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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the RadiSys fourth quarter earnings conference call with Scott Grout, President and CEO of RadiSys. As a reminder, today, Tuesday, February 1, 2011, this call is being recorded. Later we will conduct a question-and-answer session. (Operator Instructions). Mr. Grout, please go ahead.

Scott Grout - *RadiSys Corporation - President, CEO*

Thank you, Felicia. Good afternoon, and thank you for participating in our fourth quarter conference call.

In this call we will review our results for the fourth quarter as well as our outlook for the first quarter and the full year, and then open up the call for questions. Participating on the call are Holly Stephens, Finance and Investor Relations Manager; 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 Holly for a caution about forward-looking statements.

Holly Stephens - *RadiSys Corporation - Finance & IR Manager*

Thanks, Scott.

Any statements in this call regarding future expectations for business of RadiSys constitute forward-looking statements and involve a number of risks and uncertainties. We caution you to not place undo reliance on these statements. Factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in our earnings release today and in our SEC filings, most recently in 2009 annual report on Form 10-K.

All information provided in this call is as of today. RadiSys undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in Company's expectations. In addition, during the call, we will refer to some non-GAAP measures. We provided a GAAP to non-GAAP reconciliation for these measures in our earnings release issued today.

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

Scott Grout - *RadiSys Corporation - President, CEO*

So thank you, Holly.

Revenues for the fourth quarter were $66.8 million, and non-GAAP EPS was $0.08. Our fourth quarter results finished higher than our revised guidance provided in December, due to upsides in our media server business at the end of the quarter. During the fourth quarter, we were awarded business with a number of new and existing customers across a wide range of applications.

We also received several industry awards recognizing a number of our new products introduced in 2010. In our media server business, we won the 2010 Internet Telephony Excellence Award for our VQE capability introduced on our market-leading media server product in 2010. To give you some background on this product, voice-over-IP services based on IP media servers are increasingly being deployed due to their compelling economic benefits. Our VQE solution significantly proves the quality of these VoIP solutions by addressing common issues such as noise, packet loss, and echo. In the quarter we were awarded new media server business with another top 10 global IP solutions provider for a full conferencing application. With this latest win, we now sell to nine of the top ten global conference server providers.

In addition, we won new business in VQE, 3G mobile video, and a number of other emerging VoIP applications. Also in the quarter we were -- announced a partnership with Ethrix, a SIP video application partner, to deploy our Integrated Mobile Media Server, or IMMS, with Planet41 in the emerging Indian market.

Moving to our ATCA products, our new LTE Security Gateway received two industry awards during the quarter; the2010 product of the year award from 4G Wireless Evolution, and the ATCA Summit 2010 Best-of-Show Award in the category of Best Unique Customer Application.

Our LTE Security Gateway, or SEG, is a carrier class solution, providing user authentication, data integrity, and encryption for IP-based wireless networks. Our LTE SEG solution can be deployed as a stand-alone network element or seamlessly integrated into other wireless network elements. in the fourth quarter we completed lab trials of our Security Gateway with a tier one equipment maker and began end field customer trials in the quarter. We expect our LTE Security Gateway to be commercially available in the first half of 2011.

We were awarded new ATCA-based systems business for use in an optical transport application with a leading networking company providing high-capacity optical solutions for carrier networks. We also won new business in applications such as satellite network gateway; fixed mobile convergence for cable networks, which is a new market for us; and mobile video in the network. In our commercial business, we introduced a new COM Express module that delivers high-performance processing power for enterprise telecom, military-aerospace, and medical applications. Also in the quarter, we were awarded new COM Express business in North America with an enterprise telecom IP network provider and in two military communications applications. Our COM Express product line is performing very well, and we expect 20%-plus revenue growth on this business in 2011.

Returning to our financial results for the quarter, our top five customers in the fourth quarter in alphabetical order were Agilent, GE Healthcare, NEI, Nokia Siemens Networks, and Philips Healthcare. Collectively these top five customers represented 55% of our revenue in the quarter, with 32% from Nokia Siemens Networks. For the full year, Nokia Siemens Networks represented approximately 37% of total revenues, and about quarter came from our next-generation products. Our business with NSN continues to diversify across legacy and next-generation products, with the percent of next-generation products increasing materially in 2011.

