FINAL TRANSCRIPT

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CORPORATE PARTICIPANTS

Scott Grout
RadiSys Corporation - President, CEO

Holly Stephens
RadiSys Corporation - Finance, IR Manager

Brian Bronson
RadiSys Corporation - CFO

CONFERENCE CALL PARTICIPANTS

George Notter
Jefferies & Company - Analyst

Aalok Shah
D. A. Davidson & Co. - Analyst

Ted Moreau
Cardinal Capital Management - Analyst

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 2, 2010, this call is being recorded. (Operator Instructions). Mr. Grout, please go ahead.

Scott Grout - *RadiSys Corporation - President, CEO*

Thank you very much, Christie. 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 we'll open up the call for questions.

As usual, participating on the call with me today 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'd 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 the business of RadiSys constitute forward-looking statements that involve a number of risks and uncertainties. We caution you to not to place undue 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 our 2008 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 statements to conform the statement to actual results or changes in the 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*

Thanks, Holly. So we had a very strong finish to our year, with fourth-quarter revenues at the top of our guidance range. We delivered better-than-expected gross margins, earnings, and cash flow, which put our year-ending cash balance at $101 million.

Our next-generation communications revenues were up more than 30% sequentially in the quarter. We have grown our next-generation communication revenues, which have blended gross margins between 40% and 50%, from $36 million in 2007 to over $100 million this past year.

Our overall non-GAAP gross margin rate has increased by five percentage points during this same timeframe. We expect additional expansion in our margin rates as our revenue mix continues to shift to higher-value next-generation products.

So I'd like to give a little bit more context and talk about some of our strategic highlights over the past couple of years, particularly as it relates to our next-generation communications products. So we've achieved significant traction with our new products, with our next-generation ATCA and media server platforms, and we've achieved a strong number-one market share position in our target markets.

Over the past two years, we have meaningfully increased the value of our next-generation network products, developing them into more complete, software-rich, application-ready platforms. By doing this, we have increased our ASPs by more than 10X when you compare our next-generation platforms with our historic legacy board products.

Our new platforms sell for between $20,000 to $70,000 per platform.

Our media server product is the leading high-performance IP media-processing platform for voice and video services. Carriers deploy our media-server products to deliver value-added IP subscriber services, such as conferencing, interactive voice response, messaging, and, increasingly, new interactive video applications. Virtually all of our value-added features are implemented in software, creating a highly flexible architecture on which to launch innovative new IP services.

Our AT&T -- or, our ATCA solutions were launched several years ago as the first-to-market fully 10 gig application-ready platform. Our ATCA solutions include a broad array of core packet and media processing switching and high-speed I/O hardware and software integrated into a fully-managed platform.

In 2009, we announced the industry's first fully integrated 40 gig ATCA platform. This newest generation of ATCA products from RadiSys will offer significant density and capacity increases that will enable ever more bandwidth-hungry applications to be deployed on our own award-winning ATCA products.

Both our ATCA and media server products offer customers a better way to bring more new applications to market faster and at a lower cost. Both of these platform products are inherently flexible, allowing them to be designed into multiple different applications with little customization.

Our next-generation platforms have been designed into over 50 different programs during the past two years, across dozens of compelling new applications as we've talked about in the past, including 3G, 4G, LTE, femtocell, WiMAX, voiceover IP, mobile video, video gateways, video conferencing, IPTV, IP messaging, network surveillance, deep-packet inspection, and defense, to name a few.

We are now selling next-generation products into many of the largest and most innovative communication customers in the market. Our next-generation products are sold to eight of the top 10 conferencing service providers. Nine of the top 10 -- or, I'm sorry, nine of the top Tier 1 TEMs and more than three dozen TEMs worldwide.

As mentioned earlier, because of this we have almost tripled our next-generation revenue over the past two years, growing it from $36 million in 2007 to over $100 million in 2009. Combined gross margins on our next-generation platforms are in the mid-40s and are approximately 20 percentage points higher than our legacy products.

Over the last two years, we have also developed our global team well to match our strategies and have significantly enhanced our team's ability to sell, to develop, and to deliver more software-rich application platforms.

In R&D, over 150 of our 240 engineers focus on software and systems development, up dramatically from the Company's historic hardware-only approach. Our R&D team is highly skilled at defining and developing innovative new software, hardware, and systems solutions that give RadiSys a competitive edge in our markets.

