FINAL TRANSCRIPT

Thomson StreetEvents℠

RSYS - Q2 2008 RadiSys Corporation Earnings Conference Call

Event Date/Time: Jul. 29. 2008 / 5:00PM ET

CORPORATE PARTICIPANTS

Scott Grout
RadiSys Corporation - CEO, President

Brian Bronson
RadiSys Corporation - CFO

CONFERENCE CALL PARTICIPANTS

Matt Petkun
Davidson and Company - Analyst

Ed Jackson
Cantor Fitzgerald - Analyst

Peter Johnson
- Analyst

PRESENTATION

Operator

Good afternoon. My name is Kristy and I will be your conference operator today. At this time, I would like to welcome everyone to the RadiSys second quarter earnings call. (OPERATOR INSTRUCTIONS) Thank you. Mr. Grout, you may begin your call.

Scott Grout - *RadiSys Corporation - CEO, President*

Thank you, Kristy. Good afternoon and thank you for participating in our second quarter conference call. In this call we'll review our financial and strategic results for the second quarter of 2008 as well as our outlook for the third quarter and for the year and then open the call up for your questions.

Participating on the call today are Brian Bronson, our Chief Financial Officer, and myself, Scott Grout, President and CEO. Before we get started, I would like to turn the call over to Brian for a caution about forward-looking statements.

Brian Bronson - *RadiSys Corporation - CFO*

Thanks, Scott. Any statements in this call regarding future expectations for the business of RadiSys constitute forward-looking statements that involve a number of risks and uncertainties. We caution you to not place undue reliance on these statements. Factors that could cause result results to differ materially from those in the forward-looking statements are discussed in our earnings release today and in our SEC filings. All information provided in this call is as of today. RadiSys undertakes no duty to update any forward-looking statement to conform a statement to actual results or changes in the Company's expectations.

Now I'll turn the call back over to Scott.

Scott Grout - *RadiSys Corporation - CEO, President*

Thanks, Brian. So we had a very good quarter from both a strategic and financial perspective. We grew revenues pretty nicely and per share results nicely over last year as well as over the prior quarter. Our Q2 revenues were $97.6 million, up 29% over last year. Our GAAP net loss improved by $0.22 from last year to a $0.12 loss and our non-GAAP net income was $0.14 for the quarter which was up $0.14 from the same quarter in '07 as well as up $0.14 over the first quarter.

The growth in revenues and per share results were driven by strong demand in our wireless and media server products in the second quarter. We continue to make meaningful progress in the deployment of our new communications products with increased shipments of both our higher margin media server and ATCA products. Overall, I'm quite pleased with our progress in the first quarter and the combined first half of the year.

Our media servers were up in the IP conferencing space again this quarter. We're also seeing increased growth opportunities in other applications such as messaging, call center, voice services and interactive voice recognition. These opportunities are driven by our target markets moving from TDM to packet where our IP media servers are required. Our global sales team is also leveraging our successes in North America in applications in Europe and Asia.

We had a robust quarter of ATCA shipments up again over the first quarter and we expect them to be up again in the third quarter as some of our customers move into the later stages of development, testing and some customers begin to deploy.

Our top five customers for the quarter in alphabetical order were AT&T, Converse, Danaher, Nokia Siemens Network and Phillips Healthcare. Collectively, these top five customers represented 63% of our revenue for the quarter. We had a robust demand from Nokia Siemens Network and they represented 48% of second quarter revenues. AT&T, who is an end customer of our IP media server products, entered as a top five customer for us in Q2. As we have stated previously, we expect our top five customers to vary from quarter to quarter.

I would like to talk a little bit about product highlights and some deployment highlights for the business in the quarter. Overall deployment and delivery of our new communications products is going well. Our first half 2008 next generation communication revenues came in ahead of plan and are over prior projections that supported the $80 million full year outlook that we gave you earlier.

And some examples of progress include a new tier one Radisys customer completing its development phase and entering into testing for a wireless networking voice quality enhancement using our ATCA platform. Fuel deployment for this application is projected to begin in the second of 2008.