I would like to talk about some of our 2010 full-year financial and strategic results. Our total revenues for 2010 were $284 million. Our next-generation revenues finished the year at $118 million. While the year-over-year growth was below our original projections, we did grow this business by 16% year-over-year. Our next-generation revenues, which have overall gross margins of between 40% and 50%, represented 42% of our total 2010 sales, which was up from 34% in 2009. We currently expect that our next-generation business will grow at a rate of 20% or better, and grow to be close to, if not over, 50% of total customer revenues by the end of 2011.

We announced many new products this year, including our Integrated Mobile Media Server for mobile video services, our LTE Security Gateway solution, new 10- and 40-gig ATCA products, our media server-based VQE, our C2 server, our ruggedized ATCA platform for military and aerospace market, transcoding services for media server, and new Com E modules for our commercial business. Strategically we are focused on providing our customers more and more solution-level products that leverage and add value to our existing platforms. These solutions command margins of over 50% for ATCA and close to 80% for media server solutions.

In March we acquired Pactolus Communications software corporation that further strengthened our higher-value software-based solutions, and this is a great example of added software on top of our existing platforms that enable us to provide a more complete solution to our [TEM] customers.

We had a strong year for design wins, with awards across a number of new and growing market segments. Some of our media server wins this past year were in applications such as voice-over-IP; VQE, a new market for us; conferencing; voice network services; and IVR. In ATCA we won business in LTE, network security, unmanned vehicle reconnaissance, WiMAX access service network gateways, Femtocell Gateways, W-LAN, satellite communications to name a few. In commercial we won new COM Express business in network switching, medical imaging, voice-over-IP, and various telecommunications and defense applications. I'm excited about the many telecommunication growth markets where products are being deployed, along with adjacent markets where we are gaining nice traction, such as military and aerospace.

From a manufacturing perspective, this past year, we transferred remaining in-house production to our contract manufacturers in Asia. By going touchless, we have been able to reduce overhead significantly and improve our cost structure. We are also making some further changes to our manufacturing structure that Brian will discuss shortly.

In summary, in 2010 we showed nice revenue growth on our new products, continued today market leaders in our target segments, won new businesses in a number of growth markets, announced several new solution-level products that command nice gross margins, and optimized our overall Company structure.

With that I would now like to turn the call over to Brian, who will talk a bit more about our fourth quarter financial results and projections for the first quarter.

Brian Bronson - *RadiSys Corporation - CFO*

Thanks, Scott.

As Scott previously mentioned, our fourth quarter revenue was $66.8 million, and our next-gen revenue was $28 million. Four the year, our next-gen revenues were $118.1 million, and up approximately 16% year-over-year. In the quarter, we delivered non-GAAP EPS of $0.08, and our GAAP net loss was $0.09 per share. Our Q4 non-GAAP gross margin rate was 34.7%, and up nicely from 32.8% last quarter.

The sequential increase is mainly due to product mix within our next-gen revenues, as well as lower legacy COMs revenues. This should give investors a good look at what is possible once we can get past our legacy gross margin declines. That being said, I currently expect our non-GAAP gross margin rate to be down to approximately 31% in the first quarter. Over half of the decline is due to reductions to the gross margin rates of our legacy business. Specifically, the legacy business was at 28% in the fourth quarter, will be 20% in the first quarter, and will drop to 15% or so as we go through the year. Another piece of the projected Q1 gross margin decline is due to mix inside our next-generation business, as our media server revenue will be down sequentially, as we don't expect our largest media server customer to pick back up on larger deployments until the second quarter.

Our long-term Corporate gross margin target continues to be between 35% and 40%. However, throughout 2011, I do expect gross margins to fluctuate between 31% and 33% as our legacy communications business moves towards end of life, and we will also continue to see quarter-to-quarter variability inside our next-generation business. As I have stated previously, our next-again business commands gross margins of 40% to 50%, but it can fluctuate up and down that range depending on the mix of media servers versus solutions versus ATCA systems and versus ATCA blades. Our commercial business gross margins were in the mid to high 20s during 2010, and I expect that to continue in 2011.

Moving over to operating expenses, non-GAAP, R&D, and SG&A expenses totaled $19.9 million, which is around the same level as the prior quarter. We currently expect that our first quarter non-GAAP R&D and SG&A expenses will be down about $750,000. The decrease is mainly due to lower sales and employee-related cost as a result of the restructuring actions that we took in the fourth quarter. Throughout the year we will see expenses go up a bit due to our annual merit expenses and incentive compensation expense, but that would be directly tied to our non-GAAP operating income achievement to [plan]. Bottom line, I expect our total non-GAAP R&D and SG&A expenses to be between $77 million and $78 million, plus or minus, or flat to slightly down versus 2010.

