

Investec Inc.

Equity Research

Radware Ltd.
(RDWR - \$9.21)
Rating: BUY

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February 4, 2003

Strong Q4 Results, but Mild Growth Outlook for Radware

- Q4-02 results in line with company preannouncement, above previous estimates.
- Strong balance sheet and enhanced operating parameters.
- New customer wins form FY2003 growth basis.
- Revenue guidance for Q1-03 at \$12.5 million and EPS guidance of \$0.04.
- Improved outlook, reiterate BUY recommendation.

Market Cap (M)	\$152	52-Week Range (NYSE)	\$11.8-\$6.1
Avg. Daily Trading Volume (000s)	85,000	Institutional Holdings	28%
Shares Out. (M)	16.6	Total Debt to Total Capital	0%
Float Shares (M)	13.2	Proj. 5-Year EPS Growth Rate	16%

	FY 2001A		FY 2002A		FY 2003E	
			OLD	NEW	OLD	NEW
March	\$0.12		(\$0.08)	(\$0.08)	(\$0.01)	\$0.03
June	\$0.11		(\$0.05)	(\$0.05)	\$0.00	\$0.05
September	(\$0.16)		(\$0.02)	(\$0.02)	\$0.00	\$0.08
December	(\$0.12)		\$0.03	\$0.03	\$0.01	\$0.09
FY EPS	(\$0.08)		(\$0.12)	(\$0.13)	0.00	\$0.25
FY P/E	NM		NM	NM	NM	37x
FY P/S	NM		NM	NM	NM	2.9x
FY Rev (M)	43.4		\$49.8	\$44.6		\$52.2

Note: An explanation of ratings and disclosures can be found at the end of this report.

Q4-02 results in line with company preannouncement, above previous estimates. Revenues grew by 9.1% sequentially to \$12.0 million in Q4-02, above our expectations of \$11.4 million and in line with the company's guidance of \$11.0 million to \$11.5 million. Gross margin was maintained at 82.0%, while operating costs remained stable at \$10.5 million, bringing operating loss down to \$0.7 million from \$1.5 million in Q3-02. Financial income of \$1.1 million shifted the bottom line to the green for the first time following 5 consecutive negative quarters. Net income increased to \$0.44 million or EPS of \$0.03, above our expectations and company guidance for negative EPS of \$0.01 in Q4-02, and negative EPS of \$0.02 in Q3-02.

Strong balance sheet and enhanced operating parameters. Radware's results in Q4-02 reflected an overall improvement in its operational and financial parameters. The company's positive cash flow of \$0.4 million increased its cash position to \$125.3 million at the end of Q4-02. DSO's decreased to 67 days from 70 days in Q3-02, continuing the decreasing trend of DSO's during the last 4 quarters. Inventory decreased to \$3.0 million from \$3.5 million in Q3-02, increasing inventory turns to 2.4x from 2.1x. Sales mix consisted of 51% U.S., 49% ROW suggesting a continuing trend of stronger U.S. sales due to an increased sales effort in this region during 2002. ASP amounted to \$50k in the quarter. For 2003 we expect the company's efforts in Asia Pacific to bear fruit, especially in Korea, China and Japan. In terms of market potential Japan is second only to U.S., while in the Japanese market F5(FFIV) enjoys strong presence.

New customer wins form FY2003 growth basis. During the quarter Radware was able to close an impressive line of orders from customers such as eBay, Reuters, Korea Telecom etc. The company's stable repeat order rate

is about 45%. Historically, once a new big customer implements Radware's solutions, the original order is followed by a larger repeat order. The challenge for Radware, as we see it, is breaking into these new accounts, which then become a growth pipe on their own. From what we saw during 2H-02 and especially in Q4-02, we believe there is growing evidence of Radware's ability to leverage on its existing sales platform and increase new customer sales. On a relative perspective, Radware's performance is slightly better than the competition. Foundry (FDY) has announced a drop in its revenues from the ITM business, focusing on the switching business. F5 experienced almost flat growth during the past 5 consecutive quarters and the company's guidance was for 0-5% growth in sales for the next quarter. Cisco remains the leading competitor with market share of approximately 40% to 50%, due to its existing customer relationships, while still not investing in new products/solutions in their ITM business.

Revenue guidance for Q1-03 at \$12.5 million and EPS guidance at \$0.04. We have adjusted our estimates to reflect the improved business outlook. We increase our revenues estimate to \$12.4 million and \$52.2 million from previous \$11.6 million and \$48.0 million for Q1-03 and FY2003 respectively. We estimate an EPS of \$0.03 for Q1-03, flat sequentially and up from our previous negative EPS estimate of \$0.01. For FY2003 we project an EPS of \$0.25, compared to negative \$0.13 in FY2002 and to our previous \$0.00 EPS estimate for FY2003. We see the upside for Radware in FY2003 within its fixed cost structure. Providing the company manages to maintain its operating costs at \$10.5 million level, any additional dollar in revenues above \$12.7 million to \$13.0 million will result in a substantial impact on the bottom line at rate of about 80 cents per dollar of revenues.

