

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

---

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2004  
Commission File Number 000-30229**

---

**SONUS NETWORKS, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**04-3387074**

(I.R.S. employer identification no.)

**250 Apollo Drive, Chelmsford, Massachusetts 01824**

(Address of principal executive offices, including zip code)

**(978) 614-8100**

(Registrant's telephone number, including area code)

---

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2004, there were 245,759,931 shares of \$0.001 par value per share, common stock outstanding.

---

---

SONUS NETWORKS, INC.  
FORM 10-Q  
QUARTER ENDED MARCH 31, 2004

TABLE OF CONTENTS

|  | <u>Page</u> |
|--|-------------|
| <b>PART I—FINANCIAL INFORMATION</b>  |             |
| Item 1. Financial Statements   |             |
| <a href="#">Condensed Consolidated Balance Sheets as of March 31, 2004 (unaudited) and December 31, 2003</a>                   | 1           |
| <a href="#">Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2004 and 2003 (unaudited)</a> | 2           |
| <a href="#">Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2004 and 2003 (unaudited)</a> | 3           |
| <a href="#">Notes to Condensed Consolidated Financial Statements (unaudited)</a>   | 4           |
| Item 2. <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>                  | 19          |
| <a href="#">Cautionary Statements</a>  | 28          |
| Item 3. <a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>   | 39          |
| Item 4. <a href="#">Controls and Procedures</a>  | 39          |
| <b>PART II—OTHER INFORMATION</b>   |             |
| Item 1. <a href="#">Legal Proceedings</a>  | 42          |
| Item 6. <a href="#">Exhibits and Reports on Form 8-K</a>   | 44          |
| <a href="#">Signature</a>  | 44          |

---

## Item 1. Financial Statements

## SONUS NETWORKS, INC.

## Condensed Consolidated Balance Sheets

(In thousands, except share data)

|  | March 31,<br>2004 | December 31,<br>2003 |
|--|-------------------|----------------------|
|  | unaudited         |                      |
| <b>Assets</b>  |                   |                      |
| <b>Current assets:</b>   |                   |                      |
| Cash and cash equivalents  | \$ 151,971        | \$ 133,715           |
| Marketable securities  | 149,953           | 171,677              |
| Accounts receivable, net   | 32,062            | 23,754               |
| Inventory, net   | 15,292            | 13,739               |
| Other current assets   | 8,390             | 6,935                |
|  | <u>357,668</u>    | <u>349,820</u>       |
| Total current assets   | 357,668           | 349,820              |
| Property and equipment, net  | 5,607             | 5,009                |
| Purchased intangible assets, net   | 1,802             | 2,402                |
| Other assets   | 1,057             | 1,193                |
| Long-term investments  | 5,814             | —                    |
|  | <u>371,948</u>    | <u>358,424</u>       |
|  | \$ 371,948        | \$ 358,424           |
| <b>Liabilities and Stockholders' Equity</b>  |                   |                      |
| <b>Current liabilities:</b>  |                   |                      |
| Accounts payable   | \$ 5,651          | \$ 3,248             |
| Accrued expenses   | 21,321            | 22,165               |
| Accrued restructuring expenses   | 285               | 565                  |
| Current portion of deferred revenue  | 65,242            | 62,698               |
| Current portion of long-term liabilities   | 153               | 182                  |
|  | <u>92,652</u>     | <u>88,858</u>        |
| Total current liabilities  | 92,652            | 88,858               |
| Long-term deferred revenue, less current portion   | 29,518            | 24,302               |
| Long-term liabilities, less current portion  | 754               | 829                  |
| Convertible subordinated note  | 10,000            | 10,000               |
| Commitments and contingencies (Note 9)   |                   |                      |
| <b>Stockholders' equity:</b>   |                   |                      |
| Preferred stock, \$0.01 par value; 5,000,000 shares authorized, none issued and outstanding  | —                 | —                    |
| Common stock, \$0.001 par value; 600,000,000 shares authorized, 248,056,841 and 247,146,477 shares issued and 245,759,931 and 244,849,567 shares outstanding at March 31, 2004 and December 31, 2003 | 248               | 247                  |
| Capital in excess of par value   | 1,044,866         | 1,043,581            |
| Accumulated deficit  | (805,548)         | (808,562)            |
| Deferred compensation  | (275)             | (564)                |
| Treasury stock, at cost; 2,296,910 common shares at March 31, 2004 and December 31, 2003   | (267)             | (267)                |
|  | <u>239,024</u>    | <u>234,435</u>       |
| Total stockholders' equity   | 239,024           | 234,435              |
|  | <u>\$ 371,948</u> | <u>\$ 358,424</u>    |

The accompanying notes are an integral part of these condensed consolidated financial statements.

## SONUS NETWORKS, INC.

## Condensed Consolidated Statements of Operations

(In thousands, except per share data)

(unaudited)

|  | Three months ended<br>March 31, |                     |
|--|---------------------------------|---------------------|
|  | 2004                            | 2003<br>as restated |
| <b>Revenues:</b>   |                                 |                     |
| Product  | \$ 26,245                       | \$ 3,517            |
| Service  | 10,287                          | 5,692               |
| Total revenues   | 36,532                          | 9,209               |
| <b>Cost of revenues (1):</b>                                 |                                 |                     |
| Product  | 8,141                           | 1,538               |
| Service  | 4,259                           | 2,555               |
| Total cost of revenues                                       | 12,400                          | 4,093               |
| <b>Gross profit</b>  | 24,132                          | 5,116               |
| <b>Operating expenses:</b>                                   |                                 |                     |
| Research and development (1)                                 | 8,928                           | 7,705               |
| Sales and marketing (1)                                      | 6,860                           | 3,971               |
| General and administrative (1)                               | 4,827                           | 1,839               |
| Stock-based compensation                                     | 379                             | 924                 |
| Amortization of purchased intangible assets                  | 600                             | 602                 |
| Total operating expenses                                     | 21,594                          | 15,041              |
| <b>Income (loss) from operations</b>                         | 2,538                           | (9,925)             |
| Interest expense   | (122)                           | (130)               |
| Interest income  | 765                             | 381                 |
| <b>Income (loss) before income taxes</b>                     | 3,181                           | (9,674)             |
| Provision for income taxes                                   | 167                             | 33                  |
| <b>Net income (loss)</b>                                     | \$ 3,014                        | \$ (9,707)          |
| <b>Net income (loss) per share:</b>                          |                                 |                     |
| Basic  | \$ 0.01                         | \$ (0.05)           |
| Diluted  | 0.01                            | (0.05)              |
| <b>Shares used in computing net income (loss) per share:</b> |                                 |                     |
| Basic  | 244,607                         | 198,703             |
| Diluted  | 255,592                         | 198,703             |

(1) Excludes non cash, stock-based compensation expense as follows:

|                            |        |        |
|----------------------------|--------|--------|
| Cost of revenues           | \$ 4   | \$ 12  |
| Research and development   | 110    | 377    |
| Sales and marketing        | 211    | 405    |
| General and administrative | 54     | 130    |
|                            | \$ 379 | \$ 924 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

## SONUS NETWORKS, INC.

## Condensed Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

|  | Three months ended<br>March 31, |                     |
|--|---------------------------------|---------------------|
|  | 2004                            | 2003<br>as restated |
| <b>Cash flows from operating activities:</b>   |                                 |                     |
| Net income (loss)  | \$ 3,014                        | \$ (9,707)          |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                                 |                     |
| Depreciation   | 1,632                           | 2,885               |
| Stock-based compensation   | 379                             | 924                 |
| Amortization of purchased intangible assets  | 600                             | 602                 |
| Changes in current assets and liabilities:   |                                 |                     |
| Accounts receivable  | (8,308)                         | (132)               |
| Inventory  | (1,553)                         | (2,521)             |
| Other current assets   | (1,455)                         | (1,656)             |
| Accounts payable   | 2,403                           | (919)               |
| Accrued expenses   | (1,169)                         | (3,694)             |
| Deferred revenue   | 7,760                           | 3,616               |
| Net cash provided by (used in) operating activities  | 3,303                           | (10,602)            |
| <b>Cash flows from investing activities:</b>   |                                 |                     |
| Purchases of property and equipment  | (2,230)                         | (956)               |
| Maturities of marketable securities  | 29,187                          | 3,647               |
| Purchases of marketable securities   | (7,463)                         | (3,797)             |
| Purchases of long-term investments   | (5,814)                         | —                   |
| Other assets   | 136                             | 21                  |
| Net cash provided by (used in) investing activities  | 13,816                          | (1,085)             |
| <b>Cash flows from financing activities:</b>   |                                 |                     |
| Sale of common stock in connection with employee stock purchase plan                               | 796                             | 447                 |
| Proceeds from exercise of stock options  | 400                             | 21                  |
| Payments of long-term liabilities  | (59)                            | (423)               |
| Net cash provided by financing activities  | 1,137                           | 45                  |
| <b>Net increase (decrease) in cash and cash equivalents</b>  | <b>18,256</b>                   | <b>(11,642)</b>     |
| <b>Cash and cash equivalents, beginning of period</b>  | <b>133,715</b>                  | <b>57,278</b>       |
| <b>Cash and cash equivalents, end of period</b>  | <b>\$ 151,971</b>               | <b>\$ 45,636</b>    |
| <b>Supplemental disclosure of cash flow information:</b>   |                                 |                     |
| Cash paid during the period for interest   | \$ 3                            | \$ 12               |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**SONUS NETWORKS, INC.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**(1) Description of Business**

Sonus Networks, Inc. (Sonus) was incorporated on August 7, 1997 and is a leading provider of packet voice infrastructure solutions for wireline and wireless service providers. Sonus offers a new generation of carrier-class switching equipment and software that enable telecommunications service providers to deliver voice services over packet-based networks.

