

F R O S T & S U L L I V A N  
INDEPENDENT EQUITY RESEARCH



allot



Today's forms of communication have made the world into a very small place. We can easily communicate with our families, friends, and colleagues **via our cellular network**, to message them about the latest episode of our favorite show, streamed **via our home WiFi network**. Because these networks have become such a vital part of our lives they have become a vital asset for communication service providers (CSPs) that supply us with cellular, internet, and other services.

Allot Ltd. (NASDAQ, TASE: ALLT) is a B2B2C software company with over 20 years of experience that focuses on Network-based Security Solutions and Network Intelligence Solutions. These solutions enable entities such as communication service providers and enterprises to secure and optimize the digital experience of their users. Allot's motto is "See. Control. Secure." and it is a precise definition of the company's value proposition. The company allows its customers to see what is going on in their network, control their network to give the best experience to end users on all connected devices, and secure all of these devices against threats. It does this while providing network insights that save its customers significant capital and while creating new revenue streams for them. In essence, Allot empowers its customers to get more out of their networks.

The Company's solutions are deployed globally for network analytics, traffic control and shaping, and network-based security including mobile security, DDoS protection, IoT security, and more. Allot's multi-service platforms are deployed by over 500 mobile, fixed, and cloud service providers and over 1000 enterprises. Their network-based security as a service solution has achieved over 50% penetration with some service providers and is already used by over 23 million subscribers in Europe.

# 26% increase in Q3 revenue YoY; major new recurring revenue deals; target price maintained at 46.85 NIS / 13.6 USD

**Stock Exchange:** NASDAQ / TASE

**Ticker:** ALLT

**Sector:** Technology

**Sub Sector:**  
Software/Internet

**Stock target price:**

**46.85 NIS / 13.6USD**

**Closing price:** 33.9 NIS

**Market cap:** 1.19B NIS

**# of shares:** 35.1 million

**Stock performance (YTD):**  
15%

## Recent Highlights

Allot consistently meets our progress expectations and therefore we maintain our target equity. We estimate Allot's stock price target to be in the range of approximately 43 NIS to 51 NIS with a mean of 46.85 NIS or 13.6 USD.

Allot generates revenues from two sources: (1) sales of Network Intelligence Solutions which show communication service providers (CSPs) exactly what is happening on their networks allowing them to control network traffic for a high quality experience for subscribers (2) sales of Network-based Security solutions, such as security as a value added service (SecaaS) that communication service providers can offer to their subscribers in order to protect them from cyber threats. These offerings solve major problems for communication service providers such as creating new streams of monthly recurring revenue to deal with serious pricing pressures and allow providers to navigate the new 5G ecosystem successfully.

**Exploring the third quarter and recent months of 2020 indicates the following:**

-**Total revenues** for the third quarter of 2020 were \$34.8 million, an increase of 26% compared to \$27.6 million in the third quarter of 2019. The Company expects profitability in Q4.

-**Cash and investments** as of September 30, 2020 totaled \$107.2 million, compared with \$109.2 million, as of June 30, 2020.

-MEO Portugal and an additional European telecom provider launched a cybersecurity service for mobile subscribers powered by Allot. (Oct. 2020)

-A Tier-1 telecom service provider in APAC selected Allot Home Secure to provide cyber-protection to consumers. This is Allot's largest home secure deployment to date and will protect the routers and wifi networks in the homes of millions of customers. (Oct. 2020)

-A Tier-1 telecom service provider in APAC selected Allot Congestion Management for quality of experience improvement and CAPEX savings (Oct. 2020)

-Telefónica expanded 'Conexión Segura' their security-as-a-service solution powered by Allot to protect Spanish SMBs from cyberattacks (Oct. 2020)

-New Zealand's DIA Selected Allot to protect its citizens from digital child exploitation content (Aug. 2020)

-Allot launched Business Secure, a new Solution for Telcos to protect their business customers from cyberattacks (May. 2020)

In the recent earnings call on Nov. 4 2020, Allot additionally shared the following:

The Company was selected by several operators from EMEA, APAC, and Latin America to provide security products and launch services to their end consumers and SMB customers and expect to sign some additional recurring revenue agreements by the end of the year. The Company expects to see CSPs expand their offering to SMBs due to the growing threat to this type of organization and consequently the willingness of SMBs to pay more to secure themselves. It is important to note that sales cycles as well as launch times are long and that Covid-19 may delay the launch of deals signed. Not all of Allot's customers sign recurring revenue deals but these types of deals are what lead to strong growth for Allot and we consistently see the Company closing these types of deals with either new customers or existing customers wanting to expand their Allot product offering.

Read our annual initiation report [here](#) in order to get a comprehensive understanding of Allot's executive investment thesis, offering, market, competition, and growth drivers.

