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ALLT.TA - Q4 2019 Allot Ltd Earnings Call

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CORPORATE PARTICIPANTS

Ehud Helft *Allot Ltd. - GK IR*

Erez Antebi *Allot Ltd. - CEO & President*

Ziv Leitman *Allot Ltd. - CFO*

CONFERENCE CALL PARTICIPANTS

Jeffrey M. K. Bernstein *Cowen Inc. - VP*

Marc Silk *Silk Investment Advisers - President*

Roger Foley Boyd *Needham & Company, LLC, Research Division - Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Allot's Fourth Quarter and Full Year 2019 Results Conference Call. (Operator Instructions)

As a reminder, this conference is being recorded. You should have all received by now the company's press release. If you have not received it, please contact Allot's Investor Relations team at GK Investor & Public Relations at 1(646) 688-3559 or view it in the news section of the company's website www.allot.com.

I would now like to hand over the call to Mr. Ehud Helft of GK Investor Relations.

Mr. Helft, would you like to begin?

Ehud Helft *- Allot Ltd. - GK IR*

Thank you, operator. Welcome to Allot's fourth quarter 2019 conference call. I would like to welcome all of you to the conference call and thank Allot's management for hosting this call.

With us on the call today are Mr. Erez Antebi, President and CEO; and Mr. Ziv Leitman, the CFO. Erez will summarize the key highlights, followed by Ziv, who will review Allot's financial performance of the quarter. We will then open the call for the question-and-answer session.

Before we start, I'd like to point out that this conference call may contain projections or other forward-looking statements regarding future events or the future performance of the company. These statements are only predictions and Allot cannot guarantee that they will in fact occur. Allot does not assume any obligation to update that information. Actual events or results may differ materially from those projected, including as a result of changing market trends, reduced demands and the competitive nature of the security system industry as well as other risks identified in the documents filed by the company with the Securities and Exchange Commission.

And with that, I would now like to hand over the call to Erez. Erez, go ahead, please.

Erez Antebi *- Allot Ltd. - CEO & President*

Thank you, Ehud. Welcome, everyone, to our conference call, and thank you for joining us today. I'd like to start with some key financial parameters for the fourth quarter and the full year 2019. The fourth quarter was another quarter of solid growth. Our revenues grew 14% year-over-year for the fourth quarter and 15% year-over-year for the entire year.

Our bookings for 2019 were significantly higher than in 2018, and the result is that we finished 2019 with a backlog of $138 million, double the backlog we had at the end of 2018. This growth came from strong bookings in both the Allot Smart product line for visibility and control as well as CapEx booking and the Allot Secure product line for security.

This is our eighth straight quarter of double-digit revenue growth year-over-year. I am very pleased with the results we achieved during the fourth quarter and in 2019 as a whole. And I believe it shows that we are on track and successfully executing on our plan.

The number of opportunities we see continues to grow. We continue to close new deals, win against competition, bring more Tier 1 business and our revenues are growing. We expect revenue growth to not only continue into 2020, but to accelerate. As we see our opportunities grow, we are continuing to increase our investments to capitalize on the significant numbers of opportunities we see.

As we work with more Tier 1 operators worldwide, we take upon ourselves additional commitments that expand product development, delivery and customer support. This is the reason we are investing further in our R&D and customer success organizations. I believe this is the right thing to do, as this investment enables us to fuel our growth, catch up on certain product gaps we still have and create differentiation.

I expect that in 2020, the rate of growth in our expenses will be lower than that of the revenues, allowing us to reach profitability in the fourth quarter of this year. While Ziv will provide more details on our financials later, I did want to start with the financial highlights that demonstrate our growth.

I would like to turn now to a general discussion on our business. I will begin briefly by discussing the visibility and control domain. We are continuing to see an active market here with a healthy pipeline of opportunities for our Allot Smart product line. We see similar use cases to what we saw in previous quarters, such as traffic management, analytics, congestion management and roaming analytics. We are also seeing a growing pipeline on 5G deployments, some of them with an RFP process and some without. I will elaborate further on where we find opportunity in 5G deployments a bit later. As I discussed in previous calls, we see a growing need for governments to curtail illegal traffic on the Internet, which results in regulations imposed on the operators, who then require technology such as ours. The type of illegal traffic, targeted by these means includes, for example, child pornography and VPNs used by criminal organizations. We won several such deals in 2019 and they're seeing growing interest in this use case worldwide.