**(2) Restatement of Consolidated Financial Statements**

As reported in Sonus' 2003 Annual Report on Form 10-K/A filed with the SEC on July 28, 2004, Sonus has restated its consolidated financial statements for the years ended December 31, 2002 and 2001 and the nine months ended September 30, 2003. The restated financial statements include a number of adjustments, the largest of which relate to revenue, deferred revenue, inventory reserves, purchase accounting, impairments, accrued expenses and stock-based compensation.

Sonus anticipates amending its previously filed quarterly reports on Form 10-Q for each of the first three quarters of 2003 for the purpose of restating its consolidated financial statements for the first three quarters of 2003 and 2002. The restated consolidated financial statements in these amended quarterly reports on Form 10-Q will include significant adjustments. Sonus does not anticipate amending its previously filed annual reports on Form 10-K or its quarterly reports on Form 10-Q for any periods prior to 2003. The consolidated financial statements and related consolidated financial information contained in previously filed reports for years ended December 31, 2002 and 2001 and for the quarterly reports during 2002 and the first three quarters of 2003 should no longer be relied upon.

The following condensed consolidated statement of operations for the three months ended March 31, 2003, on a comparative basis, summarizes the effects of the restatement adjustments on various line items of Sonus' statement of operations.

**Condensed Statements of Operations  
As Reported and As Restated  
(In thousands, except per share data)**

|                                      | Three Months Ended March 31, 2003 |                   |                   |
|--------------------------------------|-----------------------------------|-------------------|-------------------|
|                                      | As Reported                       | Adjustments       | As Restated       |
| Revenues                             | \$ 16,019                         | \$ (6,810)        | \$ 9,209          |
| Cost of revenues                     | 5,430                             | (1,337)           | 4,093             |
| <b>Gross profit</b>                  | <b>10,589</b>                     | <b>(5,473)</b>    | <b>5,116</b>      |
| Operating expenses                   | 15,221                            | (180)             | 15,041            |
| <b>Loss from operations</b>          | <b>(4,632)</b>                    | <b>(5,293)</b>    | <b>(9,925)</b>    |
| Interest income, net                 | 251                               | —                 | 251               |
| <b>Loss before income taxes</b>      | <b>(4,381)</b>                    | <b>(5,293)</b>    | <b>(9,674)</b>    |
| Provision for income taxes           | —                                 | 33                | 33                |
| <b>Net loss</b>                      | <b>\$ (4,381)</b>                 | <b>\$ (5,326)</b> | <b>\$ (9,707)</b> |
| Basic and diluted net loss per share | \$ (0.02)                         | \$ (0.03)         | \$ (0.05)         |

### **(3) Summary of Significant Accounting Policies**

The accompanying consolidated financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying condensed consolidated financial statements and notes.

#### ***(a) Basis of Presentation and Principles of Consolidation***

The accompanying unaudited condensed consolidated financial statements have been prepared by Sonus and reflect all adjustments, consisting only of normal recurring adjustments that in the opinion of management are necessary for a fair statement of the results for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), and omit or condense certain information and footnote disclosures pursuant to existing SEC rules and regulations. Results for the interim periods are not necessarily indicative of results to be expected for any other interim period or for the entire fiscal year. These statements should be read in conjunction with the consolidated financial statements and related notes included in Sonus' Annual Report on Form 10-K/A for the year ended December 31, 2003 filed with the SEC.

The accompanying condensed consolidated financial statements include the accounts of Sonus and its wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated.

#### ***(b) Use of Estimates and Judgments***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates relied upon in preparing these financial statements include revenue recognition for multiple element arrangements, allowances for doubtful accounts, estimated fair value of investments, including whether any decline in such fair value is other-than-temporary, expected future cash flows used to evaluate the recoverability of long-lived assets, estimated fair values of long-lived assets used to record impairment charges related to intangible assets and goodwill, restructuring and other related charges, contingencies associated with revenue contracts, contingent liabilities, and recoverability of Sonus' net deferred tax assets and related valuation allowance. Although Sonus regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. Sonus bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results may differ from Sonus' estimates if past experience or other assumptions do not turn out to be substantially accurate.

#### ***(c) Cash Equivalents and Marketable Securities***

Cash equivalents are stated at cost plus accrued interest, which approximates market value, and have maturities of three months or less at the date of purchase.

Marketable securities are classified as held-to-maturity, as Sonus has the intent and ability to hold to maturity. Marketable securities are reported at amortized cost. Cash equivalents and marketable securities are invested in high-quality credit instruments, primarily U.S. Government obligations. There have been no material gains or losses to date.

**(d) Concentrations of Credit and Off-Balance Sheet Risk, Significant Customers and Limited Suppliers**

The financial instruments that potentially subject Sonus to concentrations of credit risk are cash, cash equivalents, marketable securities, accounts receivable and long-term investments. Sonus has no off-balance sheet concentrations such as foreign exchange contracts, options contracts or other foreign hedging arrangements. Sonus' cash and cash equivalent holdings are diversified among four financial institutions.

For the three months ended March 31, 2004 and 2003, three and two customers each contributed more than 10% of Sonus' revenues, representing an aggregate of 67% and 40% of total revenues. The following customers contributed 10% or more of Sonus' revenues in the three months ended March 31, 2004 and 2003:

| Customer                       | Three Months Ended March 31, |      |
|--------------------------------|------------------------------|------|
|                                | 2004                         | 2003 |
| Qwest Communications           | 11%                          | *%   |
| Softbank BB                    | 26                           | —    |
| Verizon Global Networks        | 30                           | —    |
| Global Crossing                | *                            | 29   |
| Nissho Electronics Corporation | *                            | 11   |

\* Less than 10%.

As of March 31, 2004 and 2003, three customers each accounted for more than 10% of Sonus' accounts receivable balance. Sonus performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. Sonus maintains allowances for potential credit losses and such losses have been within management's expectations.

International revenues, primarily from Asia and Europe, were 29% and 26% of revenues for the quarters ended March 31, 2004 and 2003.

Certain components and software licenses from third parties used in Sonus' products are procured from a single source. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby materially adversely affect Sonus' revenues and operating results.

**(e) Accounts Receivable**

Accounts receivable consist of the following, in thousands:

|                                 | March 31,<br>2004 | December 31,<br>2003 |
|---------------------------------|-------------------|----------------------|
| Earned accounts receivable      | \$ 11,269         | \$ 11,326            |
| Unearned accounts receivable    | 21,200            | 12,713               |
| Accounts receivable, gross      | 32,469            | 24,039               |
| Allowance for doubtful accounts | (407)             | (285)                |
| Accounts receivable, net        | \$ 32,062         | \$ 23,754            |

Unearned accounts receivable represent products shipped to customers where Sonus has a contractual right to bill the customer and collectibility is probable prior to satisfying Sonus' revenue



recognition criteria. The allowance for doubtful accounts is based on Sonus' detailed assessment of the collectibility of specific customer accounts.

**(f) Inventory**

Inventory consists of the following, in thousands:

|   | <u>March 31,<br/>2004</u> | <u>December 31,<br/>2003</u> |
|---|---------------------------|------------------------------|
| On-hand final assemblies and finished goods inventory | \$ 12,546                 | \$ 11,366                    |
| Unearned inventory                                    | 9,225                     | 10,173                       |
| Evaluation inventory                                  | 6,014                     | 6,014                        |
|   | <u>27,785</u>             | <u>27,553</u>                |
| Inventory, gross                                      | 27,785                    | 27,553                       |
| Excess, obsolete and evaluation reserve               | (12,493)                  | (13,814)                     |
|   | <u>15,292</u>             | <u>13,739</u>                |
| Inventory, net  | \$ 15,292                 | \$ 13,739                    |

Unearned inventory represents deferred cost of revenues prior to satisfaction of Sonus' revenue recognition criteria.