## Forecast and Price Action:

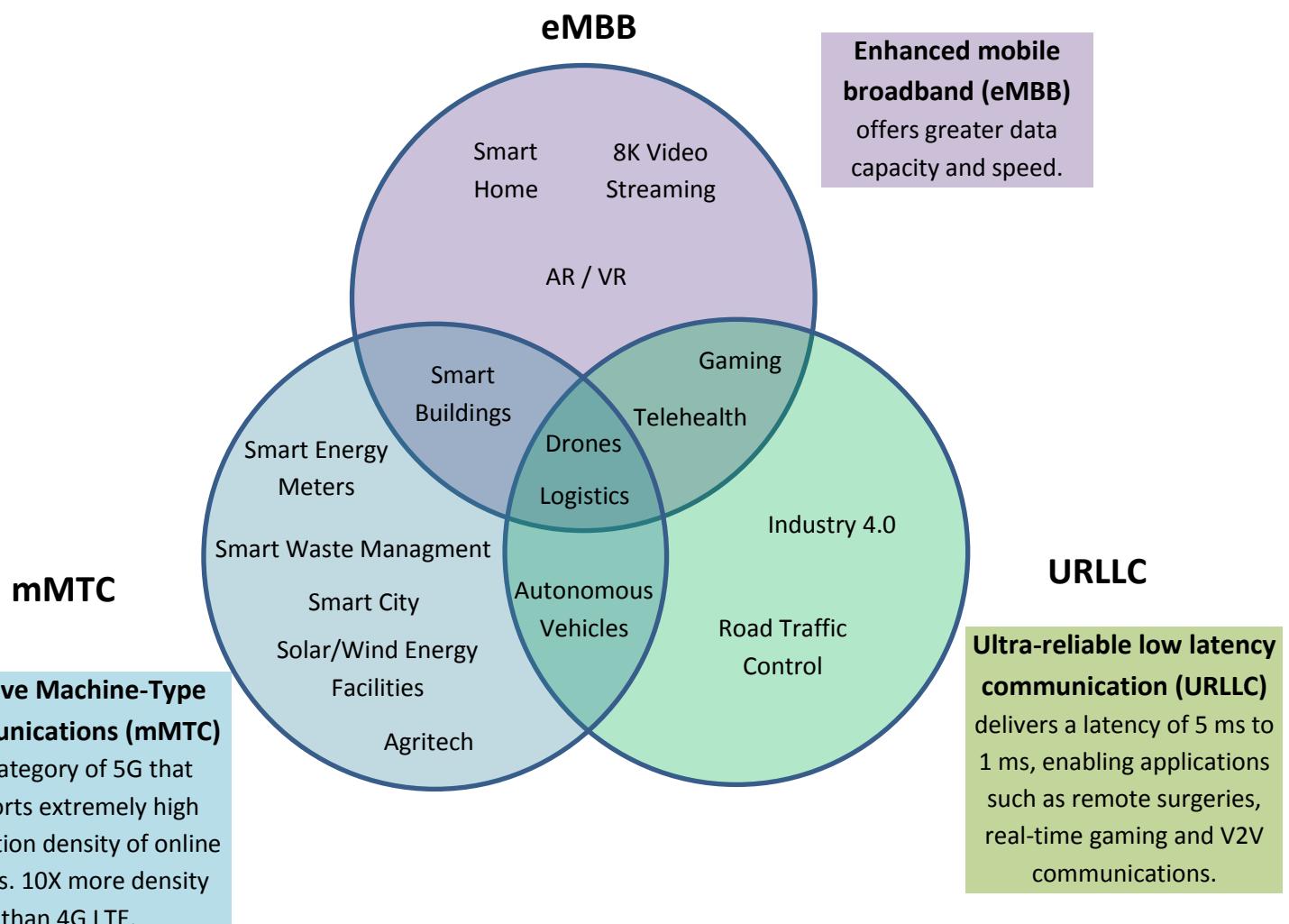
000, \$	2018A	2019A	2020E	2021E	2022E	2023E
<b>Revenues</b>	95,837	110,100	136,125	166,158	215,071	277,153
<b>Gross profit</b>	67,751	76,266	101,229	117,474	152,055	195,947
<b>Operating (loss) profit</b>	-4,810	-8,978	1,245	2,961	15,102	33,268

## Executive Investment Thesis:

Today's forms of communication have made the world into a very small place. We can easily communicate with our families, friends, and colleagues, on the other side of the world, **via our cellular network**, to message them about the latest episode of our favorite Netflix show, streamed **via our home WiFi network**. Because these networks have become such a vital part of our lives they have become a vital asset for communication service providers (CSPs) that supply us with cellular, internet, and other services.

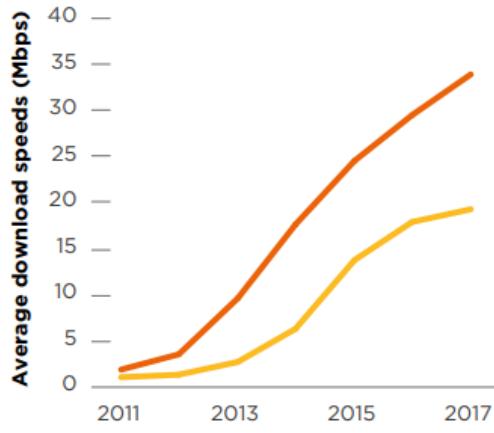
The problem is that as our **networks become more advanced to meet our expectations**, by supplying us with capabilities such as 8K video streaming, gaming, virtual reality, ultra-reliable low latency/low bandwidth V2X collision avoidance systems and other machine-to-machine communications on a massive scale, **we expect to pay less to use them**. That is, network costs are rising for CSPs but Average Revenue per User (ARPU) is not.

## New Applications Empowered by 5G

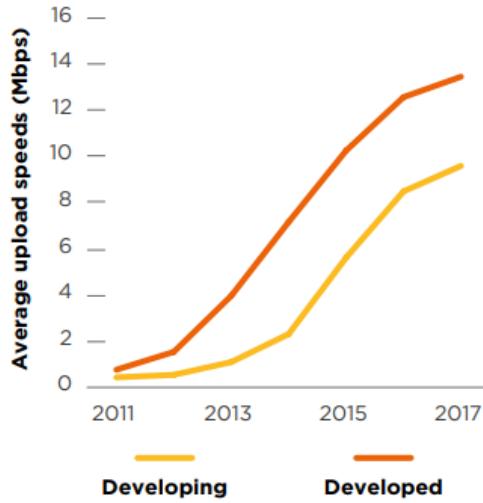


From the figures below it is evident that mobile networks have given users increasingly better download and upload speed as well as significantly improved latency but all the while have drastically dropped prices (both in developed and developing countries).