Overall, we see a strong pipeline for our Allot Smart product line serving the visibility and control domain. We are winning against our competition in new deals and even replacing their products in some of their existing customers. I feel comfortable with our continued growth in this area. I would like to now turn our attention to the security domain, which, as we stated in the past, is our main long-term growth engine.

Recently, we announced 2 deals with European operators. One is with Meo, Portugal, a member of the Altice Group. Their plan is to launch a security service to consumers, consisting of both network-based security and endpoint security. The other is with the Central and Eastern European mobile group. In this case, they plan to initially launch a network-based security service with the option to add an endpoint security app later on. Both operators currently plan to launch the service to their customers as soon as possible in 2020. In both these cases, we believe that once service is launched and successful, we will expand the discussions to other operators in the group and hopefully launch in their countries as well.

As a result of these and other deals, our total MAR for deals signed in 2019 was $85 million. While we plan to sign a total of $100 million MAR worth of deals in 2019, a couple of potential deals slipped beyond the end of the year. We have a strong and growing pipeline of security deals with a growing number of operators. I can share with you that we are in advanced negotiation stages with several additional operators that already selected us, and I expect to sign additional recurring security revenue deals in the next few months.

As a reminder of our definition of this metric, the MAR or Maximum Annual Revenue potential of concluded transactions was estimated by a lot upon transaction signature and constitutes an approximation of the theoretical annual revenues Allot would receive if 100% of the customer subscribers, as estimated by Allot signed up for the service.

As I mentioned in previous calls, we see a growing number of CSPs who understand the need to provide secure broadband services and see value in 3 elements: One, an important enhancement to their brand value, becoming a "secure broadband" provider; 2, a potentially large new source of revenue and 3, a key element in their customer satisfaction. The relative importance of these elements differs from one operator to another.

One operator we are working with sees the quality of security provided as the main value to its customers. This is one of the key reasons they chose us even after previously deploying DNS-based security. Another operator sees this as a major differentiator from the competition and the means to attract additional customers. All of them in varying degrees of importance are interested in the new revenues this service can bring them.

As the market recognizes the importance of providing a broadband security service, the number of CSPs we are engaged with continues to grow. This growing interest is across the breadth of the Allot Secure product family, including Network Secure, IoT Secure, HomeSecure, DDoS secure and the combination with our partners, Endpoint Secure.

In the previous calls, I discussed the presentation -- excuse me, in previous call, I discussed the penetration levels we see but would like to share with you once more a little of what we are seeing in the market today in terms of rollout and penetration.

In Vodafone, our largest security customer, the total number of subscribers is continuing to grow, albeit at a lower rate than before as some markets have now reached saturation levels. Looking across the 10 different markets where Vodafone launched the mobility security service, we see adoption rates maintained between 15% and 60%, 1-5 and 6-0 percent of the total mobile customer base. In markets where security services were launched in recent years, such as in the U.K., Turkey and Germany, we are seeing healthy, consistent growth every month.

Telefónica Spain launched the Niji service less than a year ago. The security service is offered to a converged customers as a bundled service with speed and content. Telefónica Spain, Telefónica Brazil and Telefónica Argentina have plans to roll out the service to a broad customer base, but the timing is unclear.

A couple of months ago, Telefónica announced some major changes in their focus and structure. These include focusing on the operations in Spain, Brazil, U.K. and Germany. Launching Telefónica Texas focus on greater potential areas, including cybersecurity and creation of a separate Telefónica infrastructure unit. It is not clear to us what impact this will have, if any, on the rollout plans and schedule in the various Telefónica operating units.

As we discussed, towards the end of August, Hutchison Drei launched security services in Austria under the name Internetschutz. The service is based on our network secure platform. And as we announced, this is a revenue share deal. The service is offered primarily to new users in both mobile and fixed wireless broadband categories, primarily in physical stores.

Over the past few months, we have seen extremely encouraging take-up rates in the Drei stores. I can share with you that out of those who are offered the security service, tens of percent signed up for it, and we were told security as the value-added service with the highest acceptance rate they have seen in a long time.