Our global sales and service organization has become highly effective at selling and supporting turnkey solutions that enable our customers to short-cut long and expensive new product development cycles, and bring innovative new applications to market in less time and at a lower cost.

Finally, our global footprint has increased significantly over the last couple of years, with now approximately half of our total team outside of the United States working with some of the largest global communications companies in markets all around the world. In Asia in particular, we've significantly grown our presence with a 40% increase in Asia-based revenues and nearly a 90% increase in Asia-based R&D and operations employees over the last two years.

During 2009, we also doubled the size of our R&D facility in Shanghai, China.

And finally, the payoff from this strategic work is selling products with higher ASPs, higher margins, and this has enabled us to generate $60 million of cash flow from operating activities during the past two years, once again ending this year with over $100 million in cash and investments.

Moving back to our results for the quarter, our top five customers in the fourth quarter, in alphabetical order, were Danaher, IBM, Nokia Siemens Networks, Philips Healthcare, and Tellabs. Collectively, these top five customers represented 61% of our revenue in the quarter, with 37% coming from Nokia Siemens Networks.

Nokia Siemens Networks continues to be a very strategic customer for RadiSys, with revenues diversifying nicely beyond legacy products to include meaningful new business in ATCA and our IP media servers.

From a geographic perspective for the full year, 33% of our revenues came from North America, 27% from Europe, and 40% from Asia. We continue to see good market strength in Asia, and as I mentioned earlier, our revenues have grown in this region from 17% of total revenues in 2006 to 40% of revenues in 2009.

With that, I'd like to now turn the call over to Brian, who will cover a little bit more detail about our fourth-quarter financial results, as well as projections for the first quarter.

Brian Bronson - *RadiSys Corporation - CFO*

Thanks, Scott. Our fourth-quarter revenue was $78.1 million, which was at the high end of our guidance range. Our next-generation business was up approximately 7% year over year, and up over 30% sequentially, while our legacy wireless business continued to decline.

For the year, our revenue was $304.3 million, and despite a tough economic climate, our next-gen comms revenues held in very nicely at $102 million.

We had strong earnings for the quarter, as our GAAP results were a profit of $0.02 and non-GAAP EPS was $0.19, which exceeded the high end of our guidance range.

Moving over to gross margins, our Q4 GAAP gross margin percentage was 30.4% and was up 1.9 percentage points year over year. Our Q4 non-GAAP gross margin rate was 32.7%, up 1.1 percentage points year over year, and about 0.5 point better than we had previously expected.

These increases were mainly due to an improving mix of higher margin products and lower manufacturing and operational costs.

For the year, our GAAP gross margin rate was 30.5%, up 4.7 percentage points year over year, and our non-GAAP gross margin rate was 33%, up 3.1 percentage points year over year.

Our Q1 non-GAAP gross margin is expected to be between 30% and 31% at the midpoint of our guidance range as we incur transition-related operational costs in the first half of the year associated with our manufacturing outsourcing initiative. In addition, more of our highest-margin media processing and platform revenue is currently projected to be shipped in the second half of the year. Our gross margin rate projections can fluctuate based on overall revenue levels as well as product mix.

With a shift in revenue toward next-generation products, as well as the completion of our manufacturing outsourcing initiative, we project our corporate gross margin rate to be in the mid- to high 30s by the end of the year as our outsourcing will be complete and we will have our higher-margin products deploying at an increasing rate.

Q4 GAAP R&D and SG&A expenses totaled $21.2 million in the fourth quarter. Non-GAAP R&D and SG&A expenses totaled $19.6 million, which was down $2.3 million, or 11%, from the prior year and up $300,000 from the prior quarter. Our expenses were down year over year as a result of putting more of our operations in lower-cost geographies, as well as general cost control.

We currently expect that our non-GAAP R&D and SG&A expenses will be down in the first quarter by about $200,000.

We took a restructuring charge of $817,000 in the fourth quarter associated with employee-related expenses, as we continued to align resources with lower-cost geographies, as well as complete our remaining work in manufacturing outsourcing initiative. We expect to incur around $250,000 of restructuring expense in the first quarter.