In other case, end customer lab trials started for a new RadiSys customer who is a leading provider of video networking solutions. As a final example, our ATCA products were recently deployed by a new China customer to support web live TV service for the upcoming 2008 Olympic games in Beijing. While we're still in early ATCA deployment, these are just a few examples of customer's progress against using our ATCA products.

In terms of new design wins, we also had a fairly good quarter. New wins were across a diverse set of applications including packet inspection, medical imaging, RMC, security gateway, IP conferencing, tested measurement, session border controller, video on demand, patient monitoring, access gateways, and in the military. In the quarter, we saw a nice increase of wins in Asia with over a third of the value of the new product wins coming from that geography.

Within the media server family of products we announced that we're ranked as the top media server provider for the fourth consecutive year in recent reports by Infonetics and iLocus. Both firms track the voice over IP and IMS equipment to end markets.

On our media server products, we also introduced continuance presence video conferencing capability that support multiple realtime video streams. We also announced automatic speech recognition and text to speech in multiple languages for IP contact center applications. Within the Promentum ATCA family of products, we received the 2007 Communication Solutions Product of the Year Award for our two Promentum ATCA blades including our 7220 with a smart front end architecture.

The Communications Solutions Product of the Year Awards recognize the most innovative products that facilitate voice, video and data applications. Within the Procelerant Com E family of products we introduced the new product using Intel's Core 2 Duo Processor for high performance portable applications in medical imaging, test and measurements, and communications. This product is early to market and begins -- offers low power with increasing processor capability.

Finally in the quarter, we completed the formal integration plan for Intel's MCPD acquisition that we closed late last year. Overall, I'm really happy with how well this integration went and how effectively the combined team managed a pretty complex program. With that, I would now like to turn the call over to Brian who will give you some information about our second quarter results as well as projections for the third quarter and full year.

Brian Bronson - *RadiSys Corporation - CFO*

Thanks, Scott. As Scott already mentioned, revenue and per share results were up nicely. Our second quarter GAAP gross margin percentage was 25.1, up 4.6 points year-over-year. Our non-GAAP gross margin rate was 29.4, up 4.1% year-over-year due to a greater mix of higher margin products and operational improvements.

Gross margin increased 1.6 points for the first quarter due to higher media server revenue, Intel MCPD transition costs going away, and lower other costs of sales. We currently expect our third quarter costs to be similar or slightly up sequentially.

R&D and SG&A expenses totaled $26.1 million in the second quarter. Non-GAAP R&D and SG&A expenses totaled $23.9 million which was up about $700,000 from the prior quarter. The increase was due to higher sales commissions and incentive compensation expenses driven by higher revenues, profitability levels, and new product wins relative to the prior quarter.

We currently expect third quarter total non-GAAP R&D and SG&A expenses to be down sequentially by about $500,000 due to cost savings from our recent restructuring efforts. This projection assumes revenue earnings level at the mid point of our guidance range.

Stock-based compensation expense was $2.5 million in the second quarter. We expect stock-based expense to be around the same level again in the third quarter. Restructuring charges were approximately $600,000 in the second quarter related to employee termination expenses.

Our second quarter net non-operating expense, which includes interest income, interest expense, and other non-operating items was $178,000 which is done from income of $877,000 in the first quarter due to increased interest expense associated with our new convertible notes in addition to lower yields on our investments partially offset by positive cash flow in the quarter. We currently expect non-operating expense to be around the same level in the third quarter.

Our second quarter GAAP tax rate was 25% and our non-GAAP tax rate was 18%. Our tax rates were better than we originally expected due to higher earnings. We currently expect our third and fourth quarter GAAP and non-GAAP tax rate to be around 25%.

Our basic weighted average shares increased to 22.4 million in the second quarter from 22.2 million in the first quarter. Our diluted weighted average shares used for the calculation of our Q2 non-GAAP earnings were 29.1 million which includes the remaining shares associated with our old converts and the 4.2 million shares associated with the new converts.