As we discussed in previous calls, the SMB segment is one where we are seeing growth -- growing interest globally. To be more precise, we are looking at SMBs that typically have between a few employees up to a few hundred, but do not have an internal IT department with a security expert. This is an interesting segment for several reasons. One, SMBs pay more for connectivity and should be willing to pay more for security. Two, the security requirements of SMBs are similar to those of consumers. And three, the perceived risk of not having security is high.

Telefónica Spain launched the SMB security service about 9 months ago to customers with fixed line connectivity. I will remind you that Telefónica Spain SMB customers enjoy a network-based security provided by Allot technology together with endpoint app protection provided by McAfee.

In this deal, the security revenue is shared between Telefonica Spain, Allot and McAfee. The service was launched with a "try and buy" go-to-market strategy and is priced at EUR 10 per month per line to the SMB for a fixed line. The service is offered to SMBs joining the Telefónica network or renewing the service plan. And the adoption rate of the security service is close to 50%, 5-0 percent. This is very encouraging and is a testament to the appeal of security services to SMB customers.

These cases show us that the high adoption rates achieved by Vodafone for mobile subscribers in Europe can be replicated by other operators and at the commercial incentive for operators to launch security service to the mass market is high.

Unfortunately, working with CSPs takes time. It's typically exceeding 12 months and often much more time than we would like it to take. While we are engaging with more CSPs, we are still challenged by the time it takes to close the deals. For example, in one of the deals, we announced recently, the time from initial discussions until the contract was signed was over 2 years.

We are engaged at various stages with a large number of additional operators for more security deals on all the various elements of Allot Secure family. And I am encouraged by the size of our pipeline, the continuous growth in number of CSPs we are engaging and the interest within the CSPs to launch such security services for the mass market.

As I previously noted, we are in advanced negotiation stages with several additional operators that already selected us, and I expect to sign additional recurring security revenue deals in the next few months.

As I mentioned in previous calls, to view this market, I look at the combination of several indicators, including: one, the initial recurring security revenue deals we signed; two, the growth in tenders and RFPs that are being issued; three, the healthy pipeline we have in hand; and four, the penetration rates and speed of adoption where the service is launched. Looking at all the above, I am confident that we are heading in the right direction, and I'm very optimistic about this market segment and our future growth in it.

I remind us all that upon signing the deal, we don't record bookings or revenues. But as service is launched and penetration levels grow, our recurring long-term revenue stream is gradually built. These deals should form a base for continued and sustainable growth for Allot.

Looking into the future, I would like to spend a bit of time and explain where we see our value in 5G deployments. I will start with the visibility and control area. In 4G networks, the operator allocated traffic packages to a user without considering which applications were used.

In 5G networks, the focus shift from the size of the monthly package the operator provides to guaranteeing quality of experience. This is done by what is called "slicing" meaning allocating end-to-end resources to achieve the experience needed by the specific applications. For example, different slices could be provided for file downloads that are not latency sensitive and for gaming, that is very latency sensitive. These slices will be used to provide different quality of experience at different price levels to users.

Slicing can provide the resources to deliver, for example, video, but cannot differentiate between, for example, standard definition video and high-definition video.

Differentiating between these and pricing them differently requires a granular DPI employing machine learning and artificial intelligence algorithms, such as those being deployed by Allot.

In the security domain, I believe we may even have a larger opportunity in 5G. 5G networks will have higher security vulnerability due to a combination of several factors. One, there is an expectation of orders of magnitude more IoT devices in the 5G network; two, bandwidth per device will be much higher; and three, the network has a distributed design with many Internet connectivity points. Allot has network-based security capabilities that include several interesting and relevant elements: One, malware protection, as we provide with our network secure; two, DDoS protection, as we provide with our DDoS secure offering; and three, firewall protection, which is part of our IoT secure offering.

All of these solutions are telco-grade. They are scalable to very high capacity, are operating in the virtualized environment of operators and have multi-tenancy capabilities. They can be deployed in the core, as well as at the edge.

Our solutions fit extremely well for operators wishing to provide enterprise SMB and consumers with fixed wireless and very high broadband connectivity while providing all of these protections as a service from the network.

Since the primary use of 5G is expected to be provision of fixed broadband access to SMBs and consumers, we see a large opportunity for Allot here. As additional operators are looking to launch 5G networks, we are actively engaged with several operators with 5G plans.