As I mentioned on our December call, we did take a restructuring charge totaling $1.8 million that was primarily attributable to employee-related expenses as a result of our initiative to reduce our operating infrastructure associated with revenue declines in our legacy business. This includes some reductions in manufacture and support, R&D, as well as SG&A.

One specific action that I would like to emphasize is our planned 2011 move from two contract manufacturers, Foxconn and Jabil, to one, which will be Jabil. Foxconn has been a wonderful partner for us, and this decision was driven by three factors. First, Foxconn has principally produced our legacy products, and volumes for these products are in natural decline. Second, we want to reduce the total cost of operations by consolidating to one manufacturing partner. And third, there was a good likelihood that Foxconn production would have needed to move from the Shinzen factory to a different site further inland in China. This consolidation and transfer will be a large block of work that we believe we will materially complete on or before December 30 of this year.

The transition will also require that we build some buffer levels of inventory throughout the year. We haven't finalized the amount, but our preliminary projection is that inventory would move up from $21 million today, to $25 million or $30 million later this year. Then the plan would be to quickly burn that off in the fourth quarter and into the first quarter of 2012. We will provide more information on this transfer plan as it gets finalized over the next couple of months.

Non-GAAP operating income for the fourth quarter was $3.3 million, or 4.9% of revenues. This compares to 6.4% in the third quarter and to 7.7% in the same quarter last year. Our longer term operating income target remains at 8% to 10 %, and I feel stronglythat we have and continue to be focused on setting up our financial model to scale nicely when revenue increases. Net non-operating expense, which includes interest income, interest expense and other non-operating items, was $500,000 in the fourth quarter. We current I will expect our non-operating expense to be around $400,000 in the first quarter.

Our non-GAAP tax rate was 26.8% in the fourth quarter. The full annual rate for 2010 on a non-GAAP basis was 7%. We currently expect that our 2011 rate will be around 7% again for non-GAAP and around 30% for GAAP results. However, keep in mind that this rate, as usual, can fluctuate due to a variety of factors.

Our fourth quarter non-GAAP diluted weighted average shares were 24.8 million, and our GAAP basic shares were 24.3 million. We project our diluted shares to be 24.9 million for non-GAAP results and 24.4 million for GAAP results in the first quarter. As a reminder, when you are calculating EPS for net income over $3 million, the convert shares of $3.8 million and an interest income add back to net income of $456,000 should be included in the calculation. If net income is under $3 million, obviously these items would be anti-dilutive.

Moving on to the balance sheet. DSO was 59 days in the fourth quarter, which was up from 53 days in the prior quarter, but again in line with my expectations given the timing of shipments in the fourth quarter due to supply. Specifically, 75% of our Q4 revenue was shipped in the second half of the quarter. I expect DSO to be in the mid to high 50s in 2011. Our total inventory balance was $21.4 million at then of the fourth quarter, which was up from $18.4 million at the end of the third quarter. The increase a result of adding buffer inventory to compensate for on-going industry material supply shortages. As I mentioned earlier, I expected our inventory balance to increase throughout the first three quarters of the year, and then start to materially decline in the fourth quarter and on into the first quarter of 2012 as we get past moving from two CMs to one.

As expected we burn $3.2 million of operating cash during the fourth quarter. Our annual operating cash flow was a little over $16 million, and we ended the year with $129.1 million of cash, which is up from $100.7The increase reflects the annual operating cash flow, plus the successful resolution of the ARSs. We currently expect operating cash flow to be positive in the first quarter of $1 million to $2 million.

Now I'll turn the call back over to Scott to talk about the revenue and per-share outlook for the first quarter and our revenue outlook for the full year.

Scott Grout - *RadiSys Corporation - President, CEO*

Thank you, Brian.

Regarding our outlook for the first quarter and for the full year, please note that this is our view as of today, and it is a forward-looking statement subject to risks and uncertainties as discussed previously, and in our press release made available earlier today. We currently expect our first quarter revenues to be between $67 million and $71 million, and we expect our next-generation product revenues to increase sequentially from the fourth quarter. We currently expect our first quarter GAAP net loss to be between $0.02 and $0.06 per share. We expect our non-GAAP EPS to be between $0.04 and $0.09. For the full year 2011, we expect total Company revenues to increase over 2010.