Non-GAAP operating income was $6 million, or 7.7% of revenues, in the fourth quarter. For the year, our operating income on a non-GAAP basis was $20.6 million, or 6.8%, and up $700,000 from the prior year, despite a meaningful decline in our legacy revenues.

Net Q4 non-operating expense, which includes interest income, interest expense, and other nonoperating items, was $317,000 in the fourth quarter. We currently expect our non-operating expense to be around the same level in the first quarter.

Our Q4 non-GAAP tax rate was 11.4% in the fourth quarter. We currently expect our GAAP and non-GAAP tax rates to be around 15% for the first quarter, as well as for the full year.

Our fourth-quarter GAAP diluted weighted average shares were 24.1 million and our non-GAAP diluted weighted average shares were 28.1 million, which includes 3.8 million shares related to our convertible notes. We project our weighted average basic shares to be 23.9 million for GAAP results and our dilutive shares to be 24.4 million for non-GAAP results in the first quarter. This excludes the 3.8 million of converted shares as the threshold for inclusion is $1.8 million of net income.

With our improving product mix and highly scalable cost structure, we are targeting quarterly operating income of 10% starting in the middle of 2011.

Switching to the balance sheet, DSO was 52 days in the fourth quarter, compared to 48 days in the third quarter. I expect DSO to stay around the mid-50s throughout 2010.

On the inventory front, the team achieved remarkable results. In this past quarter, we dropped inventory by about $11 million from the prior quarter and we expect our inventory balance to continue to decrease around $15 million later this year.

Our cash flow from operations was $10.6 million during the fourth quarter and better than we had previously expected. We ended the year with $100.7 million of cash.

We currently expect a couple of million dollars in operating cash flow in the first quarter. And if you take our $101 million of cash and add $21 million, which is the net amount due from UBS in about five months, I view our total cash and investment position to be approximately $122 million.

So, based on treating our 2013 convertible debt as equity, our current market cap, and fully diluted shares, we are trading at approximately 1.7 times cash, or $4.34 per share in cash.

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

Scott Grout - *RadiSys Corporation - President, CEO*

Thanks, Brian. Regarding our outlook for the first quarter and for the year, please note that this is our view as of today, and it's a forward-looking statement subject to risks and uncertainties as discussed previously and in our press release made available earlier today.

We currently expect first-quarter revenues to be between $63 million and $70 million. We expect revenues to decrease from the fourth quarter, due to first-quarter seasonality and ongoing revenue declines in our legacy wireless products. We expect our next-generation product revenues to be up in Q1 over the same quarter last year.

We currently expect our first-quarter GAAP results to be between a loss of $0.14 and $0.09, and our non-GAAP results to be between breakeven and an EPS of $0.05.

For the full year, we expect next-generation products to grow 20% to 30% over 2009. We also project our lower margin legacy products to decline by 20% to 30% in 2010 from 2009, as older programs continue to roll off. We expect that our next-generation products will overtake our legacy products during the year and that they will become a higher percentage of our total revenue over our legacy products by the end of 2010.

So in summary, we've made excellent progress driving our next-generation products into many new customers and applications, giving us a wide breadth of new growth opportunities. We have developed new market-leading, software-rich, platform-based products, and built a strong technology, sales, and support team to drive our platform strategies.

As a result, we expect strong revenue growth in our higher-margin next-generation products in 2010 and project that next-generation revenues will overtake legacy revenues as we exit the year. This substantial revenue transformation, along with our ongoing focus on operational efficiency, we believe will enable us to grow our gross margins and earnings at a faster pace than our revenues.

I'm pleased with our traction across a wide variety of new applications and believe that we have set the stage well for a highly scalable financial model.

So with that, I'd like to thank you for participating in our call today, and believe that we are ready to open the call up for questions, Christie.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). George Notter, Jefferies & Company.

George Notter - *Jefferies & Company - Analyst*

I wanted to ask about the legacy products here. You mentioned that you expect legacy products to decline 20% to 30% for the year. And certainly the Q1 guidance, I assume, reflects a good piece of that, also.

But can you talk about -- is that NSN? Which legacy products are you talking about? And more specifically, is this something that's a new point of view for you guys? What has changed in the marketplace or among your customers that create what seems to be a little bit more negative view here? Thanks.