I would now like to summarize the overall picture. We are proceeding according to plan and growing the business. I believe our fourth quarter numbers, including year-end backlog and signed recurring security revenue deals are a testament of that.

In the visibility and control area, we have a growing number of opportunities in various areas. We see longer-term opportunities as 5G networks are deployed and as governments demand more regulation on Internet traffic.

In the security area, which we see as our major long-term growth engine, we have signed several deals for Allot Secure products, including several security OpEx deals.

Adoption rates in these -- in the services already launched are very encouraging. Our pipeline of recurring security revenue deals with CSPs is encouraging as well. It is expanding, and most operators we talk to are accepting of the recurring revenue or revenue share model we offer.

In addition to the deals we already signed, we were selected already by several additional operators for recurring security revenue deals are -- and are in contract negotiations with them.

Looking further ahead, we see further opportunities and growth possibilities, providing security for 5G fixed wireless connectivity. Based on our current backlog and on our pipeline of new deals that is growing and strong, our 2020 revenues expectations are between $135 million and $140 million. In addition, we expect to sign additional recurring security revenue deals with an MAR of at least $140 million in 2020. Ziv will provide further details on our expectations for 2020.

And now, I would like to hand the call over to Ziv Leitman, our CFO. Ziv, please go ahead.

Ziv Leitman - *Allot Ltd. - CFO*

Thank you, Erez. Before I begin reviewing the financial results for this quarter and for the year, I would like to inform everyone that on this call, unless otherwise noted, I will refer entirely to the non-GAAP financial measurement when discussing operational results, which is what we usually internally to judge the ongoing performance of our business.

Non-GAAP financial measurement differ in such a respect from the generally accepted accounting principle and exclude share-based compensation expenses, revenue adjustment due to acquisition, restructuring expenses, expenses related to M&A activity, amortization of certain intangible assets, exchange rate differences, changes in taxes related items and changes in deferred tax.

And now regarding the financial results. Revenue for the fourth quarter of 2019 were $30.6 million, growing by 14% compared with those of the fourth quarter of 2018. Revenues for 2019, as a whole, were $110.1 million, growing 15% compared to 2018. This is already the second consecutive year with significant revenue growth, representing a CAGR of 16%.

Our backlog increased significantly during 2019. We increased it by $69 million from the end of last year, bringing our 2019 year-end backlog to a record high of $138 million.

Now I would like to give you some more color regarding the revenue breakdown and diversification. The geographic breakdown for the fourth quarter of 2019 was as follows: Americas with $6.3 million or 21% of revenues, EMEA with $15.6 million or 51% of revenues; and Asia Pac with $8.7 million or 28% of revenues.

For the full year of 2019, geographic breakdown was as follows: Americas with $16.7 million or 15% of revenues, EMEA with $50.4 million or 46% of revenues and Asia Pac with $43 million or 39% of revenues.

Regarding the breakdown between product and services for the fourth quarter, it was as follows: Product revenues were $18.2 million compared to $16.6 million in the fourth quarter last year, professional services revenues were $3.3 million compared to $1.6 million in the fourth quarter last year, support and maintenance revenues were $9.1 million compared to $8.7 million in the fourth quarter last year.

For the full year of 2019, the breakdown was as follows: product revenue accounting for $67.6 million compared to 56.2% last year, professional services revenues were $8.5 million compared to $6.3 million in 2018, support and maintenance revenues were $34 million compared to $33.3 million in previous year.

The portion of communication service providers revenues out of the total revenues were 76% in the fourth quarter compared to 81% in the fourth quarter of 2018, 81% of total revenues for the full year of 2019 compared to 80% in 2018.

Security revenues in 2019 were $26.2 million or 24% of total revenues compared to $24.5 million or 26% of total revenues in 2018. I would like to reiterate that while the long-term potential for ongoing revenues from the recurring security revenue deals are significant, this deal will take time to ramp, as they are typically 6 to 12 months between signing with the customer and the product launch. After that, revenue slowly ramped over many months, as the subscriber sign on to the new service and penetration increases.

Also, please note that the revenue breakdown, whether geographical or product line by any other, may fluctuate from quarter-to-quarter depending on the specific revenues and deals we recognized in the specific quarter.