So for Q3 we expect the dilutive threshold to be $1.8 million with the conclusion of both converts with $423,000 of interest add back and 5.8 million shares. We are projecting Q3 diluted shares to be 29.2 million with both converts. In Q4 the net income dilutive threshold is expected to be $2.2 million for both converts with $391,000 interest add back and five million shares. And then starting in 2009 and thereafter, the net income dilutive threshold is expected to decrease to $1.9 million with only the new convert left and $321,000 of interest add back and 4.2 million shares.

Moving to cash on the balance sheet. Cash flow from operating activities was $8.3 million again in the second quarter and we ended the quarter with $115 million of total cash and investments. Based on our current cash on hand, our future cash flow projections and our line of credit, we believe we'll have no obstacles to fund ongoing operations and to pay off the remaining

$37.5 million of our old convert in November of this year. We currently expect cash flow from operating activities to be $3 to $5 million in the third quarter.

Our receivables were $55.8 million which is down about $400,000 from our Q1 balance as DSO improved which was partially offset by higher revenues. DSO for the second quarter was 52 days which was down eight days in the first quarter mainly due to improved linearly shipments in the second quarter.

Net inventory increased $3.4 million to $33.5 million due to increased raw materials associated with higher builds for expected revenues in the third quarter. Inventory turns for the quarter was 8.3. CapEx was $1.8 million and depreciation expense was $1.6 million in the second quarter.

Our cash cycle time was 35 days in the second quarter which is down two days from the first quarter. The decrease is mostly attributed to lower DSO partially offset by lower days to pay. We expect cash cycle time to remain in the 30s in the near future.

Lastly, we repurchased another $10 million of our old converts below par during the second quarter. The remaining balance is $37.5 million again and is classified as short-term debt as it will most likely be put to us in November of this year. With that, I'll turn the call back over to Scott to talk about the outlook for the third quarter and the full year.

Scott Grout - *RadiSys Corporation - CEO, President*

Thanks, Brian. So regarding our outlook for the third quarter and for the year, please note that this is our view as of today, and is a forward-looking statements subject to risks and uncertainties as discussed previously and in our press release made available earlier today. So we currently expect third quarter revenues to grow from the second quarter to be between $98 million and $103 million with projected growth in both our ATCA and commercial products over the second quarter.

We expect third quarter GAAP results to be between a loss of $0.06 per share and an income of $0.01 per diluted share. We expect non-GAAP net income to also grow between $0.16 and $0.22 per diluted share. We're increasing our full-year revenue guidance and now predict 2008 revenues to grow 14% to 16% over 2007. This is up from our prior projection of low double digit to high single -- I'm sorry, a low -- I'm sorry, high single-digit to low double digit rate.

Within that overall growth rate we're seeing stronger than expected demand in our wireless market and predict wireless revenues will grow year-over-year versus our prior estimates of flat wireless revenue for the year. And finally, we expect our next generation product revenue to be higher than earlier projections up to around $90 million for the full year versus our prior estimate of 80 million for the full year.

I'm really pleased with our strategic and operational results in the second quarter and for the first half as well as our outlook for the third quarter and full year. We're seeing good progress on shipment of our new higher value strategic products across a growing base of customers. While it is still earlier in deployment phase, we are happy with our momentum and market position and believe that we will exceed our annual objective for new business revenue this year.

Before we close the call and open it up for questions, I would you like to invite you to our annual investor day event on August 12 from 11:15 in the morning to 1:45 Pacific time at our Company headquarters here in Hillsboro, Oregon. The event is part of the 2008 AEA Oregon Technology Investor Tour that includes five other local public high-tech companies.

I will be presenting along with other members of our management team here and we'll have demonstration of our latest products. You can you register by going to our IR website calendar.

If you cannot attend in person, we'll also be webcasting the event live on our website. With that, I would now like to open the call up for questions and pass it back to Kristy. Thanks.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (OPERATOR INSTRUCTIONS) Your first question comes from the line of Matt Petkun from Davidson and Company. Your line is open.

Matt Petkun - *Davidson and Company - Analyst*

Hi. Good afternoon. First of all, nice quarter. Second of all, the guidance, Scott, that you gave, the 90 million for the next generation coms business, I think you had previously spoken about your expectations for roughly 20 million in the Com E business and the related standard space platforms in the commercial market. Is that estimate still valid for the year?