Improved outlook, reiterate BUY recommendation. We project a 19.7% annual growth for 2003. Although Q4-02 results were surprisingly good, we do not believe this to be a one-time item. Talking to management, we confirmed our assumptions regarding sales efforts across geographies, supported by real sales evidence. Looking at the results, we see a steady line of improvement in leading parameters such as sales, margins, deferred revenues, DSO's, inventory, cash flow and total cash position. Therefore, in our opinion, the current market valuation implies a discount to the company's economic value. The stock is currently trading at 37x and 15x our FY2003 and FY2004 estimates, respectively. Cash per share is approximately \$7.5 leaving an operating premium of \$1.7 per share. We believe investors are waiting for additional proof of sales growth before they grant Radware its appropriate premium. We believe that the company's standing both financially and operationally, can result in above market and peers performance. Radware's financial and operational positions combined with FY2003 planned cost structure is positioned to lead to an upside in its bottom line. Radware remains our favorite pick in the ITM market due to its proven technology, high gross margins, stable cost structure and strong balance sheet. We reiterate our BUY recommendation.

**Radware Ltd (RDWR)
Earnings Model**

	Annual Earnings						Fiscal 2003E - Quarterly Earnings												
	2001E			2002			2003E			Fiscal 2001E - Quarterly Earnings			Fiscal 2002 - Quarterly Earnings			Fiscal 2003E - Quarterly Earnings			
	Mar-01	Jun-01	Dec-01	Mar-02	Jun-02	Dec-02	Mar-01	Jun-01	Dec-01	Mar-02	Jun-02	Dec-02	Mar-03	Jun-03	Dec-03				
Net Revenues	\$43,327	\$43,663	\$52,227				\$12,810	\$13,010	\$8,104	\$9,403	\$10,101	\$10,560	\$11,001	\$12,001	\$12,443	\$12,802	\$13,407	\$13,576	
Cost of Goods and Services	7,709	7,946	10,048				2,106	2,378	1,491	1,734	1,857	1,948	1,981	2,160	2,489	2,432	2,547	2,579	
Gross Profit	35,618	35,717	42,180				10,704	10,632	6,613	7,669	8,244	8,612	9,020	9,841	9,954	10,370	10,859	10,996	
Research and Development	8,293	7,809	7,931				1,978	2,048	2,127	2,140	2,012	1,916	1,947	1,934	1,953	1,973	1,993	2,013	
Selling, General, and Administrative	34,529	34,238	34,871				8,525	8,378	9,141	8,485	8,459	8,574	8,599	8,606	8,672	8,705	8,754	8,740	
Total Operating Expenses	42,822	42,047	42,802				10,503	10,426	11,268	10,625	10,471	10,490	10,546	10,540	10,625	10,678	10,746	10,753	
Operating Profit/Loss	(7,204)	(6,330)	(622)				201	206	(4,655)	(2,956)	(2,227)	(1,878)	(1,526)	(699)	(671)	(308)	113	243	
Net Financial Income	6,312	4,240	4,974				2,043	1,873	1,459	936	858	1,089	1,153	1,140	1,128	1,203	1,278	1,365	
Profit Before Tax	(892)	(2,090)	4,351				2,244	2,079	(3,196)	(2,020)	(1,369)	(789)	(373)	441	457	895	1,391	1,608	
Taxation	389	0	0				202	187	0	0	0	0	0	0	0	0	0	0	
Net Income	(1,281)	(2,090)	4,351				2,042	1,892	(3,196)	(2,020)	(1,369)	(789)	(373)	441	457	895	1,391	1,608	
EPS, Diluted*	(\$0.08)	(\$0.13)	\$0.25				\$0.12	\$0.11	(\$0.19)	(\$0.12)	(\$0.08)	(\$0.05)	(\$0.02)	\$0.03	\$0.03	\$0.05	\$0.08	\$0.09	
Diluted Shares Outstanding (Millions)	16,422	16,654	17,477				17,317	17,518	17,554	16,557	16,540	16,566	17,554	17,277	17,327	17,377	17,427	17,477	
Ratios:																			
Gross Margin	82.2%	81.8%	80.8%				83.6%	81.7%	81.6%	81.6%	81.6%	81.6%	82.0%	82.0%	80.0%	81.0%	81.0%	81.0%	
Research and Development / Sales	19.1%	17.9%	15.2%				15.4%	15.7%	26.2%	22.8%	19.9%	18.1%	17.7%	16.1%	15.7%	15.4%	14.9%	14.8%	
Selling, General, and Administrative / Sales	79.7%	78.4%	66.8%				66.5%	64.4%	112.8%	90.2%	83.7%	81.2%	78.2%	71.7%	69.7%	68.0%	65.3%	64.4%	
Operating Margin	-16.6%	-14.5%	-1.2%				1.6%	1.6%	-57.4%	-31.4%	-22.0%	-17.8%	-13.9%	-5.8%	-5.4%	-2.4%	0.8%	1.8%	
Tax Rate	0.0%	0.0%	0.0%				9.0%	9.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Net Margin	-3.0%	-4.8%	8.3%				15.9%	14.5%	-39.4%	-21.5%	-13.6%	-7.5%	-3.4%	3.7%	3.7%	7.0%	10.4%	11.8%	

