

Ceragon Networks Q3 2021 Earnings Conference Call Script

November 1st, 2021

Welcome - Operator

Greetings and welcome to Ceragon Networks Third Quarter 2021 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 Doron Arazi, Ceragon's 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 Doron. Please go ahead.

Overview commentary by Doron Arazi

Thank you Maya, and good morning everyone.

Creating equal digital opportunities for all people around the world by bringing expert communication capabilities everywhere is the foundation of everything we do, and will do moving forward.

Today, many operators and network providers are on accelerated schedules to build the networks of tomorrow. We are proud that in the third quarter of 2021 a high number of them continued to select us. Since the days of 2G, we have worked hard to earn the trust of our customers in more than 140 countries.

So far in 2021, we have added around ten new material customers. Many of them, as well as existing customers, concern projects designed to bring a better communication infrastructure to rural areas. We are seeing a growing number of governments allocate budgets and initiate incentive plans to improve rural networks, and we are well positioned to take part in these vital projects.

We have a strong solution mix and reputation. But it is important to note that gaining new customers in our market can be a long process, often lasting more than a year depending on the type of customer and other incumbents' position. Even when we win a new customer, in most cases the business ramp up is gradual.

Our revenues in Q3 were strong. We achieved this despite an external environment marked by unprecedented challenges in the chip and shipping industries. During this challenging time, we've been doing everything in our power to maintain and grow our customer base. These efforts are crucial, but they incur expenses. I will address these issues later in my speech and so will Ran.

In Q3, we have seen further increase in our backlog which helps provide more confidence and visibility. The primary driver of this outperformance has been sustained strong bookings in different regions. In Q3, our 5G orders maintained the trend of previous quarters and showed a steady performance. And once again, we achieved two new 5G design wins.

Let me now provide a snapshot of our performance by each region.

In North America our 5G-related bookings accounted for over 50% of all North American bookings year-to-date.

As reported in the previous quarter call, we were selected by a leading US service provider for a multi-year managed services agreement. The satisfaction from our level of services and professionalism so far, has driven a discussion about potential network modernization.

We also just signed a contract with another new strategic operator in North America and are expecting orders in the coming quarters. Furthermore, we had one new 5G design win.

In addition to everything I've just mentioned, the evaluation of our IP50 products by two leading Tier 1 operators, which we reported last quarter, continues successfully. If all goes well, we expect to have two new Tier 1 customers buying our solutions in 2022.

In India, Q3 was a healthy quarter for us, as it was for telecom companies. Industry performance was driven by subscriber additions, increase in data consumption and tariff hikes as well as recovery after a severe wave of Covid-19. The quality of the network experience is becoming more important; as such, there's growing demand for network upgrades and expansion.

India is moving towards rolling out 5G by developing 5G corridors. Three telecom operators have recently been approved to start 5G trials. Spectrum auctions are expected to take place in 2022. Commercial launch is expected during the same year and we will be there to meet the demand. We are planning to participate in RFP processes. Our competitive advantages include our indisputable local market leadership position, driven by our technology, brand positioning, and experience in India as well as in other regions.

In Europe, we had a very strong quarter, especially in terms of bookings. We continued to receive orders by leading European operators from different countries, secured new orders, participated in trials, and received great feedback on our POCs. We have multiple RFPs in progress.

We are in the POC stage with a Tier 1 global operator in Western Europe. They are interested in our disaggregated wireless transport solutions. With another, we have achieved product validation and we are in the negotiation phase to secure orders.

Our European 5G-related bookings accounted for over 35% of all European bookings year-to-date. We had one new 5G design win.

In **APAC**, in terms of bookings, we had a relatively stronger quarter compared to Q2 2021. Our 5G-related bookings accounted for over 25% of all APAC bookings year-to-date. We are in a POC phase with a global tier-1 vendor regarding our disaggregated solution.

While we are building a solid pipeline and witnessing the emergence of a new momentum, it might be too early to yield to optimism. The shockwaves of the pandemic continue to radiate throughout the region, affecting people, economies, and business decisions.

In **LATAM**, we experienced some improvement in bookings. Even though the macro environment remains challenging, we received a substantial PO from new customer. We are working on POCs, and have multiple RFPs in progress.

A majority of LATAM countries have begun preparing for 5G. Several have already started trials including Brazil, Chile, Argentina, Peru, and Colombia. But 5G spectrum allocations have just started and in most countries are to be assigned in 2022 and beyond. We are taking this time to engage with existing as well as new players that may take part in the spectrum allocations in order to position ourselves as the lead 5G wireless transport vendor.

In **Africa**, we acquired new material customers, received a new PO for Managed Services, and are working on a number of new opportunities. When it comes to 5G, only a few countries have started assessing and investing in a potential infrastructure.

Overall, our global bookings increase our confidence in Q4 and beyond. Among other things, what will take us further is the expected growth in our Total Addressable Market. This is thanks to acceleration in 5G network densification, increased efforts to digitize the rural areas, as well as the shift to the OpenRAN architecture. These developments are likely to continue to have positive and profound implications for us, especially in the medium and long run. They create more opportunities for us to not only sell our product-led solutions but to also expand our offering and business model to deliver Managed Services and increase the sale of our software solutions.

I mentioned earlier the tough external environment we are operating in. While we have maintained good control and were able to increase our revenue compared to Q2, we have also encountered challenges. We believe the component shortages all across the globe will extend into 2022. At the same time, international shipping bottlenecks will continue to prolong supply chain turmoil. It looks like there's no quick fix. It impacts both delivery timelines and costs.

Our *Customer First* culture leads us to take measures to stabilize our lead times and avoid delays as much as possible, even on account of the current increased costs. Our goal during this turbulent period is to help our customers continue with their plans as smoothly as possible.