Scott Grout - *RadiSys Corporation - CEO, President*

It's what we had said before was 80 million for next gen coms, which is ATCA and media server, and then if you include that and add all new products including Com E, all other new products, that estimate was 100 million. And we're doing really well against that.

Matt Petkun - *Davidson and Company - Analyst*

So it would be safe to say 110 million then -- I mean -- yes, 110 million for the total, then?

Brian Bronson - *RadiSys Corporation - CFO*

Well the 80 million turns into north of 90. So it's up 10 million overall as well.

Scott Grout - *RadiSys Corporation - CEO, President*

And the remainder is -- the remaining new product, we haven't done the math but we're well above that number.

Matt Petkun - *Davidson and Company - Analyst*

Okay. And when you look at the specific revenue that is coming. You break out by end market, the coms related business that is not in the IP network and messaging or in the wireless segment, clearly a lot of that is coming from the MCPD business. Can you be a little bit more specific about what types of end applications are being captured in that number because that's the number that has grown the most in absolute dollar terms.

Brian Bronson - *RadiSys Corporation - CFO*

Yes, Matt I'll take a crack at it and have Scott follow up. I think you and I have talked about this, too. We need to, over time, work these submarkets and change them.

So to be clear, wireless is our largest customer today and I think that is clear. IP networking and messaging space, call it close to $14 million that we did in the second quarter. About and around half of that is our media server business and the rest of it is the old IP network and messaging.

Converse lives on for us as a strategic customer, etc. That is the ticking and [time] there. And the other com is MCPD and really all of our other ATCA business.

Matt Petkun - *Davidson and Company - Analyst*

Okay. Great. So to be clear, AT&T is clearly, again, are they a customer or are they purchasing through TEM?

Scott Grout - *RadiSys Corporation - CEO, President*

They will purchase through a TEM but the relationship is predominantly direct between the organization.

Matt Petkun - *Davidson and Company - Analyst*

Okay. I'm wondering why in this case you chose to break them out as the service provider rather than as with Nokia. Nokia is selling into service providers as well.

Scott Grout - *RadiSys Corporation - CEO, President*

To be honest, the size of revenue, highlighting media server growth and just the nature of the uniqueness of the relationship.

Matt Petkun - *Davidson and Company - Analyst*

Okay. Because clearly that is wireless related business depending on how you want to slice it.

Scott Grout - *RadiSys Corporation - CEO, President*

It is. In addition, not to pile on, Matt, some of our com, which is in strategic for us, is in wireless as well. So we've got -- I think this gives you a picture but we still have got work to do.

Matt Petkun - *Davidson and Company - Analyst*

Great.

Scott Grout - *RadiSys Corporation - CEO, President*

Yes.

Matt Petkun - *Davidson and Company - Analyst*

And then the final question, this is not a complaint because clearly my numbers need to go up, but the implied guidance for Q4 does -- if we take the mid point of your guidance for Q3, we're looking at the potential for a down year-over-year number in Q4 at the mid point of your full-year guidance.

Are you just trying to be conservative, what specific buckets do you expect a decline, and what could that do to the overall margins and relative profitability year-over-year as we look to Q4?

Scott Grout - *RadiSys Corporation - CEO, President*

That's a really good question. I'll take it in chunks. So first and foremost, I still think the comfort level around us guiding one quarter out is specifically there but what we felt and needed to do is we do not see, particularly in the high end of the range of the $103 million, we do not see a Q4 number that looks at that or above that. So we wanted to make sure we bound the streets on modeling.

That being said -- and oh, by the way I should say our wireless business in the first half was very strong. We expect it to continue to be strong in the second half, but remains to be seen what Q4 specifically looks like. And then from a profitability perspective, we did have a strong quarter in Q4 last year. Good profitability quarter as well. What I think has changed for whatever reason revenues are south of Q4 last year. We have better margin and what I think to be a better cost structure to at least meet if not beat the earnings number.