*Headline EPS = -inventory write downs,-deferred compensation,-one-off charges

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Radware Ltd (RDWVR)
Balance Sheet

December Fiscal Year (\$ in 000s, except Ratios)	FY 2000			FY 2001			FY 2002					
	Mar-00	Jun-00	Sep-00	Dec-00	Mar-01	Jun-01	Sep-01	Dec-01	Mar-02	Jun-02	Sep-02	Dec-02
Assets:												
Cash and Cash Equivalents	\$ 131,108	\$ 131,300	\$ 131,309	\$ 130,824	\$ 131,186	\$ 128,801	\$ 125,557	\$ 125,680	\$ 124,726	\$ 66,792	\$ 66,604	\$ 52,274
Trade Receivables	2,897	3,706	6,208	9,254	9,052	10,808	9,916	7,868	8,583	8,789	8,452	8,695
Inventory	1,092	1,680	2,575	4,174	4,162	4,171	4,947	4,781	4,245	4,140	3,542	2,988
Other Receiv's & Payments in Adv	1,272	1,372	942	1,613	1,113	1,440	1,399	1,174	1,654	1,019	1,201	1,152
Total Current Assets	136,369	138,058	141,034	145,865	145,513	145,220	141,819	139,503	139,208	80,740	79,799	65,109
Property and Equipment, Net	1,181	1,787	1,949	2,788	3,652	4,306	4,235	4,037	4,011	3,890	3,718	3,644
Other Assets, Net	329	391	464	1,442	2,406	3,361	4,137	921	929	58,609	59,386	74,245
Total Assets	137,879	140,236	143,447	150,095	151,571	152,887	150,191	144,461	144,148	143,239	142,903	142,998
Liabilities and Stockholders' Equity:												
Trade Payables	2,899	2,717	2,494	6,677	4,213	3,921	3,195	2,541	3,374	3,185	2,633	2,612
Other Payables & Accrued expenses	4,111	5,302	6,751	6,770	8,446	7,797	8,930	12,051	12,207	11,871	12,248	11,807
Total Current Liabilities	7,010	8,019	9,245	13,447	12,659	11,718	12,125	14,592	15,581	15,056	14,881	14,419
Non-Current Liabilities	317	425	547	672	748	880	886	930	950	1,059	1,176	1,219
Total Liabilities	7,327	8,444	9,792	14,164	13,431	12,608	13,085	15,524	16,531	16,122	16,070	15,641
Share Premium & Capital	132,275	132,045	131,902	131,942	132,000	132,097	132,027	132,028	132,028	132,254	132,254	132,518
Deferred Compensation	(1,374)	(1,199)	(1,045)	(892)	(805)	(661)	(527)	(394)	(319)	(249)	(161)	(98)
Retained Income/Loss	(349)	946	2,796	4,881	6,945	8,843	5,605	(2,697)	(4,092)	(4,888)	(5,260)	(4,809)
Stockholders' Equity	130,552	131,792	133,653	135,931	138,164	140,289	137,180	128,939	127,617	127,117	126,833	127,357
Total Liabilities and Stockholders' Equity	137,879	140,236	143,445	150,050	151,571	152,887	150,191	144,461	144,148	143,239	142,903	142,998
Ratios:												
Days O/S A/R	40	40	51	69	64	76	111	76	77	76	70	66
Inventory turns	4.5	3.9	3.3	2.3	2.0	2.3	1.3	1.4	1.6	1.8	2.1	2.4
Current ratio	19.5	17.2	15.3	10.8	11.5	12.4	11.7	9.6	8.9	5.4	5.4	4.5
Return on Equity	3%	4%	6%	6%	6%	5%	-9%	-6%	-4%	-2%	-1%	1%
Return on Sales	13%	15%	17%	17%	16%	15%	-39%	-21%	-14%	-7%	-3%	4%
Return on Assets	2%	4%	5%	5%	5%	5%	-9%	-6%	-4%	-2%	-1%	1%

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Explanation of Ratings

Buy (B) – Expected 12-month absolute performance of +20% or better from the price at the time the rating was initiated.

Hold (H) – Expected 12-month absolute performance of +20% to -20% from the price at the time the rating was initiated.

Sell (S) – Expected 12-month absolute performance of -20% or worse from the price at the time the rating was initiated.

Distribution

Coverage Universe	Count	Percent	Investment Banking	Count	Percent
Buy (B)	47	46%	Buy (B)	7	70%
Hold (H)	46	45%	Hold (H)	2	20%
Sell (S)	8	8%	Sell (S)	0	0%
Restricted	1	1%	Restricted	1	10%

Notes: Ratings distribution reflects coverage as of the last day of the prior month. Investment banking distribution includes companies for which Investec Inc. has received or is entitled to receive compensation for investment banking services in the past 12 months.

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