Sonus provides for inventory obsolescence reserves based on excess and obsolete inventories determined primarily by future demand forecasts and records changes to such reserves through adjustments to cost of revenues. Sonus records a full inventory reserve for evaluation equipment at the time of shipment to its customers as a charge to sales and marketing expense.

**(g) Property and Equipment**

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life of the related assets, which range from three to five years. Leasehold improvements are amortized over the lesser of the life of the lease or five years. When an item is sold or retired, the cost and related accumulated depreciation is relieved, and the resulting gain or loss, if any, is recognized in the statement of operations.

**(h) Purchased Intangible Assets**

Purchased intangible assets of \$1,802,000 as of March 31, 2004 are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets. Sonus expects that the remaining amount of purchased intangible assets will be fully amortized by December 2004.

**(i) Other Assets**

Other assets are deposits for leased facilities.

**(j) Deferred Revenue**

Deferred revenue consists of the following, in thousands:

|                                   | March 31,<br>2004 | December 31,<br>2003 |
|-----------------------------------|-------------------|----------------------|
| Maintenance and support contracts | \$ 47,167         | \$ 39,104            |
| Customer deposits                 | 26,393            | 35,183               |
| Unearned revenue                  | 21,200            | 12,713               |
|                                   | -----             | -----                |
| Total deferred revenue            | 94,760            | 87,000               |
| Less current portion              | (65,242)          | (62,698)             |
|                                   | -----             | -----                |
|                                   | \$ 29,518         | \$ 24,302            |
|                                   | -----             | -----                |

Maintenance and support contracts are recognized ratably over the life of the service contract. Customer deposits represent payments received in advance of revenue recognition. Unearned revenue represents billings for which payment has not been received and revenue recognition criteria has not been met.

**(k) Revenue Recognition**

Sonus recognizes revenue from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable, unless Sonus has future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which vendor specific objective evidence of fair value (VSOE) does not exist or customer acceptance is required, in which case the revenues and related costs are deferred until those obligations are satisfied or contingencies are resolved.

Many of Sonus' sales are generated from complex contractual arrangements, which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, Sonus allocates the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for one of the delivered elements in the arrangement. Sonus then recognizes revenue on each element in accordance with its policies for product and service revenue recognition. Sonus determines VSOE based upon the price charged when the same element is sold separately. If Sonus cannot establish VSOE for each undelivered element, it defers the entire contract revenues until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, Sonus defers all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. In determining whether a specified upgrade right exists, Sonus has concluded that if the specified upgrade is included in the customer contract or otherwise becomes part of the arrangement with the customer, then a specified upgrade right exists. Sonus has concluded that communications with customers in the normal course of business regarding customer feature requests and Sonus' product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when bundled with the product fees. Maintenance and support services include telephone support

and unspecified rights to product upgrades and enhancements. These services are typically sold for a one-year term and either are sold as part of a multiple element arrangement with products or are sold independently at time of renewal. Maintenance and support VSOE represents a consistent percentage of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance VSOE and Sonus' ability to recognize revenue using the residual method.

Installation service revenues are typically recognized at the time of the related product revenue recognition as installation is typically complete by the time of product revenue recognition. Professional services are recognized as the services are performed.

Sonus sells the majority of its products directly to end-users. For products sold through resellers and distributors, Sonus recognizes revenue on a sell-through method utilizing information provided to Sonus from its resellers and distributors.

Product shipped to customers and related services where amounts are (1) billed pursuant to a contractual right and collection is probable, or (2) collected prior to satisfying the revenue recognition criteria are reflected as deferred revenues. Deferred revenues also include customer deposits and amounts associated with maintenance contracts, which are recognized on a straight-line basis over the related service periods, and free or discounted products and services not yet provided to customers. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long-term deferred revenues.

Sonus defers any incremental direct costs, such as inventory, royalties, commissions and third-party installation costs, incurred prior to satisfaction of its revenue recognition criteria and records them in proportion to revenue recognized.

#### ***(l) Software Development Costs***

Sonus accounts for its software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed*. Accordingly, the costs for the development of new software and substantial enhancements to existing software are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. Sonus has determined that technological feasibility is established at the time a working model of the software is completed. Because Sonus believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date. See Note 3(s) for a discussion of Sonus' warranty reserve policy.

#### ***(m) Stock-based Compensation***

In October 1995, the Financial Accounting Standards Board (FASB) issued SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123 provides that companies may account for stock-based compensation under either the fair value-based method of accounting under SFAS No. 123 or the intrinsic value-based method provided by Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*. Sonus uses the intrinsic value-based method of APB No. 25 to account for all of its employee stock-based compensation plans and uses the fair value method of SFAS No. 123 to account for all non-employee stock-based compensation. Sonus follows FASB Interpretation (FIN) No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* and amortizes the intrinsic value for all awards as measured under APB No. 25 on an accelerated basis. SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and*

*Disclosure—an amendment of FASB Statement No. 123*, requires companies following APB No. 25 to make pro forma disclosure in the notes to the financial statements using the measurement provisions of SFAS No. 123.

Sonus has computed the pro forma disclosures required under SFAS No. 123 for stock options granted to employees and shares purchased under the 2000 Employee Stock Purchase Plan (ESPP) using the Black Scholes option-pricing model. In valuing the stock options granted, Sonus used an assumed risk-free interest rate of 3% for both the three months ended March 31, 2004 and 2003, volatility of 128% and 137% for the three months ended March 31, 2004 and 2003, respectively and an expected life of five years for both the three months ended March 31, 2004 and 2003, with the assumption that dividends will not be paid. In valuing the ESPP, Sonus used an assumed risk-free interest rate of 1.0%–3.0% for the three months ended March 31, 2004 and 1.2%–4.7% for the three months ended March 31, 2003, volatility of 26%–150% for the three months ended March 31, 2004, and 137%–150% for the three months ended March 31, 2003, and an expected life ranging from six months to two years, with the assumption that dividends will not be paid. The pro forma information is as follows:

|   | Three Months Ended<br>March 31, |                     |
|---|---------------------------------|---------------------|
|   | 2004                            | 2003<br>as restated |
| <b>Net income (loss)—</b>   |                                 |                     |
| As reported   | \$ 3,014                        | \$ (9,707)          |
| Plus: Employee stock-based compensation expense included in net income (loss) under intrinsic value method related to options | 342                             | 817                 |
| Less: Employee stock-based compensation under fair value method   | (11,670)                        | (9,750)             |
| Pro forma   | \$ (8,314)                      | \$ (18,640)         |
| <b>Basic and diluted net income (loss) per share—</b>   |                                 |                     |
| As reported   | \$ 0.01                         | \$ (0.05)           |
| Pro forma   | (0.03)                          | (0.09)              |

**(n) Comprehensive Income (Loss)**

Sonus applies SFAS No. 130, *Reporting Comprehensive Income*. The comprehensive income (loss) for the three months ended March 31, 2004 and 2003 does not differ from the reported net income (loss).

**(o) Fair Value of Financial Instruments**

The carrying amounts of Sonus' financial instruments, which include cash equivalents, marketable securities, long-term investments, accounts payable, long-term liabilities and the convertible subordinated note, approximate their fair value.

**(p) Disclosures about Segments of an Enterprise**

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, established standards for reporting information regarding operating segments and established standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for

evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, the chief operating decision maker has made such decisions and assessed performance at the company level.

**(q) Net Income (Loss) Per Share**

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of unrestricted common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of unrestricted common stock and dilutive potential common shares outstanding based on the average market price of Sonus' common stock (under the treasury stock method). Dilutive potential common shares consist of restricted common stock and common stock issuable upon the exercise of stock options and conversion of a convertible subordinated note.

The following table sets forth the computation of shares used in calculating the net income (loss) per share, in thousands:

|  | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2004                            | 2003    |
| Weighted average common shares outstanding                 | 245,465                         | 204,953 |
| Less weighted average restricted common shares outstanding | (858)                           | (6,250) |
| Shares used in basic per share calculation                 | 244,607                         | 198,703 |
| Add effect of dilutive potential common shares             | 10,985                          | —       |
| Shares used in dilutive per share calculation              | 255,592                         | 198,703 |

Excluded from the shares used in the calculations above are options to purchase shares of common stock and shares of common stock issuable upon conversion of a convertible subordinated note representing an aggregate of 2,709,290 and 10,725,125 shares (as restated) as of March 31, 2004 and 2003, as their effects would have been anti-dilutive.

**(r) Recent Accounting Pronouncements**

In November 2002, the FASB issued Interpretation No. (FIN) 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The FIN 45 disclosure requirements are included in Note 5. The adoption of FIN 45 did not have a material impact on Sonus' financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* and, in December 2003, issued a revision to that interpretation. FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or

(b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. Sonus currently does not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have any impact on Sonus' overall financial position or results of operations.