Brian Bronson - *RadiSys Corporation - CFO*

And the add that I would have on that is revenues for new product, at this point we continue to expect it to grow.

Matt Petkun - *Davidson and Company - Analyst*

Okay. Thanks so much and nice quarter.

Scott Grout - *RadiSys Corporation - CEO, President*

Thanks, Matt.

Operator

(OPERATOR INSTRUCTIONS) Your next question comes from the line of Ed Jackson with Cantor Fitzgerald. You're line is open.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Hi, Scott. Hi, Brian. Congratulations on a outstanding quarter.

Scott Grout - *RadiSys Corporation - CEO, President*

Thank you.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Brian, I want to also thank you for all of the tables if the press release.

Brian Bronson - *RadiSys Corporation - CFO*

Well I appreciate that. We have taken advice from you guys and our large shareholders and shareholders as well and changed the format of the entire release, but you're right we've added tables in the back, not just cash flow but some of the other quarterly metrics that we provide on the script, or typically provide on the script.

Ed Jackson - *Cantor Fitzgerald - Analyst*

I feel like as an analyst I'm going to be coasting downhill.

Brian Bronson - *RadiSys Corporation - CFO*

Well thank you. We tried.

Ed Jackson - *Cantor Fitzgerald - Analyst*

So a couple of questions. One is you had indicated in the last call, not this call, that you were seeing a little economic softening in the medical and testing markets. You had a good quarter commercially and I'm curious for a little color as it relates to those end markets and how you're seeing the current economic conditions impact them and then I do have a follow-up question.

Brian Bronson - *RadiSys Corporation - CFO*

So from a medical perspective, you look at first half in total and Q2 in particular, definitely some softening there so our customers have seen it and talked about it. We've seen it and talked about it a little bit. One of the drivers is the deficit reduction act in the US that allowed less reimbursements for some of the imaging applications.

Our outlook for the second half, I think it doesn't worsen. We're probably being a little bit conservative. It's probably early to tell whether we'll see a bit of uplift. But I think we've seen the extent of softening.

The other thing you may be aware of is we're adding a new tier one medical imaging player in the second half that should start shipping in the second half. So on top of current revenues I would expect to see that grow a little bit as that customer kicks into deployment.

Test and measurement I think has held in there relatively well. We're not getting any significant signal that there is a turn at all, but just watching general economy that might be one of the earlier areas that might be impacted.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Okay. Thanks. And then my follow-up question has to go into the media server business. And first of all, I was curious if you could comment in terms of what the specific application, the platform is being deployed for within AT&T. And then, secondly, I wonder if you could put some commentary on that business, as it relates to China, given the movements you've seen there relative to restructuring of the wireless industry and 3G network deployment.

Scott Grout - *RadiSys Corporation - CEO, President*

And I would like to be oblique on answering that as it's competitively kind of sensitive. Conferencing is a big application. There are a number of other applications we do with AT&T as well.

In terms of China, we are starting to see some interesting signs of life there. Probably not yet related to 3G and IMS infrastructure, but over the last six months our level of engagement with the number of different TEMS on some new applications has picked up. I think standing out there and looming out there is still opportunity as they begin to deploy IMS but it's not something that we're counting in our numbers yet.

The last thing I would point to is Europe has started to pick up really nicely in the last six months to nine months, so sales team is fully equipped and doing a really nice job finding some new business. We're counting them in our design win process and it's actually been pretty robust. So North America has always been a strong point, China starting to pick up a little bit on some new applications and Europe picking up as well.

Ed Jackson - *Cantor Fitzgerald - Analyst*

And is the relationship with Huawei still intact?

Scott Grout - *RadiSys Corporation - CEO, President*

It is.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Thanks very much and again superb quarter.

Operator

And your last question comes from the line of [Peter Johnson] with (inaudible). You're line is open.

Peter Johnson - *- Analyst*

Hi guys. A very good quarter. Well done.

Scott Grout - *RadiSys Corporation - CEO, President*

Thank you.