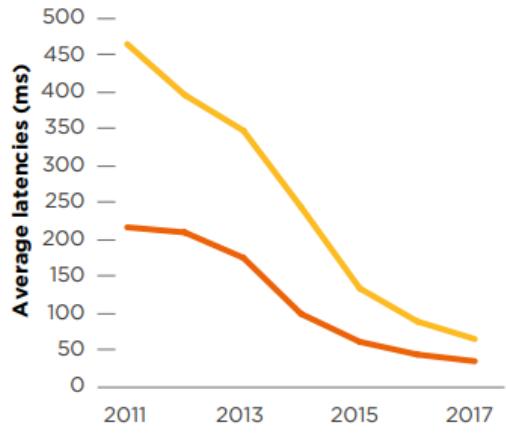
MOBILE DOWNLOAD SPEED IMPROVEMENTS, 2011-2017



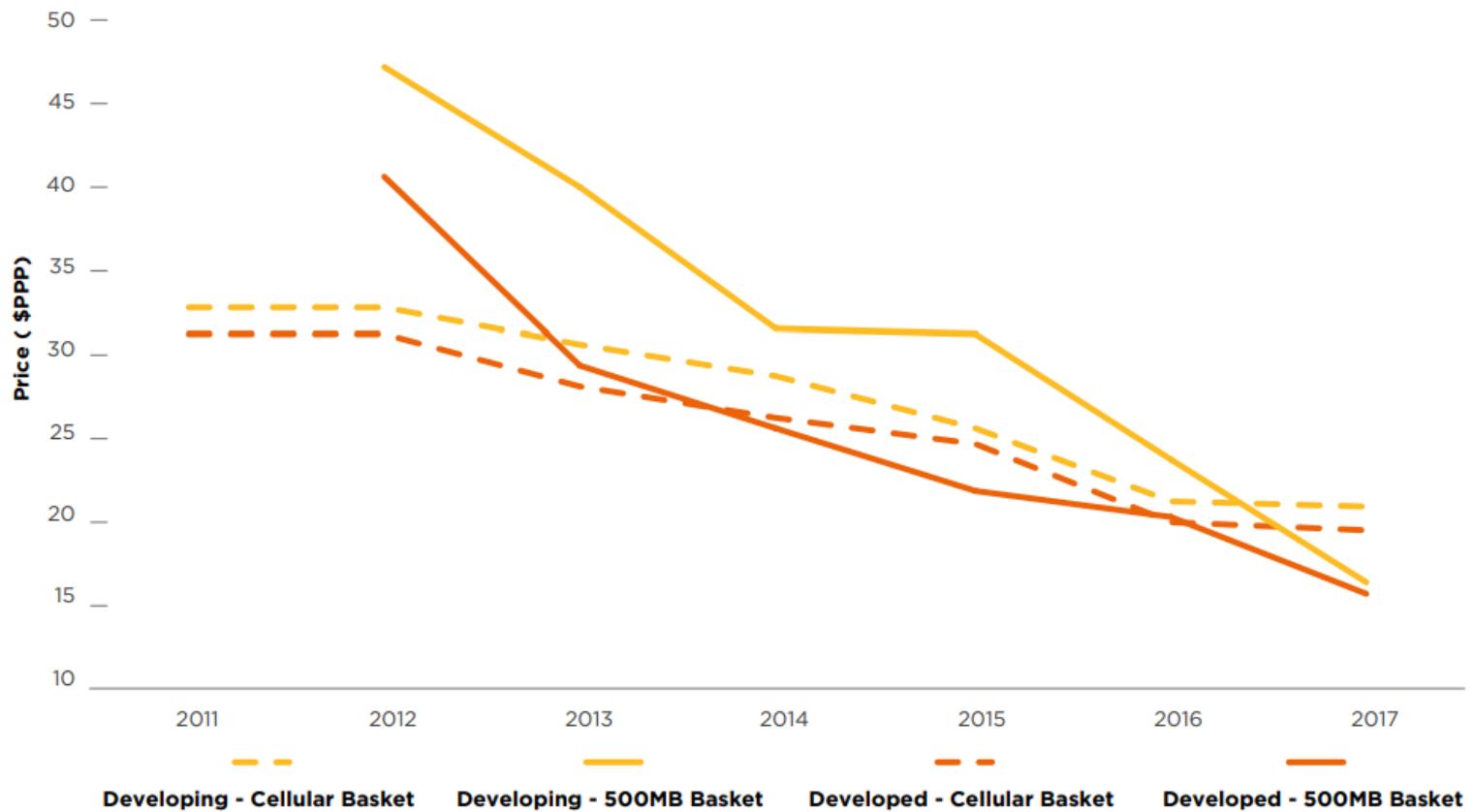
MOBILE UPLOAD SPEED IMPROVEMENTS, 2011-2017