Our customer base remains diversified. Our top 10 end customers made up 56% of our revenues in 2019 compared with 53% in 2018, while the largest consumer -- customer -- sorry, the customer in 2019 accounts for approximately 16% out of total revenues versus 22% in 2018. The 2019 booking were significant, reaching $179 million, which led to a record high book-to-bill ratio of 1.63.

Gross margin for the quarter was 68.7% compared to 70.3% in the fourth quarter of 2018. Gross margin for 2019 was 70.2% compared to 70.7% in 2018. The variation between the quarters reflect the product mix or deal mix sold in that particular quarter and is not an indicative of any specific trend. Operating expenses for the quarter were $22.8 million compared to 19 point -- $19 million as reported in the fourth quarter of 2018.

For 2019, operating expenses were $85.3 million compared to $72.6 million in 2018, the increase of which mainly reflects the increase in the number of employees. The total worldwide number of full-time employees as of December 31, 2019, were 594. This is an increase of 70 FTE compared with that of the end of 2018, which stood at 524.

Non-GAAP operating loss for the quarter was $1.8 million compared with non-GAAP operating loss of $99,000 in the fourth quarter of 2018. Non-GAAP net loss for the quarter was $1.7 million or $0.05 per share versus $455,000 or $0.01 per share in the fourth quarter of 2018.

Non-GAAP net loss for 2019 was $7.5 million or $0.22 per share versus $5.1 million or $0.15 per share in 2018. Even though 2019 revenues increased by 15%, the net loss increased by $2.4 million due to a strategic decision by the management to increase OpEx by 18% in order to support the long-term growth strategy due to the opportunities we currently see in the market.

Turning to the balance sheet. Our cash reserves comprised of cash, cash equivalents and investments as of December 31, 2019, were $117.6 million compared to $114.8 million at the end of the last quarter and $1.3.9 million (sic) [$103.9 million] in December 31, 2018.

I note that the increase in the third and fourth quarter was primarily driven by large deals in which the upfront payment was relatively large.

$34 million out of the total cash balance is restricted due to advanced payments from customers, margin required for foreign currency hedging activities and other collaterals.

For the 3 months ended December 31, 2019, the number of basic shares were 34.5 million and the number of fully diluted shares for the same period was 36.5 million.

Since we expect to recognize over 70% of the current backlog as revenues in 2020, we have relatively good visibility into the 2020 revenues.

In terms of guidance, as I have mentioned earlier, we are expecting revenue to grow significantly in 2020 to between $135 million and $140 million, representing accelerated year-over-year revenue growth of 25% at the midpoint. This growth rate will likely not to be constant on a quarterly basis, and there may be fluctuations in the actual revenue level from 1 quarter to another.

We expect gross margin for 2020 to average around the same level as we have seen in previous years, at around 70%. However, I reiterate that on a quarterly basis, the gross margin may fluctuate as a result of the deal mix and revenue recognition.

As we continue to invest in sales and marketing and R&D to facilitate the growth of the company, we expect operating expenses in 2020 to be in the range of $95 million to $98 million, representing year-over-year growth at the midpoint of $11 million or 30% over 2019. Since the increase in OpEx, we plan to be at a lower rate than that of the revenue growth, we are expecting to become profitable in the fourth quarter of 2020.

We are expecting a negative net cash flow, a few million dollars, for the entire 2020, of course, excluding any potential M&A activities. However, the net cash flow in the beginning of the year is expected to be significantly less than the net cash flow towards the end of the year, mainly we see significant high level of advance payment in 2019.

Regarding the bookings, we believe that it will be higher than 2019 revenues but lower than the 2020 revenues. While 2019 CapEx booking were exceptionally high, we are also more focused on signing additional recurring security revenue deals that produce little to no booking in 2020, but will build a strong foundation for future revenue growth. As Erez mentioned, for 2019, we achieved a total MAR of $85 million. And we believe that in 2020, we will sign additional deals, which will exceed an MAR for the year of 2020 of $140 million.

As I mentioned earlier, since it takes some time from contract day to commercial launch, we are expecting initial recurring security revenues in 2020, which will amount to a few million dollars with a much more significant amount next year.

The combined effect of our backlog, our expected booking in 2020 and the expected recurring security revenues, leads us to expect revenues to continue to grow also in 2021, but at a lower rate than the expected growth of 2020. However, it is too early to anticipate the growth rate in 2021.