In August 2003, the EITF reached a consensus on Issue No. 03-05, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*. EITF Issue No. 03-05 addresses the applicability of SOP 97-2 to non-software deliverables in an arrangement containing more-than-incidental software. In an arrangement that includes software that is more-than-incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. Software-related elements include software products and services, as well as any non-software deliverables for which a software deliverable is essential to its functionality. The adoption of this statement did not have a material impact on Sonus' consolidated financial statements.

In December 2003, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*, which supersedes SAB No. 101, *Revenue Recognition in Financial Statements*. SAB No. 104's primary purpose is to rescind the accounting guidance contained in SAB No. 101 related to multiple-element revenue arrangements that was superseded as a result of the issuance of EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. Additionally, SAB No. 104 rescinds the SEC's related *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* issued with SAB No. 101 that had been codified in SEC Topic 13, *Revenue Recognition*. While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104, which was effective upon issuance. Sonus adopted the provisions of SAB No. 104 in the fourth quarter of 2003. Sonus' adoption of SAB No. 104 did not have a material effect on its financial position or results of operations.

**(s) Warranty Reserve.**

Sonus's products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty-type provisions for epidemic or similar product failures generally for the contractual period or the life of the product in accordance with published telecommunications standards. Sonus' customers typically purchase maintenance and support contracts, which encompass our warranty obligations. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such provisions. Sonus' warranty reserve reflects estimated material and labor costs for potential or actual product issues in its installed base that are not covered under Sonus' maintenance contracts but for which Sonus expects to incur an obligation. Our estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of Sonus' customer contracts include provisions under which Sonus may be obligated to pay penalties generally for the contractual period or for the life of the product if its products fail or do not perform in accordance with specifications. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such provisions. Sonus periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. While Sonus believe its warranty reserve is adequate to address known warranty issues, an increase in product failures rates, material usage or service delivery costs may result in an increase to Sonus' warranty reserve and its gross profit could be adversely affected.

#### (4) Restructuring Charges

Commencing in the third quarter of fiscal 2001 and extending through fiscal 2002, in response to unfavorable business conditions primarily caused by significant declines in capital spending by telecommunications service providers, Sonus implemented restructuring plans designed to reduce expenses and align its cost structure with its revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write-off of excess inventory and purchase commitments.

##### 2002 Restructuring Accrual

The following table summarizes the activity during the three months ended March 31, 2004 relating to Sonus' accrual for fiscal 2002 restructuring actions, in thousands:

|                                   | Dec. 31, 2003<br>Accrual Balance | Cash<br>Payments | Mar. 31, 2004<br>Accrual Balance | Current<br>Portion | Long-term<br>Portion |
|-----------------------------------|----------------------------------|------------------|----------------------------------|--------------------|----------------------|
| Consolidation of facilities       | \$ 1,143                         | \$ (174)         | \$ 969                           | \$ 215             | \$ 754               |
| Write-off of purchase commitments | 40                               | (40)             | —                                | —                  | —                    |
| <b>Total</b>                      | <b>\$ 1,183</b>                  | <b>\$ (214)</b>  | <b>\$ 969</b>                    | <b>\$ 215</b>      | <b>\$ 754</b>        |

The remaining cash expenditures relating to the consolidation of excess facilities are expected to be paid through 2008.

##### 2001 Restructuring Accrual

The following table summarizes the activity during the three months ended March 31, 2004 relating to Sonus' accrual for fiscal 2001 restructuring actions, in thousands:

|   | Dec. 31, 2003<br>Accrual Balance | Cash<br>Payments | Mar. 31, 2004<br>Accrual Balance | Current<br>Portion | Long-term<br>Portion |
|---|----------------------------------|------------------|----------------------------------|--------------------|----------------------|
| Consolidation of facilities and other charges | \$ 181                           | \$ (111)         | \$ 70                            | \$ 70              | \$ —                 |

Remaining cash expenditures relating to the consolidation of excess facilities and other charges are expected to be paid through the second quarter of fiscal 2004.

## (5) Warranty Reserve

The following table summarizes the activity related to product warranty reserve, included in accrued expenses, during the three months ended March 31, 2004, in thousands:

|                               |    |       |
|-------------------------------|----|-------|
| Balance at December 31, 2003  | \$ | 2,500 |
| Charges to costs and expenses |    | 41    |
| Deductions                    |    | (163) |
| Balance at March 31, 2004     | \$ | 2,378 |

## (6) Long-term Liabilities

Long-term liabilities consist of capital leases and restructuring expenses (Note 4). Sonus assumed certain capital leases as part of the acquisition of TTI. The capital leases are due in monthly installments expiring at various dates through March 2005 and accrue interest at annual rates ranging from 4.8% to 10.3%. The future minimum annual payments under capital leases and amounts due for long-term liabilities, as of March 31, 2004, are as follows, in thousands:

|  |    |            |
|--|----|------------|
| <b>Capital Leases:</b>                             |    |            |
| 2004 obligations (nine months)                     | \$ | 128        |
| 2005 obligations                                   |    | 30         |
| Total minimum lease payments                       |    | 158        |
| Less amount representing interest                  |    | (5)        |
| Present value of minimum payments                  |    | 153        |
| <b>Long-term portion of restructuring expenses</b> |    | <b>754</b> |
| Total long-term liabilities                        |    | 907        |
| Less current portion                               |    | (153)      |
| Total long-term liabilities                        | \$ | 754        |

The future principal payments on long-term liabilities, excluding the capital leases, as of March 31, 2004 are \$142,000 in 2005; \$195,000 in 2006; \$204,000 in 2007; and \$213,000 in 2008.

## (7) Bank Agreement

In January 2002, Sonus established a \$10,000,000 equipment line of credit and a \$20,000,000 working capital line of credit with a bank at the bank's prime rate. As of March 31, 2004, Sonus had paid off the outstanding balance under the equipment line of credit and did not renew either the equipment line of credit or the working capital line of credit.

## (8) Convertible Subordinated Note

In May 2001, Sonus completed a private placement of an aggregate principal amount of \$10,000,000 of 4.75% convertible subordinated notes, due May 1, 2006, with a customer. Interest payments are due semi-annually on May 1 and November 1 of each year through May 2006. The notes may be converted by the holder into shares of Sonus' common stock at any time before their maturity or prior to their redemption or repurchase by Sonus. The conversion rate is 33.314 shares per each



\$1,000 principal amount of notes, subject to adjustment in certain circumstances. As of May 1, 2004, Sonus has the option to redeem all or a portion of the notes at 100% of the principal amount. Also, at any time if the market price of Sonus' common stock exceeds \$60.04 per share for twenty trading days in any thirty trading-day period, Sonus may redeem these notes through the issuance of shares of common stock or for cash. In the event of a change of control in Sonus, the holder at its option may require Sonus to redeem the notes through the issuance of common stock or cash. Interest expense related to Sonus' convertible subordinated notes was \$119,000 for both the three months ended March 31, 2004 and 2003.

## **(9) Commitments and Contingencies**

### ***(a) Leases***

Sonus leases its facilities under operating leases, which expire through December 2008. Sonus is responsible for certain real estate taxes, utilities and maintenance costs under these leases. The future minimum payments under operating lease arrangements as of March 31, 2004 are as follows: \$1,001,000 in 2004 (nine months); \$1,068,000 in 2005; \$876,000 in 2006; \$261,000 in 2007; and \$213,000 in 2008.

### ***(b) Pending Litigation and Claims***

In November 2001, a purchaser of Sonus' common stock filed a complaint in the federal district court for the Southern District of New York against Sonus, two of its officers and the lead underwriters alleging violations of the federal securities laws in connection with Sonus' initial public offering (IPO) and seeking unspecified monetary damages. The purchaser seeks to represent a class of persons who purchased Sonus' common stock between the IPO on May 24, 2000 and December 6, 2000. An amended complaint was filed in April 2002. The amended complaint alleges that Sonus' registration statement contained false or misleading information or omitted to state material facts concerning the alleged receipt of undisclosed compensation by the underwriters and the existence of undisclosed arrangements between underwriters and certain purchasers to make additional purchases in the after market. The claims against Sonus are asserted under Section 10(b) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933 and against the individual defendants under Sections 11 and 15 of the Securities Act. Other plaintiffs have filed substantially similar class action cases against approximately 300 other publicly traded companies and their IPO underwriters which, along with the actions against Sonus, have been transferred to a single federal judge for purposes of coordinated case management. On July 15, 2002, Sonus, together with the other issuers named as defendants in these coordinated proceedings, filed a collective motion to dismiss the consolidated amended complaints on various legal grounds common to all or most of the issuer defendants. The plaintiffs voluntarily dismissed the claims against the individual defendants, including those Sonus officers named in the complaint. On February 19, 2003, the court granted a portion of the motion to dismiss by dismissing the Section 10(b) claims against certain defendants including Sonus, but denied the remainder of the motion as to the defendants. Accordingly, the case proceeded against Sonus on the Section 11 claims. In June 2003, a special committee of Sonus' Board of Directors authorized Sonus to enter into a proposed settlement with the plaintiffs on terms substantially consistent with the terms of a Memorandum of Understanding negotiated among representatives of the plaintiffs, the issuer defendants and the insurers for the issuer defendants. The settlement contemplated by the Memorandum of Understanding is subject to a number of conditions including approval by the court. It remains uncertain whether and when the conditions will be met and the settlement will become final.