Peter Johnson - *- Analyst*

That's very good news. Two questions. One small and technical, the other a little broader. Could you just tell us the actual number of shares outstanding as of today's date?

Brian Bronson - *RadiSys Corporation - CFO*

22.6.

Peter Johnson - *- Analyst*

Probably more precise Brian, we couldn't get the final digit so maybe you could let me know that afterwards?

Brian Bronson - *RadiSys Corporation - CFO*

I'll let you know afterwards but I can tell you it was 22.6 was the ending basic share count. I will get you fully extended numbers.

Scott Grout - *RadiSys Corporation - CEO, President*

He wants a few more digits?

Brian Bronson - *RadiSys Corporation - CFO*

Yes.

Peter Johnson - - *Analyst*

And second thing, I wondered whether you cared to comment about some of the activity amongst the TEMS? On the one hand you see some very interesting positive developments in [Nokia Zealand]. On the other hand, news today of the CEO and the chairman going at Alcatel-Lucent. Just wondered whether you had any perspective and how that may in due course affect your business?

Scott Grout - *RadiSys Corporation - CEO, President*

So as you mentioned, we're seeing good strength with Nokia and I think they're doing extremely well in their end markets in a number of different geographies. So I think their combination, their execution, their value proposition to customers remains pretty strong.

With respect to changes at Alcatel-Lucent, it's my own personal perspective, I think it's a reasonable time frame to bring in some eyes to work -- to focus on what is next for the Company. So Pat and her team had more than their arms full executing the integration. I think that's been reasonably well done and completed and now time to think about how you grow the company.

In terms of how it affects our relationship, our expectation is certainly the trends are not to do everything yourself and everything internally and go to the ecosystem for more of your product development process. So I'm hopeful that this would represent a potential acceleration.

Peter Johnson - - *Analyst*

Very good. Thank you.

Scott Grout - *RadiSys Corporation - CEO, President*

Okay. Thank you.

Brian Bronson - *RadiSys Corporation - CFO*

Thanks, Peter.

Operator

(OPERATOR INSTRUCTIONS) We do have a follow-up question from Ted Jackson with Cantor Fitzgerald. Go ahead, your line is open.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Hi. It's not really a question. I was just wondering, Brian, when you went through your part of your presentation with the share count and the convert, if you could actually run through that again. I missed a couple of numbers.

Brian Bronson - *RadiSys Corporation - CFO*

Yes. And which point are you referencing, Q2, Q3 or Q4?

Ed Jackson - *Cantor Fitzgerald - Analyst*

Just kind of run through the whole thing. I don't trust what I wrote down.

Brian Bronson - *RadiSys Corporation - CFO*

Okay. So the shares for the quarter were 22.4 basic shares, right. And then on top of that you need to add 4.2 million shares for the new convert, 1.7 million shares for the old convert and then about 700,000 shares for normal options/restricted share dilution to get to your 29.1. Hopefully that math works. And then in Q3, expect it to be all in at 29.2. So slightly up. Really the only difference is you have about 100,000 shares less of the old convert.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Okay. So what you're saying then is that those are the different elements and if you look at the pro forma your average share count would be 29.1 in the second quarter and 29.2 in the third quarter.

Brian Bronson - *RadiSys Corporation - CFO*

Right. And then just a quick follow-up, Q4, everything else being held constant, you have 800,000 shares left in the old convert because we'll pay it off in the middle of the quarter. So I think 28.9, and then of course as we go into 2009 the only thing that is left from the convert is the 4.2, so share count gets better.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Okay. Okay.

Brian Bronson - *RadiSys Corporation - CFO*

And we can follow-up afterwards. I can help you if we need to.

Ed Jackson - *Cantor Fitzgerald - Analyst*

Okay. Thanks very much.

Operator

We have no further questions in queue.

Scott Grout - *RadiSys Corporation - CEO, President*

Okay great, thank you very much, Kristy. And thanks for all who participated on the call. And again I would encourage you to consider coming out and visiting us on August 12 for the AEA Tech Tour. Thanks much and talk to you soon.

Operator

Thank you so much. This concludes your conference call for today. You may now disconnect your line.