LATENCY IMPROVEMENTS, 2011-2017



AVERAGE PRICE TRENDS, 2011-2017



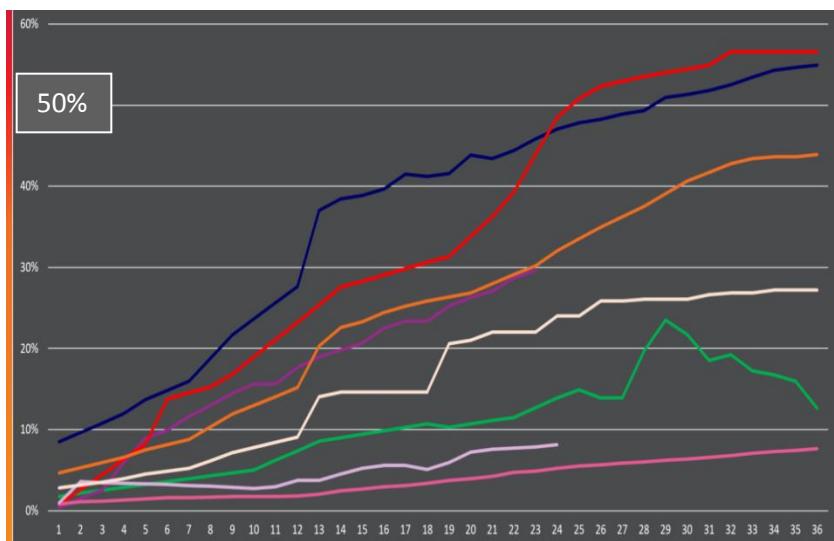
The second major problem that arises is that as more and more devices utilize CSP networks, there are more and more targets for cyber-attacks. Imagine a hacker infecting two million IoT devices and using them to launch a massive DDoS attack on vital city infrastructure.

The new Mobile Edge Computing (MEC) architecture of 5G networks only exacerbates this problem. Edge computing is a term to describe the migration of computing processes from a centralized cloud at the center of a network to a distributed cloud with nodes at the edge of the network, meaning, as close to the end user as possible. The edge computing nodes could be a local data center or even the user's device itself. The bottom-line is that there are many more points for attackers to target in the new 5G architecture.

So why are our networks migrating to a distributed architecture? This migration from a centralized computing entity to many small distributed computing entities on the edge of the network is happening for two reasons. The first is that as more and more devices connect to networks it becomes more expensive to support their needed capacity to communicate with one central cloud as opposed to many local distributed cloud entities. The second is that more and more applications are requiring ultra-low latency and this is significantly easier to achieve with computing nodes closer to the end user at the edge of the network.

The two major problems above- **1) increasing data capacity pressure with increasing pricing pressure and 2) increased attack surface** are exactly the issues that Allot solves.

**1) Increased Attack Surface-** Allot attempts to turn the security problem into an opportunity for CSPs by creating an added source of revenue for them with their **Network Security** Solutions. If we think about it, we quickly realize that our homes have become mini IT organizations with at least 10 connected devices that surround us and that we surrender our most intimate details to. Because Allot's solution is network based (it is located on the CSP network) and not end-point based (the Company also provides end-point security where necessary) users do not have to download or install anything. They are automatically protected.



The graph to the left shows the subscriber penetration rates for Allot's security solution over months for different CSPs. We can see that gradually Allot's Network Security solution is achieving penetration rates of over 50% of subscribers of some cellular CSPs in certain geographies. Should CSPs

communicate the need for this solution clearly and awareness develop with end users, the revenue potential for Allot is significant. Vodafone's (one of the largest Tier 1 CSPs in the world) CEO Vittorio Colao stated, "*Our Secure Net product (provided by Allot) is already generating 160 million in revenue... we have been building quietly and we will leverage on.*"

Allot has made a strategic decision to focus its marketing and sales efforts on Network-based Security reaching out to what seems like the blue ocean of cyber security. We expect Allot to show a significant increase in revenues over the next 5 years due to the high growth expected in this sector and importantly due to the company's transition from a CAPEX to a Rev-Share business model. The solution is offered in a SecaaS model and for every new CSP end user (subscriber) that chooses to secure their online experience, the CSP and Allot share the monthly user fee. **With each CSP servicing millions of subscribers the revenue potential of this value added service is great both for the CSP and Allot.** Allot is constantly onboarding Tier 1 and 2 telecom customers that offer Allot's security value added service to end users.

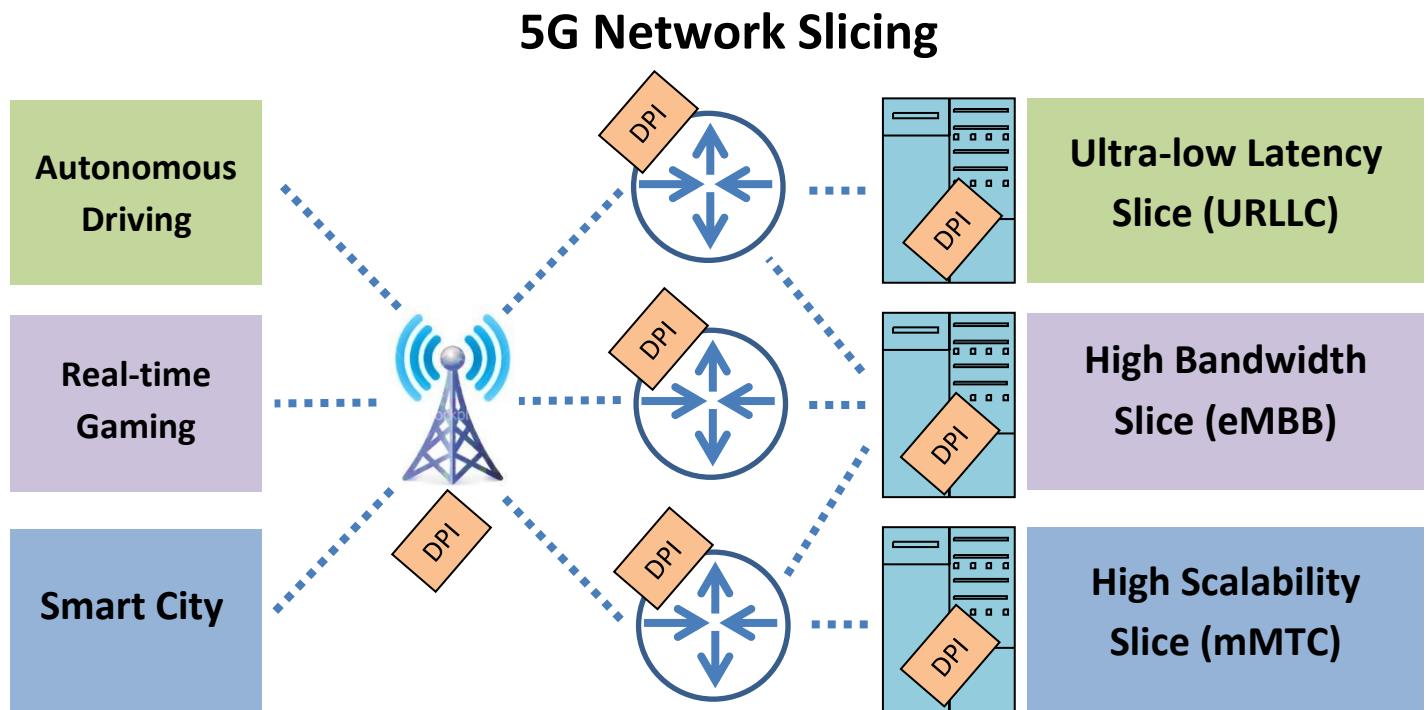
Allot's security solutions are also inherently designed to work well with the new 5G distributed architecture model. With the transition to mobile edge computing, large centralized computing clouds are replaced by smaller ones at the edge which are therefore highly sensitive to changes in bandwidth capacity. In relation to many of its competitors, Allot's solution sits inline with these edge computing nodes, meaning it does not take from their bandwidth and slow the network. Solutions such as those provided by Arbor/Netscout for example, send suspicious data to a scrubbing center which both takes up network capacity and costs more because of increased bandwidth for the CSP. Providing security solutions designed for 5G is critical for competing in this new market space. Thus Allot is well suited to address the challenges of 5G architecture and sees possible additional business offering focused securing the Network Infrastructure of the CSP itself from both inbound and "home-generated" attacks.