That concludes my remarks. We would be happy to take your question now. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Alex Henderson of Needham & Company.

Roger Foley Boyd - *Needham & Company, LLC, Research Division - Research Analyst*

This is Roger Boyd on for Alex. Congrats on a nice quarter. Wondering if you could talk about the strong 2020 revenue guidance? And what gives you confidence in that? Is it a stronger demand in DPI or quicker ramping OpEx deals that you signed last year or maybe more CapEx deals or a combination of the 3?

Erez Antebi - *Allot Ltd. - CEO & President*

It's a -- I think, it's like we said, it's a combination. We're entering 2020 with a very strong backlog. We have a very strong pipeline for additional deals. And we are going to -- we expect to start seeing a few million dollars from the recurring security revenue deals that we signed. So it's a combination of all those that lead us to our guidance for 2020.

Roger Foley Boyd - *Needham & Company, LLC, Research Division - Research Analyst*

Okay, great. And then one follow-up. With Rakuten, am I thinking about it right in that it's a CapEx deal that was mostly recognized in '19? Or is that shifted with the delay in their network? And then I think you talked about a potential OpEx component of that after the network goes live?

Erez Antebi - *Allot Ltd. - CEO & President*

I'm sorry, could you repeat the question? I couldn't hear you well.

Roger Foley Boyd - *Needham & Company, LLC, Research Division - Research Analyst*

Sorry. It was about Rakuten. Am I right in thinking about, it was a CapEx deal that was mostly recognized in 2019? Or is there an OpEx component that you benefit from after the network goes live?

Erez Antebi - *Allot Ltd. - CEO & President*

It's basically a -- if I remember correctly, it's a term license deal. So we recognize this-- we recognize revenues in 2019 from Rakuten. And as the network goes live, there will be additional upsides later on or we expect at least to be.

Operator

The next question is from Marc Silk of Silk Investment Advisers.

Marc Silk - *Silk Investment Advisers - President*

Congrats on just great progress and great guidance. So the product for the Internet security is like something, me as an American consumer would love to see. Can you kind of talk about, like, if you've talked to, like, U.S. carriers and kind of what the conversations are?

Erez Antebi - *Allot Ltd. - CEO & President*

Well, I can talk to it to a certain degree. First of all, we would like you to see this Internet security as well as a US customer, and we're working to make that happen. Look, we've announced previously that we have signed deals with the 2 U.S. Tier 1 operators, one of them in the DPI area and the other one was IoT security, which obviously will not be relevant so much for consumers. So we're -- I think -- I can say that we're actively engaged with those operators and with additional operators in the U.S. These -- if operators in general take time, U.S. operators take a longer time, mostly due to their size and the complexity, but then the fruits of being successful there are larger. So we're continuing to engage with them. I think we're making progress, and I'm optimistic.

Marc Silk - *Silk Investment Advisers - President*

Okay. And so, one thing to clarify on your product on the Internet security. So if I'm a customer, I don't need to download an app, your application is basically on the network. So basically, if I was like, let's say, a Vodafone customer, Vodafone, all they have to do is flip a switch, and it's already there for me. So the customer doesn't really need to do anything. Is that -- can you clarify that for me?

Erez Antebi - *Allot Ltd. - CEO & President*

Yes, you're absolutely correct. Our -- the software sits in the core of the operator's network. So you as a consumer, if you were a Vodafone customer, and you wanted to sign up for their, what they call Secure Net. That's the brand that they give this service in various countries, all you would have to do is agree to pay. You would not have to download anything, configure anything or anything of that sort. Vodafone would flip a switch, speaking virtually, in the network. And you will -- and your traffic will be filtered and secured from the network itself.

Marc Silk - *Silk Investment Advisers - President*

So that's very important because, like as consumers, sometimes they have to download an app or they have to do something. It really affects penetration because sometimes they can't figure it out or like no, I'm too lazy. So this is really kind of a game changing technology.

So having said that -- you can comment on that. Because I think that's really important, which it just makes this even a more compelling investment.