Brian Bronson - *RadiSys Corporation - CFO*

So the 20% to 30% decline principally is in our legacy wireless business, which is principally NSN. We are seeing a share shift from legacy products to new ATCA-based products there. Included in the number is also commercial, and I think for commercial, that business is holding up relatively well for us.

So principally, it's in the next-gen sort of custom CPU designs that we'd done a number of years ago. And I don't think there is a principle shift relative to what we've been thinking before. But I think this year is an important demarcation point from us as our new revenues eclipse the old revenues.

George Notter - *Jefferies & Company - Analyst*

Got it. So coming into this quarter, you were also thinking a 20% to 30% decline in those legacy wireless products are appropriate for 2010. Is that accurate?

Scott Grout - *RadiSys Corporation - President, CEO*

Yes, it is. Our next-gen business is hanging in there very nicely sequentially, and so really it's seasonality and, to a large extent, it's the continued decline.

George Notter - *Jefferies & Company - Analyst*

Got it. How much of your guide for Q1 is -- if you can parse the seasonality piece versus the next-gen decline, would you attribute more of it to seasonality or legacy products?

Scott Grout - *RadiSys Corporation - President, CEO*

It's hard for me to tell. But I think that you've got definitely five -- in talking about sequential drop, 5% or 10% normal quote unquote seasonality, and the rest of it consider it melt or ongoing decline of our old business.

George Notter - *Jefferies & Company - Analyst*

I'll pass it along. Nice job on all the different transformations going on inside the Company. So kudos to you guys, but I'll stop there. Thanks.

Operator

Aalok Shah, D.A. Davidson & Co..

Aalok Shah - *D. A. Davidson & Co. - Analyst*

A couple of quick questions. In terms of the NSN business and just in terms of just Convedia as well, I guess I understand the revenue declines in the legacy business and the next-gen business kind of picking back up in the second half of the year. Does the -- I guess your guidance is somewhat conservative, then. Wouldn't the mix start to improve the gross margins quite a bit more? Couldn't we see maybe even close to a 40% type of gross margins by the end of the year?

Scott Grout - *RadiSys Corporation - President, CEO*

You know, it is -- mix, as we're finding out, is playing a huge piece in gross margin rate, but the general trend as we exit the year, obviously, should be at a high point.

I mentioned mid- to high 30s earlier in the call. I think it's closer to the high end as we exit the year. And again, it's largely driven off -- so there's a bit of timing, as you heard, around some of our highest-margin products, similar to what we had in 2009, if you remember, or you probably don't, but we had a heavier first half of 2009.

We are going to have most likely a heavier second half of 2010. So, that plays a part.

But equally as important as well as our manufacturing outsourcing being done is just the improvement of mix every quarter goes by.

Aalok Shah - *D. A. Davidson & Co. - Analyst*

In terms of Q1, I understand gross margins are going to be a little bit lighter than what they were this quarter. But, how much -- can you quantify how much of that has to do with mix versus your outsourcing still?

Scott Grout - *RadiSys Corporation - President, CEO*

I would say -- and by the way, take us in between Q1 and Q2, talk about the first half. I would say it's a point to two points, for sure, is due to us wrapping up our outsourcing initiative.

Aalok Shah - *D. A. Davidson & Co. - Analyst*

And then, lastly, what do you guys plan to do with the cash at this point? The buyback is possible, or I know you've talked about potentially doing some accretive acquisitions down the road, but at this point if you can't find anything, is there kind of a timeline we should kind of think about maybe doing a buyback?

Scott Grout - *RadiSys Corporation - President, CEO*

We don't have a set timeline. We are still very happy with the flow of ideas that we have and ways that we can strategically grow the business. So I think until we get to the point of saying, boy, there's not a lot on the horizon for us to look at, that would make sense to grow the Company, I think we're going to keep pressing forward with what is a pretty interesting set of strategic growth opportunities, make sure we continue to do a good job diligencing those, and find things that will add well to the Company.

So, no set timeline, but if we run into exhaust at some point, I imagine that might be possible.

Aalok Shah - *D. A. Davidson & Co. - Analyst*

And one more quick one. NSN had a pretty decent quarter when they reported -- or Nokia reported, I think earlier this week -- or last week. What -- is there a correlation between -- I mean, they mentioned continued strong strength or continued strength in the first half of the year for wireless equipment. Is there anything to take away from that? Is there mix -- do you think your mix could actually be a little bit different as we go into the first half of the year for Nokia? I guess I'm trying to get a sense of your visibility into them.