Sonus does not expect that the settlement contemplated by the Memorandum of Understanding would have a material impact on Sonus' business or financial results.

Beginning in July 2002, several purchasers of Sonus' common stock filed complaints in federal district court for the District of Massachusetts against Sonus, certain officers and directors and a former officer under Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 (Class Action Complaints). The purchasers seek to represent a class of persons who purchased Sonus' common stock between December 11, 2000 and January 16, 2002, and seek unspecified monetary damages. The Class Action Complaints were essentially identical and alleged that Sonus made false and misleading statements about its products and business. On March 3, 2003, the plaintiffs filed a Consolidated Amended Complaint. On April 22, 2003, Sonus filed a motion to dismiss the Consolidated Amended Complaint on various grounds. On May 11, 2004, the court held oral argument on the motion, at the conclusion of which the court denied Sonus' motion to dismiss. The case is proceeding to class certification and discovery. Sonus believes the claims in the Consolidated Amended Complaint are without merit and that it has substantial legal and factual defenses, which it intends to pursue vigorously. There is no assurance Sonus will prevail in defending these actions.

Beginning in February 2004, a number of purported shareholder class action complaints were filed in the United States District Court for the District of Massachusetts against Sonus and certain of its current officers and directors. The complaints assert claims under the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, relating to Sonus' announcement that it had identified issues, practices and actions of certain employees relating to both the timing of revenue recognized from certain customer transactions and other financial statement accounts, which could affect its 2003 financial statement accounts and possibly financial statements for prior periods. Specifically, these actions allege that Sonus issued a series of false or misleading statements to the market during the class period that failed to disclose that (i) Sonus had materially overstated its revenue by improperly recognizing revenue on certain customer contracts; (ii) Sonus lacked adequate internal controls and was therefore unable to ascertain its true financial condition; and (iii) as a result of the foregoing, Sonus' financial statements issued during the class period were materially false and misleading. Plaintiffs contend that such statements caused Sonus' stock price to be artificially inflated. The complaints seek unspecified damages on behalf of a purported class of purchasers of Sonus' common stock during the period from April 9, 2003, June 3, 2003 or June 5, 2003 through February 11, 2004. On June 28, 2004, the court consolidated the claims. Sonus believes that it has substantial legal and factual defenses to the claims, which it intends to pursue vigorously. There is no assurance Sonus will prevail in defending these actions.

In February 2004, two purported shareholder derivative lawsuits were filed in the United States District Court for the District of Massachusetts against Sonus and certain of its officers and directors, naming Sonus as a nominal defendant. Also in February 2004, two purported shareholder derivative lawsuits were filed in the business litigation session of the superior court of Suffolk County of Massachusetts against Sonus and certain of its directors and officers, also naming Sonus as a nominal defendant. The suits claim that certain of Sonus' officers and directors breached their fiduciary duties to Sonus' stockholders and to the company. The complaints are derivative in nature and do not seek relief from Sonus. However, Sonus has entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors and may be obligated throughout the pendency of these actions to advance payment of legal fees and costs incurred by the defendants pursuant to Sonus' obligations under the indemnification agreements and/or applicable Delaware law. Sonus filed a motion to dismiss the state court cases and a motion to stay the federal action pending

the outcome of the motion to dismiss in state court. On June 11, 2004, the state court held oral argument on the motion and took the matter under advisement. Discovery has been stayed pending the outcome of the motion to dismiss. Sonus believes that it has substantial legal and factual defenses to the claims, which it intends to pursue vigorously. There is no assurance Sonus will prevail in defending these actions.

In June 2004, Sonus received a formal order of private investigation from the SEC. Sonus is cooperating with the investigation. There can be no assurance as to the outcome of the SEC investigation. Sonus may incur substantial costs in connection with the investigation including fines and significant legal expenses.

Sonus has been contacted by third parties, who claim that Sonus' products infringe on certain intellectual property of the third party. Sonus evaluates these claims and accrues for royalties when the amounts are probable and reasonably estimable. While Sonus believes that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.

## **(10) Stockholders' Equity**

### ***(a) Public Offerings***

In September 2003, Sonus completed a public offering of 17,000,000 shares of its common stock at \$7.75 per share, resulting in net proceeds of \$126,088,000 after deducting offering costs of \$5,662,000.

In April 2003, Sonus completed a public offering of 20,000,000 shares of its common stock at \$3.05 per share, resulting in net proceeds of \$56,730,000 after deducting offering costs of \$4,270,000.

### ***(b) 1997 Stock Incentive Plan***

On January 1 of each year, the aggregate number of shares of common stock available for issuance under the 1997 Stock Incentive Plan (Plan) shall increase by the lesser of (i) 5% of the outstanding shares on December 31 of the preceding year or (ii) an amount determined by the Board of Directors. As of March 31, 2004, 122,854,120 shares were authorized and 47,080,485 shares were available under the Plan for future issuance.

On October 16, 2002, Sonus commenced an offer to exchange (Exchange Offer) outstanding employee stock options granted under the Plan having an exercise price of \$0.67 or more per share for new stock options to be granted by Sonus. Outstanding options granted under the TTI Amended and Restated 1998 Equity Incentive Plan were not eligible for exchange. Also, Sonus' directors, executive officers and non-employees were not eligible to participate in the exchange. On November 22, 2002, the Exchange Offer expired. Outstanding options to purchase 8,973,160 shares of common stock were accepted for exchange and cancelled. On May 27, 2003, employees received an option to purchase one share of common stock for each share of common stock under the exchanged options. The new options were granted at an exercise price of \$4.08 per share, which represented the fair market value of Sonus' common stock on the date of grant.

### ***(c) 2000 Employee Stock Purchase Plan***

On January 1 of each year, the aggregate number of shares of common stock available for purchase under the 2000 Employee Stock Purchase Plan (ESPP) shall increase by the lesser of (i) 2%

of the outstanding shares on December 31 of the preceding year or (ii) an amount determined by the Board of Directors. As of March 31, 2004, 20,341,626 shares were authorized and 16,361,646 shares were available under the ESPP for future issuance.

***(d) Stock-based Compensation***

Stock-based compensation expenses include the amortization of deferred employee compensation and other equity related expenses.

In connection with certain employee stock option grants including grants related to the TTI acquisition and the issuance of employee restricted common stock between 1999 and 2001, Sonus recorded deferred stock-based compensation. This represents the aggregate difference between the exercise price or purchase price and the fair value of the common stock on the date of grant or sale for accounting purposes. The deferred compensation is recognized as an expense over the vesting period of the underlying stock options and restricted common stock based on the accelerated method prescribed by FIN 28.

Sonus recorded stock-based compensation of \$379,000 and \$924,000 for the three months ended March 31, 2004 and 2003. As of March 31, 2004, Sonus expects to record approximately \$275,000 in employee stock-based compensation expense for the remainder of fiscal 2004, which represents the remaining balance of deferred compensation as of March 31, 2004.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which are subject to a number of risks and uncertainties. These forward-looking statements are based on our current expectations, assumptions, estimates and projections about our industry and ourselves, and we do not undertake an obligation to update our forward-looking statements to reflect future events or circumstances. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including the factors set forth in "Cautionary Statements" in this Quarterly Report on Form 10-Q. This discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes for the periods specified. Further reference should be made to our Annual Report on Form 10-K/A for the year ended December 31, 2003 on file with the SEC.*

### Overview

We are a leading supplier of packet voice infrastructure solutions for wireline and wireless service providers. Our products are a new generation of carrier-class switching equipment and software that enable voice services to be delivered over packet-based networks.

We began shipping product to customers during the fourth quarter of fiscal 1999 and recorded our first revenues of \$51.8 million in fiscal 2000 and revenues of \$128.8 million in fiscal 2001, \$93.9 million in fiscal 2002 and \$93.2 million in fiscal 2003. Significant declines in capital spending by telecommunications service providers, and financial difficulties, including in some cases bankruptcies, experienced by certain emerging service providers, including some of our customers, caused the reduction in our revenues in 2002. In response to the unfavorable economic conditions, commencing in the third quarter of fiscal 2001 and continuing through fiscal 2002, we implemented restructuring plans designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write-off of excess inventory and purchase commitments. In 2003, the challenging business environment in the telecommunications industry continued to affect the spending by service providers for products such as those we offer.