Erez Antebi - *Allot Ltd. - CEO & President*

I think you are right that it is very important. We know from many operators that we talk to that resale security apps that could -- that users have to download onto their phone or computer and configure it and so on. That a typical penetration rates for apps that are downloaded is about 5% -- 3%, 5%. If they get to 5%, 6%, they're really happy. And one of the big advantages of having a network-based security that is provided by the operator to the consumer or a small business as a pure service without the consumer or business having to do anything other than agreed to pay for it, of course, is the penetration rates become very high? It's a primary reason, together with our -- the engagement tools and how we show the value and so on, but it's a primary factor in getting penetration rates into the 20%, 30%, 40% and even 50% for different operators. I agree with you on that.

Marc Silk - *Silk Investment Advisers - President*

Okay. So now. I know you're going to have a vast amount of customers for the -- again, sticking with the Internet security. Are you -- are they able to like access your information, like Vodafone, you say, has a 50% penetration rate. And even though we don't get the recurring revenue, at least you've learned a lot. So do these carriers, kind of, pick your brain and say, what do we need to do to get that 50% penetration? Or they, kind of, have their internal, like we know what we're doing type of attitude?

Erez Antebi - *Allot Ltd. - CEO & President*

Well, as you can imagine, it varies from operator to operator. But what we've set up -- in our marketing team, we've set up a specific group that is specializing on understanding, what is the right way to market these kinds of services to consumers and small businesses. And when we sign up with an operator such as Hutchison Drei in Austria, such as Meo in Portugal, a part of the package, part of the value that we bring them is this is the knowledge that this group has, to sit with their marketing teams with the operators' marketing teams and show them what kind of go-to-market schemes work better, what kind of work not as well, what is the experience from other operators, and so on and help them design their go-to-market processes, help them design their campaigns and so on to achieve higher penetration rates.

Marc Silk - *Silk Investment Advisers - President*

So now that you're hitting new highs, and you were a value stock returning to a growth stock, have you basically been talking to other analysts as far as coverage?

Erez Antebi - *Allot Ltd. - CEO & President*

We have been talking to other analysts. As you may -- as you probably know, getting additional analyst coverage is challenging. We would welcome any help you can give us on that.

Marc Silk - *Silk Investment Advisers - President*

Well, Silk Investment Advisers has you as a strong buy, how's that? And I know because you need investment banking money, but with your balance sheet, I get it.

So if you remember, a few conference calls ago, when your stock was $7, and I said, it kind of makes sense, you could use a little bit of money to buy back shares at $7. I think now that the stock where it is now, I think that offer is off the table. I think you just sit back and see what happened. So I was supposed to meet you in Boston, but I met Ziv about a month ago. So this is for Ziv. Ziv, I know you really don't even need this job because you've been successful in your previous jobs. Why did you decide to come to Allot?

Ziv Leitman - *Allot Ltd. - CFO*

As I told you, it's because of 2 reasons. First of all, I believe in the market and I see huge potential for growth for the company. And the second reason is the people. I met many of the management and the board member before I joined. And I came to the conclusion that with these kind of people, we can be a winning team. And Allot can be a huge success story.

Marc Silk - *Silk Investment Advisers - President*

All right. Maybe, Erez, one day, you'll get to Boston. But I think you guys are going in the right direction in an environment where there's not many growth companies. This is going to be an exciting next -- this decade should be very exciting for Allot. So congratulations on the progress and continued good luck.

Operator

The next question is from (inaudible).

Unidentified Analyst

Congratulations on the good year and the great guidance. Well, actually, you did talk about it a little beforehand to Erez, to the guy who talk with you beforehand, I forgot his name. But maybe some -- a little more clarification. Maybe if you can elaborate, you seem to have a lot of activity, and deals are mainly signed in Europe and Asia. And I wanted to ask, do you have any chance to penetrate the American market? even -- I mean, you have 15% or 14% of your revenues are from there, but maybe do you plan to have more? What are you doing to get it -- to get there?

Erez Antebi - *Allot Ltd. - CEO & President*

Well, like I said, we signed a couple of deals with 2 of the Tier 1 U.S. carriers, one for DPI and one for IoT security, both of which are not very large, but I think they're an important start. We are definitely focusing a lot more efforts in the North American market. I think there's a tremendous potential there. And from my perspective, I see it has a significant potential for growth for us, and we're definitely investing resources to get there.