We expect new product revenues to grow strongly again this year as our legacy revenues continue to fall off. Specifically, we project that next-generation product revenues will grow by over 20% in 2011, with solid growth expected in both ATCA and media server products. We expect our legacy and traditional tele -- traditional communications revenues to continue to decline by as much as 20%. And finally, we expect our overall commercial product revenues to decline in total by as much as 10%. However, within commercial business, we expect our COM Express product line to continue to grow very nicely for us, offset by declines in legacy commercial and our medical rack-mount server business.

In addition to the progress that we have made on organic business over the past year, M&A remains a strategic area of focus for us. We continue to have a large funnel of compelling opportunities that we are excited about and that would accelerate our core strategies and growth. There are several acquisition areas that are of interest to us and getting most of our focus. First are acquisitions that bring new capabilities to our current platforms that allow us to offer more complete solutions for our customers. Pactolus is a good example of this case. The second are acquisitions that bring us into new adjacent markets where we can leverage our current product portfolio into new applications. And finally are acquisitions that consolidate one or more of our end markets. Are target profile continues to be acquisitions that are accretive within a reasonable time frame, and that would strategically increase the value of our solutions to our customers.

In summary, we grew our next-generation business well in 2010 and expect to grow this business at an even higher rate in 2011. I am pleased with our strong market position and next-generation platforms, and I am excited about our early progress on solution-level products like LTE Security Gateway. Our portfolio and growth of new products will allow us to continue to expand our value, addressable markets, and margins over time. This, in addition to a strong balance sheet and an appetite for smart, strategic acquisitions, will further accelerate our revenue and earnings growth potential in the future.

With that I would like to thank you for participating on the call, and, Felicia, I think we're ready to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of George Notter with Jefferies & Company.

George Notter - *Jefferies & Company - Analyst*

Hi, thanks very much. Hey, the question I wanted to ask was on Q4. I mean, you obviously preannounced the quarter, and then these expectations that came in above what you were looking for just back in December. I guess I was trying to figure out what exactly happened at quarter end that caused the surprise here?

Brian Bronson - *RadiSys Corporation - CFO*

Well -- I mean, what caused the surprise for preannounce was we had a big block of revenue with our largest media server customer push out into 2011. That was something that, given the size of revenue, and more importantly, the margin stream associated of that, something that we didn't feel like we could make up. From middle of December to the end of the year, we did see a couple of million dollars worth of media server business upside beyond that customer that we're referencing, and that ultimately drove the difference. And everything else was as expected, frankly, back from the October call.

Scott Grout - *RadiSys Corporation - President, CEO*

Yes.

George Notter - *Jefferies & Company - Analyst*

Got it. And then -- so that large media Server customer that had the push-out to 2011, I assume then that you would see that revenue flow through in Q1? Is that fair?

Brian Bronson - *RadiSys Corporation - CFO*

No, actually calibration on that -- And by the way, I keep using the word "push-out." It's unclear how much is push-out. There are elements of that business that we will see happen later this year, but I think I did mention in certain forums that I didn't think it would be Q1 either. It's more Q2 into the summer time frame. So very little business from that customer inside media server in Q1, and one of the reasons for the gross margin decline sequentially.

Scott Grout - *RadiSys Corporation - President, CEO*

But the rest of your forecast for the customer holding (inaudible -- overlapping speakers). It's holding in there. Yes. Yes.

George Notter - *Jefferies & Company - Analyst*

Got it. Okay. And then just separately -- I guess this suspect even related, but you mentioned that 75% of the business, I think, was shipped in the second half of the quarter. Can you give me that number for comparison back in Q3, and talk about what is driving that? Certainly, a couple million dollars of media server business would come into play here, I assume, but what is the bigger picture on linearity?

Scott Grout - *RadiSys Corporation - President, CEO*

The bigger picture on linearity -- by the way, leading up to Q4, despite our messaging around supply challenges, because we have a ton of churn, was relatively linear. In Q4 -- and by the way, not media server business related, really. It's more along our ATCA product line, where we're having a heck of a time getting certain components, working with our CM. And so that drove, really, not timing of bookings or demand filling in, again, being able to satisfy that demand with supply. And so that was particularly, I'm going to say. problematic in Q4. We were able to get it out, but we weren't able collect it in Q4. And thus the reason for the cash burn. Q1, by the way, looks good as well, so bookings in some areas are 75% or more. Yes. Very strong.