In the second half of 2003 and continuing into 2004, there has been a trend towards increased interest and activity in the market for packet-based voice infrastructure products. While it remains uncertain as to the speed and extent of the adoption of carrier packet voice infrastructure products by large carriers, we believe that over time the market opportunity for packet voice solutions is substantial. For the quarter ended March 31, 2004, revenues were \$36.5 million and total deferred revenues increased to \$94.8 million as of March 31, 2004 reflecting continuing improvements in the market for packet-based voice infrastructure products.

We sell our products primarily through a direct sales force and, in some markets, through resellers and distributors. Customers' decisions to purchase our products to deploy in commercial networks involve a significant commitment of resources and a lengthy evaluation, testing and product qualification process. We believe these long sales cycles, our expectation that customers will tend to sporadically place large orders with short lead times and the application of complex revenue recognition rules to certain transactions may cause our revenues and results of operations to vary significantly and unexpectedly from quarter to quarter. We expect to recognize revenues from a limited number of customers for the foreseeable future.

Since our inception, we have incurred significant losses and, as of March 31, 2004, had an accumulated deficit of \$805.5 million. Although we achieved a quarterly profit in the first quarter of fiscal 2004, we have not achieved profitability on an annual basis and may incur additional net losses in future quarters and years. We have a lengthy sales cycle for our products and, accordingly, we expect to incur sales and other expenses before we realize the related revenues. We expect to continue to incur

significant sales and marketing, research and development and general and administrative expenses and, as a result, we will need to generate significant revenues to maintain profitability.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements and related disclosures requires management to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Management bases its estimates and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. On an on-going basis, we re-evaluate our estimates for changes in facts and circumstances, and material changes in these estimates could occur in the future if past experience or other assumptions do not turn out to be substantially accurate. Changes in estimates are recorded in the period in which they become known.

A summary of those accounting policies, significant judgments and estimates that we believe are most critical to fully understanding and evaluating our financial results is set forth below. This summary should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report.

**Revenue Recognition.** We recognize revenues from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable, unless we have future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which vendor specific objective evidence of fair value (VSOE) does not exist or customer acceptance is required, in which case the revenues and related costs are deferred until those obligations are satisfied or contingencies are resolved.

Many of our sales are generated from complex contractual arrangements, which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, we allocate the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for one of the delivered elements in the arrangement. We then recognize revenues on each element in accordance with our policies for product and service revenue recognition. We determine VSOE based upon the price charged when the same element is sold separately. If we cannot establish VSOE for each undelivered element, we defer the entire contract revenues until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, we defer all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. In determining whether a specified upgrade right exists, we have concluded that if the specified upgrade is included in the customer contract or otherwise becomes part of the arrangement with the customer, then a specified upgrade right exists. We have concluded that communications with customers in the normal course of business regarding customer feature requests and our product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when bundled with the product fees. Maintenance and support services include telephone support and unspecified rights to product upgrades and enhancements. These services are typically sold for a one-year term and either are sold as part of a multiple element arrangement with products or are sold independently at time of renewal. Maintenance and support VSOE represents a consistent percentage

of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance VSOE and our ability to recognize revenue using the residual method.

Installation service revenues are typically recognized at the time of the related product revenue recognition as installation is typically complete by the time of product revenue recognition. Professional services are recognized as the services are performed.

We sell the majority of our products directly to end-users. For products sold through resellers and distributors we recognize revenues on a sell-through method utilizing information provided to us from our resellers and distributors.

Product shipped to customers and related services where amounts are (1) billed pursuant to a contractual right and collection is probable, or (2) collected prior to satisfying the revenue recognition criteria are reflected as deferred revenues. Deferred revenues also include customer deposits and amounts associated with maintenance contracts, which are recognized on a straight-line basis over the related service periods, and free or discounted products and services not yet provided to customers. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long-term deferred revenues.

We defer any incremental direct costs, such as inventory, royalties, commissions and third-party installation costs, incurred prior to satisfaction of revenue recognition criteria and record them in proportion to revenue recognized.

**Loss Contingencies.** We are subject to ongoing business risks that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies, arising in the ordinary course of business. Under SFAS No. 5, an estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such amounts should be adjusted. Based on our analysis, we have established the following allowance and reserves:

**Allowance for Doubtful Accounts.** We establish billing terms at the time we negotiate purchase agreements with our customers. We continually monitor timely payments and assess any collection issues. The allowance for doubtful accounts is based on our detailed assessment of the collectibility of specific customer accounts. While we believe that our allowance for doubtful accounts is adequate and that the judgment applied is appropriate, if there is a deterioration of a customer's creditworthiness or actual defaults are higher than our historical experience, the actual results could differ from these estimates. While such credit losses have historically been within our expectations and the allowances we established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances may be required. Our failure to accurately estimate the losses for doubtful accounts and ensure that payments are received on a timely basis could have a material adverse effect on our business, financial condition and results of operations.

**Inventory Reserves.** Inventory purchases and commitments are based upon estimated future demand for our products. We value inventory at the lower of cost or net realizable value and provide inventory reserves based on excess and obsolete inventory determined primarily by future demand forecasts and record changes to such reserves through adjustments to cost of revenues. We assess such demand forecasts on at least a quarterly basis. If we record a charge to reduce inventory to its estimated net realizable value, we cannot increase its carrying value due to subsequent changes in demand forecasts. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, we may realize improved gross profit margins on those transactions.

We also record a full inventory reserve for evaluation equipment at the time of shipment to our customers as a charge to sales and marketing expense as our experience with this type of inventory indicates it is probable that the inventory will not be realizable. If these evaluation shipments should convert to revenue, we record a benefit to sales and marketing expenses and record the full cost of revenues in the period of revenue recognition.

We have experienced significant changes in our product demand and, as a result, our required inventory reserves have fluctuated in recent periods. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a sudden and significant change in the demand for our products, changes in the amount of customer evaluation inventory or higher risks of inventory obsolescence because of rapidly changing technology.

**Warranty Reserve.** Our products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty-type provisions for epidemic or similar product failures generally for the contractual period or the life of the product in accordance with published telecommunications standards. Our customers typically purchase maintenance and support contracts, which encompass our warranty obligations. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such provisions. Our warranty reserve reflects estimated material and labor costs for potential or actual product issues in our installed base that are not covered under our maintenance contracts but for which we expect to incur an obligation. Our estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of our customer contracts include provisions under which we may be obligated to pay penalties generally for the contractual period or for the life of the product if our products fail or do not perform in accordance with specifications. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such provisions. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary. While we believe our warranty reserve is adequate to address known warranty issues, an increase in product failures rates, material usage or service delivery costs may result in an increase to our warranty reserve and our gross profit could be adversely affected.

**Royalty Accrual.** We accrue for royalty-related technology we license from vendors based on established royalty rates and usage. In certain cases, we have been contacted by third parties, who claim that our products infringe on certain intellectual property of the third party. We evaluate these claims and accrue for royalties when the amounts are probable and reasonably estimable. While we believe that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.

**Reserve for Litigation and Legal Fees.** We are subject to various legal claims, including securities litigation and intellectual property claims. We reserve for legal contingencies and legal fees when the amounts are probable and reasonably estimable. Our director and officer liability insurance policies provide only limited liability protection relating to the securities class action and derivative lawsuits against us and certain of our officers and directors. We intend to defend these matters vigorously, although the ultimate outcome of these items is uncertain and the potential loss, if any, may be significantly higher or lower than the amounts we have previously accrued.

**Accounting for Income Taxes.** SFAS No. 109, *Accounting for Income Taxes*, requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We evaluate all available evidence, such as recent and expected future operating results by tax jurisdiction, and current and enacted tax legislation and other temporary differences between book and



tax accounting, to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

As a result of net operating losses incurred in most jurisdictions in which we operate in the past, and uncertainty as to the extent, jurisdiction and timing of profitability in future periods, we have continued to record a full valuation allowance against deferred tax assets. The establishment and amount of the valuation allowance requires significant estimates and judgment and can materially affect our results of operations. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the deferred tax assets would increase net income in the period such determination was made. Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss in each jurisdiction, changes to the valuation allowance, changes to federal, state or foreign tax laws, future expansion into areas with varying country, state, and local income tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions.

### Three Months Ended March 31, 2004 and 2003

**Revenues.** Revenues for the three months ended March 31, 2004 and 2003 were as follows, in thousands:

|                  | Three Months Ended<br>March 31, |          |
|------------------|---------------------------------|----------|
|                  | 2004                            | 2003     |
|                  | as restated                     |          |
| <b>Revenues:</b> |                                 |          |
| Product          | \$ 26,245                       | \$ 3,517 |
| Service          | 10,287                          | 5,692    |
| Total revenues   | \$ 36,532                       | \$ 9,209 |

Product revenues comprise sales of our voice infrastructure products, including our GSX9000™ Open Services Switch, Insignus™ Softswitch, Sonus Insight™ Management System and related product offerings. Product revenues for the three months ended March 31, 2004 increased 646% from the same period in fiscal 2003. The higher revenues were the result of an increase in the sale of our voice infrastructure products to telecommunications service providers and a deferral of revenues from the three months ended March 31, 2003 attributable to a significant customer transaction until the final delivery of software in the fourth quarter of 2003.