**2) Increasing Data Capacity Pressure with Increasing Pricing Pressure-** One of the cardinal challenges for CSPs is dealing with decreasing profitability in this new generation of communication networks. Tailored offerings have become crucial to providing added value to basic connectivity. In order to provide tailored services, CSPs need to have high resolution **Network Intelligence termed Network Visibility or Deep Packet Inspection (DPI)** in order to understand what data is flowing through their pipes and how they can capitalize on it. The higher the level of DPI sophistication, the more detailed a picture the CSP can obtain of the data flowing through their network pipes and in turn they are better able to act on this insight.

Allot's DPI solution provides insight that allows CSPs to get more out of their existing network bandwidth without intensive CAPEX investment from the part of CSPs. That is, simple broadband pipes, where data flows, become smart and sophisticated allowing CSPs to see what type of data is flowing and to adapt to points of congestion. By more efficiently using their existing infrastructure, CSPs are able to save significantly on CAPEX. In addition to this major benefit, Allot's solution also allows CSPs to offer a plethora of new services to customers such as

parental controls, monetization (real-time data package offers based on user behavior), and most importantly, high Quality of Experience (QoE) to ensure that customers remain happy with their CSP no matter what their user behavior or application use case is.

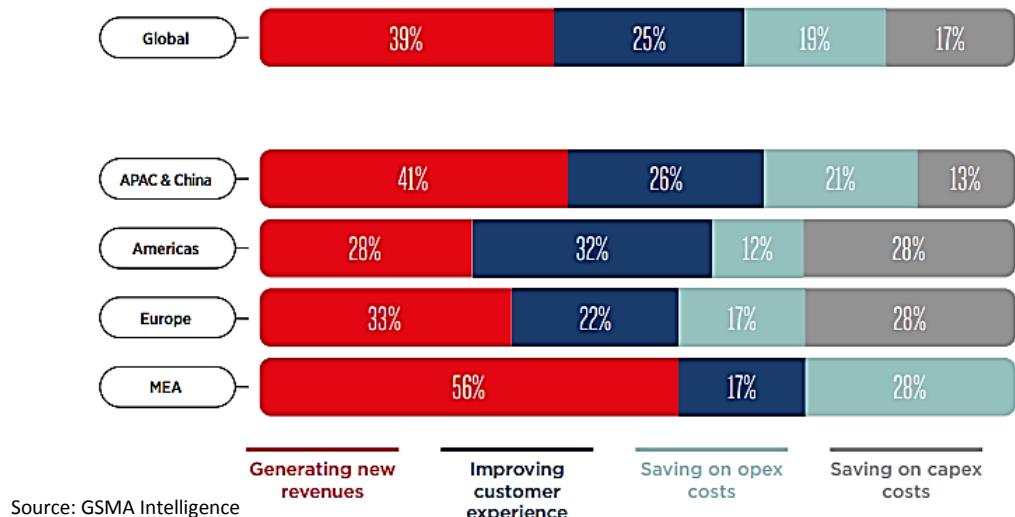
In 5G, Network Intelligence or DPI are essential to meeting user needs. 5G by its very nature was designed to handle a wide variety of applications shown on the Venn diagram above. Each of these applications has unique requirements and therefore it is necessary for the data flowing through the network to be identified and categorized in order to meet these requirements. For example, data to stream an 8K video requires more bandwidth while data to perform a remote surgery requires ultra-low latency, and data to support smart utility meters requires high scalability but very little bandwidth, while data to support mobile banking requires high levels of security. The allocation of network resources to support these different market segments is known as 5G Network Slicing. Network slicing virtually slices networks from the core to the RAN (meaning throughout all parts of the network) in order to allocate resources for specific use cases. 5G Network slicing utilizes network functions virtualization (NFV) and software defined networking (SDN) to create different virtual networks on physical infrastructure. Network visibility or DPI is critical to 5G slicing to ensure Quality of Experience (QoE) analysis and management. This is also true from a security perspective; DPI allows identifying suspicious traffic patterns that could signal DDoS attacks or malware.