In parallel, we are working to optimize our product costs. We have undertaken an in-depth analysis of our Bill of Material (BOM) cost in order to identify all the necessary cost reduction options that are in our control, without sacrificing an ounce of quality along the way. We believe our initiatives will start bearing fruit in the next few quarters.

While the big picture is complex and the global market dynamics are beyond our control, we remain confident in our mid and long-term prospects. We may experience shift of revenues between quarters and temporary gross margin pressures, on which Ran will elaborate.

Before turning over the call to Ran, I would like to refer to the progress of our new 5G SoC. As mentioned in our Q2 call, we expect the tape-out towards the end of this year.

Immediately after the tape-out, we will start the productization process of the SoC which will be followed by the integration phase into Ceragon's future products.

Once launched, our new SoC-based product series will enable our customers to increase wireless transport capacity by 16x using only 1/4th as much of the spectrum, providing a several-year lead on the rest of the market. It is ideal for the bulk of the 5G networks that will be rolling out 2-3 years from now. Moreover, it will be significantly more cost efficient and less component market dependent, reducing our inventory and improving our delivery lead times.

With that, let me now turn the call over to Ran to discuss the financials for the quarter. Ran?

Financials - Ran Vered

Thank you, Doron, 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.

Like Doron mentioned, during Q3 2021 we saw very strong bookings coming from North America, India, and Europe as well as some recovery in APAC. In fact, Q3 is the fourth consecutive quarter with book to bill above 1. Our revenues for the quarter were at the high end of our projections.

Let me now review the actual numbers with you.

Revenues for the third quarter were \$76.1 million, up by 8% compared with \$70.6 million in Q3 last year. This was achieved despite the challenging environment with regards to component shortages. We are proud of this achievement and the fact that most of our customers' demands were fulfilled.

Our strongest region in terms of revenues for the quarter was **India**, reflecting ongoing deliveries for our main customers and in line with the strong demand we are seeing in this region.

Our second strongest region in terms of revenues for the quarter was **Latin America**, reflecting the deliveries and installations from the major win we had in the beginning of the year with a Tier 1 carrier in Colombia.

Europe also had a strong quarter, continuing its positive momentum and reflecting more initial revenues from 5G projects.

In **North America** we continued to see strong momentum with our Tier-1 customer, other leading ISPs, and smaller carriers. However, even though the demand continued to be very strong we were not able to deliver in the same pace as previous quarters as a result of the component shortages.

Revenues in **Africa** and **APAC** were slightly lower than in the previous quarter, reflecting the still challenging situation in both regions.

We had 3 above 10% customer in the third quarter.

Gross profit for the third quarter on a non-GAAP basis was \$23.6 million, giving us a non-GAAP gross margin of 31%, compared with 33.5% for the third quarter of 2020. This gross margin is thanks to an especially favorable mix of products and solutions sold to certain customers this quarter. It's a great achievement for us.

That said, there are growing challenges associated with component shortages and high supply chain costs that can impact our gross margin. Our effort to satisfy our customers' needs, as mentioned by Doron, is taking a toll as we pay significantly higher prices to resolve component scarcity. We believe this situation will be temporary.

Operating expenses on a non-GAAP basis for the third quarter were \$19.6 million, slightly better than our expectations.

Research & Development expenses for the third quarter on a non-GAAP basis were \$6.6 million, a decrease from \$7.3 million in Q3 2020, mainly as a result of utilization of vacation in August. We expect these expenses to be higher in the next quarter until we reach tape-out towards the end of this year.

Sales & Marketing expenses for the third quarter on a non-GAAP basis were \$8.3 million, an increase from \$7.8 million in Q3 2020, but still reflecting the reduced travel that has come with Covid-19. We expect to gradually increase our sales and marketing expenses as markets open post-pandemic.

General and Administrative expenses for the third quarter on a non-GAAP basis were \$4.6 million, a slight decrease from \$4.8 million in Q3 2020.

Financial and Other Expenses for the third quarter on a non-GAAP basis were \$2.3 million, an increase from \$1.2 million in Q3 2020.

Our tax expenses for the third quarter on a non-GAAP basis were \$0.3 million, in line with our expectations.

Net profit on a non-GAAP basis for the third quarter was \$1.4 million, representing \$0.02 earnings per diluted share on a non-GAAP basis.

Our **inventory** for the third quarter was \$53.2 million, higher than the \$51.9 million in Q3 2020 and represents the activities we are undertaking while facing the global component shortage crisis. We have been taking measures to optimize our inventory model, to make sure we meet our commitments to our customers.

Our **trade receivables** are now at \$109.9 million, up from \$108.4 million in Q3 2020. Our DSOs now stand at 140 days.

Net cash used in operating activities for the third quarter was \$0.7 million.

Net cash used in investing activities for the third quarter was \$2.3 million.

Looking ahead, our strong bookings in Q3, along with a very healthy backlog, reflect increasing business activity mainly in North America, India, and Europe. I am happy to report today that we continue to be confident about our revenue growth in 2021 and still expect it to be on the higher end of our annual revenue guidance, which is between \$275-\$295 million.

That said, the global component and shipping challenges still create fluctuations in our quarterly revenues and influence our gross margin. Despite these challenges, we expect our net income for the second half of 2021, on a non-GAAP basis, to be around break-even.

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

Doron's Closing Remarks

Thank you.

In the third quarter of 2021, we not only enjoyed strong bookings and a healthy backlog, we also achieved considerable success in containing the impact of the unfolding challenges around us in different industries.

Looking beyond the operational challenges this turbulent period creates for us, we see very high market traction that we expect to convert into growth and margin expansion in the mid and long term.

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

Have a good day everyone.