Service revenues primarily comprise hardware and software maintenance, network design, installation and other professional services. Service revenues for the three months ended March 31, 2004 increased 81% from the same period in fiscal 2003. The increase in service revenues were primarily due to an increase in maintenance revenues as a result of our growing installed customer base.

For the three months ended March 31, 2004 and 2003, three and two customers each contributed more than 10% of our revenues, representing an aggregate of 67% and 40% of total revenues. The following customers contributed 10% or more of our revenues in the three months ended March 31, 2004 and 2003:

| Customer                       | Three Months Ended March<br>31, |      |
|--------------------------------|---------------------------------|------|
|                                | 2004                            | 2003 |
| Qwest Communications           | 11%                             | *%   |
| Softbank BB                    | 26                              | —    |
| Verizon Global Networks        | 30                              | —    |
| Global Crossing                | *                               | 29   |
| Nissho Electronics Corporation | *                               | 11   |

\* Less than 10%.

International revenues, primarily from Asia and Europe, were 29% and 26% of revenues for the three months ended March 31, 2004 and 2003.

**Cost of Revenues/Gross Profit.** Cost of revenues consists primarily of amounts paid to third-party manufacturers for purchased materials and services, manufacturing and professional services personnel and related costs and inventory obsolescence. Cost of revenues and gross profit as a percentage of revenues for the three months ended March 31, 2004 and 2003 were as follows (in thousands, except percentages):

|  | Three Months Ended<br>March 31, |                     |
|--|---------------------------------|---------------------|
|  | 2004                            | 2003<br>as restated |
| <b>Cost of Revenues:</b>                       |                                 |                     |
| Product  | \$ 8,141                        | \$ 1,538            |
| Service  | 4,259                           | 2,555               |
|  | <hr/>                           | <hr/>               |
| Total cost of revenues                         | \$ 12,400                       | \$ 4,093            |
|  | <hr/>                           | <hr/>               |
| <b>Gross profit (% of respective revenues)</b> |                                 |                     |
| Product  | 69%                             | 56%                 |
| Service  | 59                              | 55                  |
| Total gross profit                             | 66                              | 56                  |

The increase in product gross profit as a percentage of product revenues was primarily due to a greater proportion of revenues from higher margin products and, to a lesser extent, a reduction in purchased component costs. The increase in service gross profit as a percentage of service revenues was primarily due to the higher volume of service revenues and a greater mix of higher margin professional and installation services.

Our gross profit as a percentage of total revenues in a particular quarter is highly variable due to many factors such as our revenue volume. Gross profit may also be affected by the following factors: demand for our products and services; new product introductions and enhancements both by us and by our competitors; product service and support costs associated with initial deployment of our products in customers' networks; changes in our pricing policies and those of our competitors; write-off of any excess or obsolete inventory; unfavorable warranty experience; the mix of product configurations sold; geographic mix; the mix of sales channels through which our products and services are sold; the timing of revenue recognition; and the volume of manufacturing and costs of manufacturing and components.

**Research and Development Expenses.** Research and development expenses consist primarily of salaries and related personnel costs and prototype costs related to the design, development, testing and enhancement of our products. Research and development expenses were \$8.9 million for the three months ended March 31, 2004, an increase of \$1.2 million, or 16%, from \$7.7 million for the same period in fiscal 2003. This increase primarily reflects an increase in salaries and related expenses associated with increased headcount and the cessation in April 2003 of a temporary salary reduction imposed in April 2002 and, to a lesser extent, increases in development costs, partially offset by a reduction in depreciation expense associated with fully depreciated assets. Some aspects of our research and development efforts require significant short-term expenditures, the timing of which can cause significant variability in our expenses. We believe that rapid technological innovation is critical to our long-term success and we intend to continue to make substantial investments to enhance our products and technologies to meet the requirements of our customers and market. We believe that our research and development expenses for the second quarter of fiscal 2004 will increase from the first quarter of fiscal 2004 primarily as a result of an increase in salary expense.

**Sales and Marketing Expenses.** Sales and marketing expenses consist primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions, customer evaluations and other marketing expenses. Sales and marketing expenses were \$6.9 million for the three months ended March 31, 2004, an increase of \$2.9 million, or 73%, from \$4.0 million for the same

period in fiscal 2003 due primarily to increases in salaries associated with increased headcount, the cessation in April 2003 of a temporary salary reduction imposed in April 2002 and commissions and, to a lesser extent, increases in costs for travel and entertainment. We believe that our sales and marketing expenses for the second quarter of fiscal 2004 will increase from the first quarter of fiscal 2004 primarily as a result of higher marketing expenditures for trade shows and higher commissions.

**General and Administrative Expenses.** General and administrative expenses consist primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses, allowance for doubtful accounts and professional fees. General and administrative expenses were \$4.8 million for the three months ended March 31, 2004, an increase of \$3.0 million, or 162%, from \$1.8 million for the same period in fiscal 2003. This increase primarily reflects the professional fees incurred as part of our investigation and audit process and, to a lesser extent, increases in salaries and related expenses associated with increased headcount and the cessation in April 2003 of a temporary salary reduction imposed in April 2002. We believe that our general and administrative expenses for the second quarter of fiscal 2004 will increase from the first quarter of fiscal 2004 primarily as a result of additional professional fees incurred as part of our investigation, the SEC investigation and securities class action litigation, and for costs associated with improvements we expect to make in our internal control environment to remedy material weaknesses and to meet the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

**Stock-based Compensation Expenses.** Stock-based compensation expenses include the amortization of stock compensation charges resulting from the granting of stock options, including those telecom technologies, inc. (TTI) stock options assumed by us, stock awards to TTI employees under the 2000 Retention Plan and the sales of restricted common stock. Stock-based compensation expenses were \$379,000 for the three months ended March 31, 2004, a decrease of \$545,000, or 59%, from \$924,000 for the same period in fiscal 2003. The decrease is primarily due to lowered deferred compensation balances resulting from write-offs made in connection with employee terminations and our offer to exchange certain employee stock options and as a result of our policy of accelerating amortization of deferred compensation under FIN 28. As of March 31, 2004, we expect to record approximately \$275,000 in employee stock-based compensation expense for the remainder of fiscal 2004.

On October 16, 2002, we commenced an offer to exchange outstanding employee stock options for new stock options to be granted on a date that is at least six months and one day from the expiration date of the exchange offer. The exchange offer expired on November 22, 2002, and outstanding options to purchase approximately 8,973,000 shares of common stock were accepted for exchange and cancelled. On May 27, 2003, employees received an option to purchase one share of common stock for each share of common stock under the exchanged options at an exercise price of \$4.08 per share, representing the fair market value of our common stock on the date of grant.

**Amortization of Purchased Intangible Assets.** In fiscal 2001, we acquired certain intellectual property and other intangible assets, as well as in-process research and development in connection with our acquisitions of TTI and Linguatq. Amortization of purchased intangible assets was \$600,000 for the three months ended March 31, 2004 as compared to \$602,000 for the same period in fiscal 2003.

**Interest Income, net.** Interest income consists of interest earned on our cash balances and marketable securities. Interest expense consists of interest incurred on convertible subordinated notes, equipment bank debt and capital lease arrangements. Interest income, net of interest expense, was \$643,000 for the three months ended March 31, 2004, as compared to \$251,000 for the same period in fiscal 2003. The increase primarily reflects an increase in our cash and investment balances resulting from the proceeds from our public offerings of common stock in April and September of 2003.

**Income Taxes.** A provision for income taxes in the amount of \$167,000 has been recorded for the three months ended March 31, 2004, which is primarily attributable to foreign income taxes and to state minimum income taxes in the U.S.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### Liquidity and Capital Resources

At March 31, 2004, our principal sources of liquidity were our cash, cash equivalents and marketable securities that totaled \$301.9 million. In September 2003, we completed a public offering of 17,000,000 shares of our common stock at a price of \$7.75 per share resulting in net proceeds of \$126.1 million after deducting offering costs of \$5.7 million. In April 2003, we completed a public offering of 20,000,000 shares of our common stock at a price of \$3.05 per share, resulting in net proceeds of \$56.7 million after deducting offering costs of \$4.3 million.

Our operating activities provided net cash of \$3.3 million for the three months ended March 31, 2004, as compared to net cash used in operating activities of \$10.6 million for the same period in fiscal 2003. The increase in cash provided by operating activities was primarily due to our improved results of operations, which generated \$5.6 million of net income before non-cash expenses of depreciation, amortization and stock-based compensation, and an increase in our deferred revenues of \$7.8 million for the three months ended March 31, 2004, partially offset by an increase in accounts receivable of \$8.3 million and other working capital accounts of \$1.8 million.