In conclusion, Allot's DPI solution allows CSPs to 1) manage network traffic in order to relieve congestion and minimize CAPEX expenditure 2) ensure high QoE for users 3) enable policy creation and charging control such as parental controls and data usage limits 4) secure network traffic as an added revenue source for CSPs.

**Revenue generation and customer experience prioritised over cost-cutting as the primary stimulus for network transformation**

What is the primary goal driving your network transformation strategy? (% of respondents)



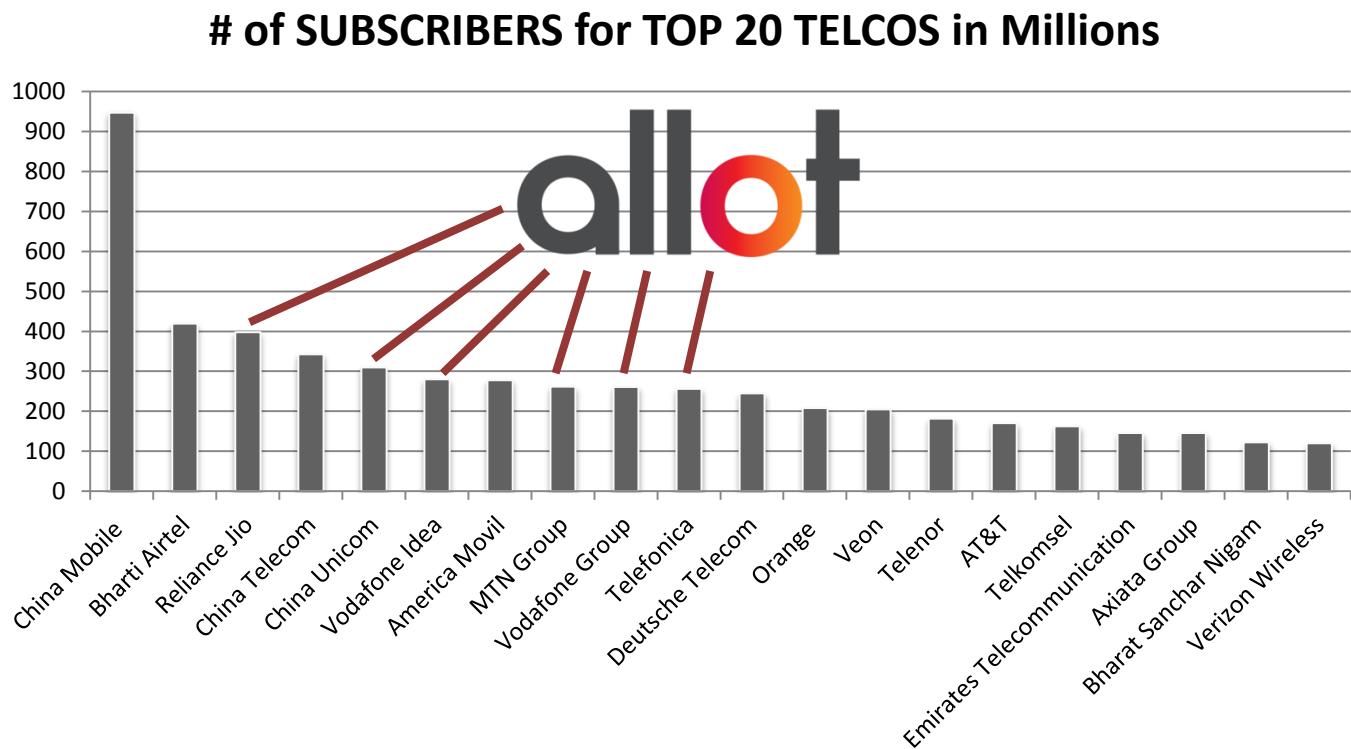
In addition to 5G there are a number of other trends driving adoption of Network Intelligence and Network Security Solutions. These include the heightened use of networks during the COVID pandemic and the ever progressing regulatory landscape. **Under the 3GPP 5G standard it is mandatory for CSPs to have DPI capabilities.** Other regulatory policies strengthening Allot's offering include examples such as the UK introducing a law requiring all visitors of adult content websites to prove that they are 18 or over. This was done to reduce the risk of children accessing or stumbling into adult content and to set a standard for international child protection online. Sites that do not comply with the law will be blocked by mobile and fixed CSPs. Further regulations such as the implementation of the Network and Information Security Directive (NISD) and the General Data Protection Regulation (GDPR) in the EU that require network operators to ensure that their network and information systems meet minimum standards of cyber security could lead to significant upside for Allot.

Within the competitive landscape Allot is well positioned and provides network awareness and security of the highest quality. The nature of the company can be characterized to investors by its two offerings. The Network Intelligence solution brings in a constant and steady stream of revenues which according to our evaluation will show low two digit growth in the next two years and then transition to high one digit growth. The second offering, mobile Network Security, is a relatively new and growing business which we expect to have significant high double digit CAGRs in the next five years based on Allot's reputation, deep know how on a global scale, and the high potential of the Rev-Share model. Allot's main customer segment is telecom service providers which can leverage both of Allot's solutions. Due to the synergy between these offerings (one allows customers to see and control their networks and the other to secure them) we believe in the investment potential of the company.

## Customers

Allot solutions are deployed globally by the world's leading service providers and enterprises to improve network performance, ensure QoE, and deliver value added security services. Allot's combined customer base consists of 3000 installations and over 1 billion end users.