Scott Grout - *RadiSys Corporation - President, CEO*

Yes, unfortunately -- so we've got pretty good visibility. Unfortunately, due to confidentiality, there's not a lot we can disclose about their end business, but I can tell you, again, so our new next-generation products are growing pretty nicely for them as we exit last year and go into beginning of this year.

Operator

Ted Moreau, Cardinal Capital Management.

Ted Moreau - *Cardinal Capital Management - Analyst*

One of your customers is potentially acquiring some assets from Nortel, and I know that with the Nortel assets, one of your competitors is a ATCA supplier there. Do you have any sense, if that acquisition goes through, what direction the combined entities might go with their ATCA assets?

Scott Grout - *RadiSys Corporation - President, CEO*

So if we're thinking about the same one, not a lot of visibility into what will happen. I think our expectation is the wins that we have there are pretty solid and moving along pretty well. We believe we have technically superior product.

So, I think overall we feel in a good position, and this may even open up some new opportunities for us down the road.

Ted Moreau - *Cardinal Capital Management - Analyst*

Then with your -- with Nokia Siemens, we've kind of talked about it a little bit here so far. You mentioned that ATCA activity has picked up there. Has there been any indication that Nokia Siemens is moving more towards systems or platforms versus where they are today?

Scott Grout - *RadiSys Corporation - President, CEO*

So there is a continued evolution there. Again, probably difficult for us to disclose in detail. But there's definitely been an evolution in terms of the role they ask of providers like RadiSys to do more and more of the solution for them.

So it's a trend that we like, and we want to keep earning more and more business from them and others at the platform level.

Ted Moreau - *Cardinal Capital Management - Analyst*

So then on the design wins, the 50 next-gen design wins over the last couple of years, how does that break down between ATCA and media server? Can you give any kind of -- is it dominated by ATCA or is it a fairly even mix? Can you give any color there?

Scott Grout - *RadiSys Corporation - President, CEO*

So, we don't have the exact details here. Let me say it was a good mix of both. So, it wasn't dominated by either ATCA or media server. Whether it's 50-50, I don't know, but it was a good mix of both products.

So both have just done extremely well over the last two years in terms of going out and competing and winning business out there. So competitively, I continue to like our position quite a bit on both products.

Brian Bronson - *RadiSys Corporation - CFO*

And since -- hey, Ted, since you brought this up, too, the other thing I really like about those 50 new wins is about a half of them are with new customers. And not -- we value, obviously, and treasure our current customers, but in the spirit of diversification into many different apps, as well as many different customers, we've come a long way.

Scott Grout - *RadiSys Corporation - President, CEO*

And just one other comment, so we don't really want to get back in the mode of having you focus on design wins. I just thought it's been a while since we've talked about that kind of a two-year perspective.

The real measure that we're driving for is real revenue growth and gross margin growth. So that's where we've got our focus is to make sure that we turn those things into a really strong revenue stream.

Ted Moreau - *Cardinal Capital Management - Analyst*

Then one more question on the defense market. Can you provide any update there? I know you guys wanted to utilize your ATCA assets to target defense. Can you provide any updates there? Thanks.

Scott Grout - *RadiSys Corporation - President, CEO*

Yes. In the second half of the year last year, we made really nice progress from a marketing perspective. So if you go to our website, there's a lot of good collateral there.

We've got our sales team equipped for the last quarter or two, lined up a number of partners, and the funnel is growing really nicely in the defense space. That being said, as long as telecommunications is, defense might be a little bit longer in terms of the design cycle, but there are some pretty meaty programs out there that we believe ATCA is well suitable for.

So, a couple of quarters into it, I'm pretty happy with the progress of the team, and it's an area that we're committed to, and we think we bring a lot of value and core competence for defense customers.

So, Christie?

Operator

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

Scott Grout - *RadiSys Corporation - President, CEO*

So, once again, I want to thank everybody for support and listening in on the call, both live and I imagine a number of folks who will listen to recording. Thanks for your support and look forward to seeing you in the upcoming months and talking to you next quarter. Thanks again. Bye-bye.