Operator

The next question is from Jeff Bernstein of Cowen.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

I'll -- my congratulations on a great year and a great outlook. Just a couple of questions on competition. I think I heard you say that you had replaced or added on top of a competitor that was already in place with a DNS-based product. And I wanted to understand a little bit more about that and how you see your technology versus D&S kind of playing out here, first.

Erez Antebi - *Allot Ltd. - CEO & President*

Well, maybe I'll clarify a bit more what happened there. This is a group of companies that in one of their operations, they have deployed DNS security. And then when they looked at us, they understood that the security level that we can provide with inline security is significantly better than what DNS security can do. And therefore, they decided to work with us in other markets.

Now it's -- the rationale is very simple, right? DNS security is a nice offering, but it's very easy to bypass and it doesn't capture many cases of either fishing or bot attacks or things like that.

So it's -- and our technology simply provides a much more secure and better service to the end users. And I think that many operators are realizing that. However, it's still a lot easier to deploy DNS security. So as I said before, there are going to be operators that look at this and say, okay, I don't care really if the level of security is good or bad, I just want it to be really easy for me. And we'll use DNS security. But I see many operators that understand that you can't do so-so security. You have to do something serious. And those operators will go with an inline solution like we provide.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Great. So it sounds like for the time being, we're happy for DNS providers to raise the consciousness about security products and at some point, those folks will come your way, looking for a more robust solution?

Erez Antebi - *Allot Ltd. - CEO & President*

It's hard for me to say if they will come our way. They won't. I think we'll continue to work with the market and explain and prove to them that our solution is superior. And I think that over time, more people and more operators will understand that security is something very serious, and you need to provide a serious and good solution, and I believe in this direction.

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

Great. And then a question just on virtualization. Wondering if you have seen your competitor offer virtualization yet and sort of demonstrate at scale? And then on the 5G demands, it seems like it's even more important. It does sound like your machine learning and AI capabilities become more important. Just talk a little bit about the defensibility of your technical position in that market versus what had become more commoditized in DPI for a few years in the past?

Erez Antebi - *Allot Ltd. - CEO & President*

Look, I'll start -- the first question was whether our competitors are deploying a virtualized solution? And the answer is, yes. I think they're -- we're starting to see them. We're definitely seeing them offer it. I assume they're starting to deploy it. I'm not sure I've seen them deployed in a massive scale yet, at least I'm not aware. That doesn't mean that they haven't. It just means that I'm not aware of it. But everybody is moving in that direction. So they will get there as well. I think we have a leg up on them, and I think we're doing a better job, but I think everybody is going out. So all our competition is going in that direction as well. Regarding -- I'm sorry, your second question was?

Jeffrey M. K. Bernstein - *Cowen Inc. - VP*

That was about 5G and sort of greater requirements?

Erez Antebi - *Allot Ltd. - CEO & President*

Yes, yes, yes. Look, 5G. 5G is going to be -- many operators are starting to roll out 5G in the U.S. I think Verizon definitely is, AT&T is and other operators are starting to think about it. You're starting to see operators in Europe think about 5G, even in Asia. So 5G is happening. And like I said, I think what we're doing is, we have many elements that are very important and added a tremendous value to a 5G delivery, especially in security, but not only security, but really, most of it in security but also in DPI.

Now what we're doing with machine learning and artificial intelligence is just applying these kinds of -- these techniques and this kind of technology to the problem of identifying protocols, identifying malware, doing things like -- identifying other things of interest in the telecommunication network. It's not so much -- you asked about defending it. I don't think it's so much an issue of specific patents around that. It's simply putting in the work, providing a good product, focusing on the needs of operators in these fields. And delivering value to them on what we're doing. And there are going to be many other people that are doing machine learning and artificial intelligence for a variety of means. Our focus is delivering it to operators to be used for both DPI and some visibility and the security applications.

Operator

(Operator Instructions) There are no further questions at this time. Mr. Antebi, would you like to make your concluding statements?

Erez Antebi - *Allot Ltd. - CEO & President*

Yes. I'd like to thank you all for listening in, and I'd like to thank you for your support in Allot. And I look forward to seeing you in the coming weeks and months, wherever we are. Thank you very much. Bye-bye.

Operator

Thank you. This concludes Allot's Fourth Quarter and Full year 2019 Results Conference Call. Thank you for your participation. You may go ahead and disconnect.