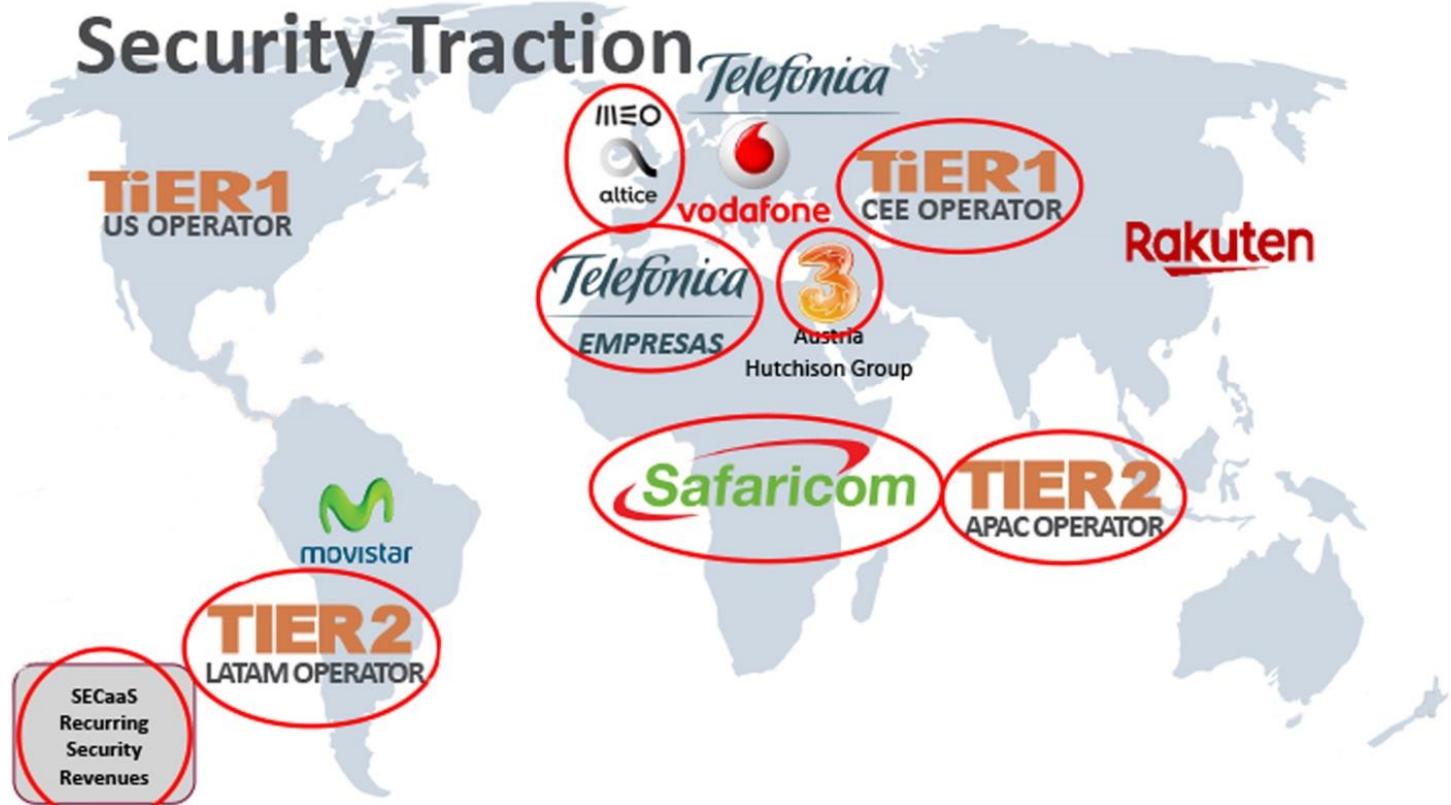
Allot provides its services to 13 tier 1 operators. The graphic below shows the largest mobile CSPs in the world by number of subscribers. Six of them toward the top of the list are publically verified Allot customers. For customer size comparison you can see that AT&T and Verizon are towards the bottom of the list. Allot also provides network intelligence and security solutions to enterprises. Customer breakdown is about 80% CSPs and 20% enterprises.



## Some Allot Smart Customers Include:

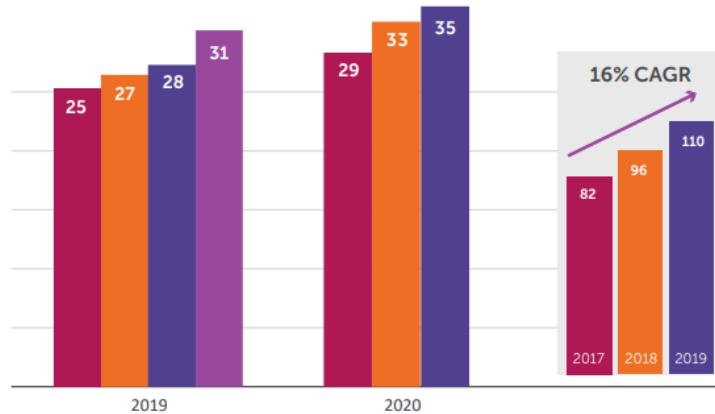


## Major Allot Secure Customers Include:



## Financial Analysis:

### QUARTERLY REVENUES – in \$M



Allot generates revenues from two sources: (1) sales of Network Intelligence Solutions which show network operators what is happening on their networks at the highest resolution and (2) sales of Network Security solutions, such as security as a value added service that communication service providers can offer to subscribers in order to protect them from cyber threats. The Company additionally provides maintenance and support services pursuant to a one to three-year maintenance and support program, which may be purchased by customers at the time of product purchase or on a renewal basis.

Exploring the third quarter of 2020 indicates the following:

**Total revenues** for the third quarter of 2020 were \$34.8 million, an increase of 26% compared to \$27.6 million in the third quarter of 2019.