Brian Bronson - *RadiSys Corporation - CFO*

Very strong. I'm not saying that we resolved some of the supply challenges, but that puts us in better footing for linearity in the first quarter.

George Notter - *Jefferies & Company - Analyst*

I'm sorry, the 75% improvement in bookings is year-over-year, or sequentially, or what is that metric?

Brian Bronson - *RadiSys Corporation - CFO*

Going into the quarter. Going into the quarter, bookings backlog, and particularly product lines that are most important to us very heavily booked going in to the quarter.

George Notter - *Jefferies & Company - Analyst*

Got it -- I'm sorry, you threw out a 75% number. I guess I was just trying to figure out what that was.

Brian Bronson - *RadiSys Corporation - CFO*

(Inaudible -- multiple speakers) in some of our -- yes -- [ON-S] product lines.

George Notter - *Jefferies & Company - Analyst*

Got it. Okay. Great. Thank you very much.

Scott Grout - *RadiSys Corporation - President, CEO*

Thank you, George.

Operator

Your next question comes from the line of [Stephen Zucconi] with Needham & Company.

Stephen Zucconi - *Needham & Company - Analyst*

Hi, thank you for taking my question. I'm calling on behalf Rich Valera. My question revolves around ATCA business. How do you see the mix trending between blades and higher-marking system business in Q1 and then throughout 2011?

Brian Bronson - *RadiSys Corporation - CFO*

Well, I would say the mix changes from quarter-to-quarter. I would tell you that in Q4 we had a great mix of systems business, and in Q1 it will be more blades, and there is no real method to the madness other than it changes from quarter-to-quarter. So the mix over time will be more towards systems, particularly as we evolve into solutions on top of that as well. But no doubt with customers -- our largest customer and other customer, we have high-volume blade business that will grow just like our systems business will grow. Is that helpful?

Stephen Zucconi - *Needham & Company - Analyst*

Yes. Thank you very much.

Operator

(Operator Instructions). Your next question comes from the line of Torin Eastburn with CJS Securities.

Torin Eastburn - *CJS Securities - Analyst*

Hi, good evening.

Brian Bronson - *RadiSys Corporation - CFO*

Hi, Torin, welcome aboard.

Torin Eastburn - *CJS Securities - Analyst*

Thank you. Happy to be aboard. My first question is about the media server revenues. You said they were a bit above your plan this quarter, but will be a little bit slow next quarter. Was that from one customer shifting the timing of an order?

Brian Bronson - *RadiSys Corporation - CFO*

Are you referencing Q4 and Q1, just to make sure I understand?

Torin Eastburn - *CJS Securities - Analyst*

Yes. Yes.

Brian Bronson - *RadiSys Corporation - CFO*

Yes. Q4 definitely below our expectations, but ended up being better than the revised guidance, to be clear. So customers outside of the largest one that, pretty well documented, end up doing better than we expect the last couple weeks of the quarter. IntoQ1 that continues, is the bottom line. So business continues to go well outside of that largest customer, and it's just timing. Those shipments come with them later in the year. And, Torin, since you are new to the story, not a lot different than prior years, where we have had lumpiness with that customer.

Torin Eastburn - *CJS Securities - Analyst*

Okay. And would you expect any kind of margin seasonality in 2011?

Brian Bronson - *RadiSys Corporation - CFO*

Not so much. It's really more product mix, and it really is fixated on the legacy, which again, took a material step function down Q4 to Q1, 20 points to be specific again, and then it will go on to 15, and I think it will bottom in there. And mix inside of next-gen will churn from quarter. Q4 to Q1 is a great example of that.

Torin Eastburn - *CJS Securities - Analyst*

Okay. And I guess my only other question, have you repurchased any shares since quarter end?

Brian Bronson - *RadiSys Corporation - CFO*

No.

Torin Eastburn - *CJS Securities - Analyst*

Okay. That's all I have. Thank you.

Scott Grout - *RadiSys Corporation - President, CEO*

Okay. Thanks, Torin.

Operator

This concludes our question-and-answer session. Mr. Grout are there any closing remarks?

Scott Grout - *RadiSys Corporation - President, CEO*

So I wanted to thank everybody for participating on the call. We continue to make very good progress in defining and investing in more software-rich solutions, like our Security Gateway. We're showing nice growth in our next-generation business at higher gross margins. And once again want to thank you for your support and look forward to seeing many of you during the quarter. Thank you.

Operator

This concludes today's conference call. You may now disconnect.