with the typical fluctuations from quarter to quarter.

Turning to operating expenses, non-GAAP opex of $23.0 million was slightly higher than our target quarterly range due to higher variable compensation expense, primarily related to our strong business results. Looking at 2019, we expect operating expenses to remain in our target range of $21 to $22 million per quarter during the first half of the year, and slightly exceeding $23 million per quarter during the second half, primarily due to our investment in our next generation platform and the expected higher level of revenue. As we have noted in the past, we expect to continue to spend aggressively, but carefully, on our next generation 5G solutions.

Our financial expenses declined sequentially again in Q4, declining from $1.8 million in Q3 to about $900 thousand on a non-GAAP basis, due to less exchange rate differences and lower discounting fees. We expect financial expense to range between $1.0 to $1.5 million this year – assuming no further significant fluctuations in exchange rates.

I would like to spend a couple of minutes on our tax line in our GAAP numbers, as this caused a big jump in our net income and EPS for Q4 and for the full year on a GAAP basis. In Q4, we recorded income on the tax line primarily due to the need to record a tax asset of $7.2 million on our balance sheet that reflects tax benefits we anticipate as a result of utilizing our NOLs against taxable income in Israel in future years. This also means that we are expected to record higher tax expenses on a GAAP basis in the upcoming years. This tax asset does not reflect the full tax benefit of the approximately $200 million of NOLs that we have accumulated. Therefore, assuming we continue to be profitable in the very long term one should expect to see a similar accounting pattern of a tax-related income year followed by several years of tax expense. Bottom line is that this is another indication of our strong performance in the previous couple of years as well as our expectations for continued strength in the upcoming years.

On a GAAP basis, we reported $11.6 million in net income and non-GAAP net income of $5.0 million. This is a very good result and better than our expectations.

Turning to the balance sheet at December 31, receivables increased to $123.5 million, with DSOs of 131 days. This primarily relates to another timing issue and, since year-end, we have already collected most of the amounts that distorted DSOs for Q4 relative to our collection expectations.

Mainly as a result of the timing of collections we just mentioned, we had negative cash flow of about $5.7 million in Q4. However, for all of 2018, we had positive cash flow of $9.7 million, while gradually reducing our factoring activities by approximately $13 million, which is an even bigger achievement. We expect to continue to generate positive cash flow in 2019 as well.

At the year end, we had cash and cash equivalents of $35.6 million, with a $40 million unused line of credit which gives us ample financial flexibility.

Although our book-to-bill ratio was above 1 in Q4, we expect a temporary timing-related dip in revenue in Q1. This is primarily due to timing factors related to our business in India as Ira described on top of typical seasonality.

Since all regions are generally the same or stronger than 2018 in terms of overall demand and activity, we continue to expect revenue for 2019 as a whole to be about the same as 2018, but with a more favorable geographic mix due to a lower proportion of revenue from India related to the timing of orders. Since we are talking only about timing issues, the lower our Q1 revenues turn out to be, the higher we expect revenues to be in the remaining quarters of the year. Our revenues could be higher if some of the projects in our pipeline that are currently counted in our projections at very low amounts or not reflected at all will convert to orders and backlog in time to be recognized as revenues in 2019.

We are targeting 34% non-GAAP gross margin in the near term, with some improvement during the second half of 2019. Non-GAAP operating expenses will be slightly higher in 2019 versus 2018, due mainly to increased R&D investment primarily during the second half.

So, as Ira indicated, we are aiming to make 2019 our fifth consecutive year of growth in non-GAAP net income based on a similar level of revenue compared to 2018. We expect this additional net income improvement to be driven by a gradual increase in gross margin, tight control of operating expenses and lower financial expense versus 2018. With continued positive cash flow in 2019, we expect to have a solid foundation for taking advantage of the opportunities related to 5G deployments beyond this year.

Before we open the call to questions, I would like to also welcome Ran to our team and add how pleased I am that he is joining. I will supervise the completion of the 20-F and Ran and I will work together during the next several weeks on the transition of my CFO duties. He will take full responsibility for Q1 and you will be hearing from him on our first quarter results call in May. Is there anything you'd like to say before we take questions, Ran?

Ran:

Hello, everyone. I’d just like to say that I’m very excited to join the Ceragon team. I think we are in a great position to take advantage of the transition to 5G technology and I look forward to contributing as CFO. I’ll be speaking with you on the next quarterly results call and I’m eager to meet those of you I haven’t met before. Thanks, Doron.

Doron:

OK, now we will open the call for questions, operator?