**Gross profit on a GAAP basis** for the third quarter of 2020 was \$23.7 million (gross margin of 68.3%), compared with \$19.2 million (gross margin of 69.4%) in the third quarter of 2019, representing a 24% improvement.

**Gross profit on a non-GAAP basis** for the third quarter of 2020 was \$24.0 million (gross margin of 69.0%), a 24% improvement compared with \$19.4 million (gross margin of 70.2%) in the third quarter of 2019.

**Net loss on a GAAP basis** for the third quarter of 2020 was \$2.4 million, or \$0.07 per basic share, compared with a net loss of \$2.1 million, or \$0.06 per basic share, in the third quarter of 2019.

**Non-GAAP net loss** for the third quarter of 2020 was \$1.2 million, or \$0.03 per basic share, compared with a non-GAAP net loss of \$1.9 million, or \$0.05 per basic share, in the third quarter of 2019.

**Cash and investments** as of September 30, 2020 totaled \$107.2 million, compared with \$109.2 million, as of June 30, 2020.

## Appendix A - Financial Reports

**TABLE - 1**  
**ALLOT LTD.**  
**AND ITS SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(U.S. dollars in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020		2019	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues	\$ 34,752	\$ 27,637	\$ 96,831	\$ 79,533
Cost of revenues	11,007	8,456	28,455	24,050
Gross profit	23,745	19,181	68,376	55,483
Operating expenses:				
Research and development costs, net	11,741	8,091	30,836	22,898
Sales and marketing	11,439	12,233	34,741	34,919
General and administrative	3,076	1,096	10,671	4,724
Total operating expenses	26,256	21,420	76,248	62,541
Operating loss	(2,511)	(2,239)	(7,872)	(7,058)
Financial and other income, net	646	257	1,514	1,360
Loss before income tax expenses	(1,865)	(1,982)	(6,358)	(5,698)
Tax expenses	528	129	1,309	1,279
Net Loss	(2,393)	(2,111)	(7,667)	(6,977)
<b>Basic net loss per share</b>	<b>\$ (0.07)</b>	<b>\$ (0.06)</b>	<b>\$ (0.22)</b>	<b>\$ (0.20)</b>
<b>Diluted net loss per share</b>	<b>\$ (0.07)</b>	<b>\$ (0.06)</b>	<b>\$ (0.22)</b>	<b>\$ (0.20)</b>
Weighted average number of shares used in computing basic net loss per share	35,163,221	34,348,200	34,903,109	34,183,272
Weighted average number of shares used in computing diluted net loss per share	35,163,221	34,348,200	34,903,109	34,183,272

**TABLE - 2**  
**ALLOT LTD.**  
**AND ITS SUBSIDIARIES**  
**RECONCILIATION OF GAAP TO NON-GAAP CONSOLIDATED STATEMENTS OF OPERATIONS**  
(U.S. dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020		2019	
	(Unaudited)		(Unaudited)	
GAAP cost of revenues	\$ 11,007	\$ 8,456	\$ 28,455	\$ 24,050
Share-based compensation (1)	(89)	(67)	(242)	(188)
Amortization of intangible assets (2)	(152)	(237)	(456)	(701)
Changes in taxes and headcount related items (4)	-	75	-	75
Non-GAAP cost of revenues	<u>\$ 10,766</u>	<u>\$ 8,227</u>	<u>\$ 27,757</u>	<u>\$ 23,236</u>
GAAP gross profit	\$ 23,745	\$ 19,181	\$ 68,376	\$ 55,483
Gross profit adjustments	241	229	698	814
Non-GAAP gross profit	<u>\$ 23,986</u>	<u>\$ 19,410</u>	<u>\$ 69,074</u>	<u>\$ 56,297</u>
GAAP operating expenses	\$ 26,256	\$ 21,420	\$ 76,248	\$ 62,541
Share-based compensation (1)	(1,177)	(747)	(3,180)	(2,214)
Amortization of intangible assets (2)	-	(188)	-	(565)
Income (Expenses) related to M&A activities (3)	(48)	1,198	(82)	2,735
Changes in taxes and headcount related items (4)	-	(31)	-	(31)
Non-GAAP operating expenses	<u>\$ 25,031</u>	<u>\$ 21,652</u>	<u>\$ 72,986</u>	<u>\$ 62,466</u>
GAAP financial and other income	\$ 646	\$ 257	\$ 1,514	\$ 1,360
Exchange rate differences*	(370)	235	(468)	202
Non-GAAP Financial and other income	<u>\$ 276</u>	<u>\$ 492</u>	<u>\$ 1,046</u>	<u>\$ 1,562</u>
GAAP taxes on income	\$ 528	\$ 129	\$ 1,309	\$ 1,279
Tax expenses in respect of net deferred tax asset recorded	(112)	(16)	(187)	(49)
Non-GAAP taxes on income	<u>\$ 416</u>	<u>\$ 113</u>	<u>\$ 1,122</u>	<u>\$ 1,230</u>
GAAP Net Loss	\$ (2,393)	\$ (2,111)	\$ (7,667)	\$ (6,977)
Share-based compensation (1)	1,266	814	3,422	2,402
Amortization of intangible assets (2)	152	425	456	1,266
Expenses (Income) related to M&A activities (3)	48	(1,198)	82	(2,735)
Changes in taxes and headcount related items (4)	-	(44)	-	(44)
Exchange rate differences*	(370)	235	(468)	202
Tax expenses in respect of net deferred tax asset recorded	112	16	187	49
Non-GAAP Net Loss	<u>\$ (1,185)</u>	<u>\$ (1,863)</u>	<u>\$ (3,988)</u>	<u>\$ (5,837)</u>

Credit to experts: Chen Yakar

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**For further inquiries, please contact our lead analyst:**

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