Net cash provided by investing activities was \$13.8 million for the three months ended March 31, 2004, as compared to net cash used in investing activities of \$1.1 million for the same period in fiscal 2003. Net cash provided by investing activities for the three months ended March 31, 2004 primarily reflects net maturities of marketable securities and long-term investments of \$15.9 million, partially offset by capital expenditures of \$2.2 million. Net cash used in investing activities for the three months ended March 31, 2003 primarily reflects capital expenditures. We have no current material commitments for capital expenditures but do expect to incur approximately \$7.0 to \$10.0 million in capital expenditures during the next twelve months.

Net cash provided by financing activities was \$1.1 million for the three months ended March 31, 2004, as compared to \$45,000 for the same period in fiscal 2003. The net cash provided by financing activities for the three months ended March 31, 2004 and 2003 primarily resulted from the sale of common stock in connection with our employee stock purchase plan and proceeds from exercise of stock options, partially offset by payments on our long-term obligations.

The following summarizes our future contractual obligations as of March 31, 2004, in thousands:

| Contractual Obligations:    | Payment Due by Period |                     |           |           |                      |
|-----------------------------|-----------------------|---------------------|-----------|-----------|----------------------|
|                             | Total                 | Less than<br>1 year | 1-3 years | 3-5 years | More than<br>5 years |
| Long-term debt obligations  | \$ 11,188             | \$ 475              | \$ 10,713 | \$ —      | \$ —                 |
| Capital lease obligations   | 158                   | 158                 | —         | —         | —                    |
| Operating lease obligations | 3,419                 | 1,277               | 1,929     | 213       | —                    |
| Total                       | \$ 14,765             | \$ 1,910            | \$ 12,642 | \$ 213    | \$ —                 |

Based on our past performance and current expectations, we believe our current cash, cash equivalents and marketable securities will be sufficient to meet our anticipated cash needs for working

capital and capital expenditures for at least 12 months. Although it is difficult to predict future liquidity requirements with certainty, including changes in working capital, the rate at which we will consume cash will be dependent on the cash needs of future operations which will, in turn, be directly affected by the levels of demand for our products, the timing and rate of expansion of our business and the resources we devote to developing our products. We anticipate devoting substantial capital resources to continue our research and development efforts, to maintain our sales, support and marketing, and for other general corporate activities, as well as to vigorously defend against existing and potential investigations and litigation and resolve pending or potential investigations relating to the restatement of our consolidated financial statements. See "Part II-Item 1. Legal Proceedings."

### ***Recent Accounting Pronouncements***

In November 2002, the FASB issued FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The FIN 45 disclosure requirements are included in Note 5. The adoption of FIN 45 did not have a material impact on our financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* and, in December 2003, issued a revision to that interpretation (FIN 46R). FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. We currently do not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have any impact on our overall financial position or results of operations.

In August 2003, the EITF reached a consensus on Issue No. 03-05, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*. EITF Issue No. 03-05 addresses the applicability of SOP 97-2 to non-software deliverables in an arrangement containing more-than-incidental software. In an arrangement that includes software that is more-than-incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. Software-related elements include software products and services, as well as any non-software deliverables for which a software deliverable

is essential to its functionality. The adoption of this statement did not have a material impact on our consolidated financial statements.

In December 2003, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*, which supersedes SAB No. 101, *Revenue Recognition in Financial Statements*. SAB No. 104's primary purpose is to rescind the accounting guidance contained in SAB No. 101 related to multiple-element revenue arrangements that was superseded as a result of the issuance of EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. Additionally, SAB No. 104 rescinds the SEC's related *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* issued with SAB No. 101 that had been codified in SEC Topic 13, *Revenue Recognition*. While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104, which was effective upon issuance. We adopted the provisions of SAB No. 104 in the fourth quarter of 2003. Our adoption of SAB No. 104 did not have a material effect on its financial position or results of operations.

### **Cautionary Statements**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995 that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the following cautionary statements and elsewhere in this Quarterly Report on Form 10-Q. If any of the following risks were to occur, our business, financial condition or results of operations would likely suffer and the trading price of our common stock would likely decline.*

***If we are not current in our SEC filings, we will face several adverse consequences.***

NASDAQ has notified us that we must timely file all periodic reports with the SEC and NASDAQ for all reporting periods ending on or before June 30, 2005. If we are unable to remain current in our financial filings, we will not be able to have a registration statement under the Securities Act of 1933, covering a public offering of securities, declared effective by the SEC, and we will not be able to make offerings pursuant to existing registration statements (including registration statements on Form S-8 covering employee stock plans), or pursuant to certain "private placement" rules of the SEC under Regulation D, to any purchasers not qualifying as "accredited investors." In addition, our affiliates will not be able to sell our securities pursuant to Rule 144 under the Securities Act. Finally, we will not be eligible to use a "short form" registration statement on Form S-3 for a period of 12 months after the time we become current in our filings. These restrictions may impair our ability to raise funds in the public markets should we desire to do so, and to attract and retain key employees.

***Our common stock may be delisted from the NASDAQ National Market and transferred to the National Quotation Service Bureau ("Pink Sheets"), which may, among other things, reduce the price of our common stock and the levels of liquidity available to our stockholders.***

If we fail to keep current in our SEC filings, our common stock may be delisted from the NASDAQ National Market and subsequently would trade on the Pink Sheets. The trading of our common stock on the Pink Sheets may reduce the price of our common stock and the levels of liquidity available to our stockholders. In addition, the trading of our common stock on the Pink Sheets will materially adversely affect our access to the capital markets, and the limited liquidity and reduced price of our common stock could materially adversely affect our ability to raise capital through alternative financing sources on terms acceptable to us or at all. Stocks that trade on the Pink Sheets are no longer eligible for margin loans, and a company trading on the Pink Sheets cannot avail itself of federal preemption of state securities or "blue sky" laws, which adds substantial compliance costs to securities issuances, including pursuant to employee option plans, stock purchase plans and private or public

offerings of securities. Our delisting from the NASDAQ National Market and transfer to the Pink Sheets may also result in other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest and fewer business development opportunities.

***We have identified material weaknesses in our controls and procedures, which, if not remedied effectively, could seriously harm our business.***

Management and our independent auditors have concluded that our controls and procedures had material weaknesses as of March 31, 2004. We have commenced the design and implementation of new and enhanced controls and procedures to address those material weaknesses. Our inability to remedy such material weaknesses promptly and effectively could have a material adverse effect on our business, results of operations and financial condition, as well as impair our ability to meet our quarterly and annual reporting requirements in a timely manner. While we are completing the design and implementation of our controls environment, there remains risk that the transitional controls on which we currently rely will fail to be sufficiently effective. In addition, even if we are successful in strengthening our controls and procedures, such controls and procedures may not be adequate to prevent or identify irregularities or ensure the accuracy of our financial statements or SEC reporting.

***Failure or circumvention of our controls and procedures could seriously harm our business.***

We are making significant changes in our internal controls and our disclosure controls and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, and not absolute, assurances that the objectives of the system are met. The failure or circumvention of our controls, policies and procedures could have a material adverse effect on our business, results of operations and financial condition.

***If we fail to meet the requirements of new regulations regarding the effectiveness of internal control over financial reporting, our financial reporting and business will be negatively affected.***

Pursuant to new SEC rules under the Sarbanes-Oxley Act of 2002, we are required to include in our future Form 10-K filings a report by our management as to the effectiveness of our internal control over financial reporting. Beginning with our Form 10-K for 2004, our independent auditors will be required to attest to and report on the evaluation by management. We have implemented a number of changes designed to improve our internal control over financial reporting, and we anticipate making further changes to improve them, some of which may result in higher future operating expenses and capital expenditures. If we fail to strengthen our internal control over financial reporting, or receive an adverse opinion from our auditors as to the adequacy of our internal control over financial reporting, our ability to manage our business may be impaired, errors may occur or fail to be identified, and our financial condition could be harmed.

***Our business has been adversely affected by developments in the telecommunications industry and these developments may continue to affect our revenues and operating results.***

From our inception through the year 2000, the telecommunications market experienced rapid growth spurred by a number of factors, including deregulation in the industry, entry of a large number of new emerging service providers, growth in data traffic and the availability of significant capital from the financial markets. Commencing in 2001 and continuing in 2002 and 2003, the telecommunications industry experienced a reversal of some of these trends, marked by dramatic reductions in capital expenditures, financial difficulties, and, in some cases, bankruptcies experienced by service providers. These conditions caused a substantial, unexpected reduction in demand for telecommunications equipment, including our products.

We expect the developments described above to continue to affect our business in the following manner:

- our ability to accurately forecast revenue and plan our business is diminished;
- our revenues could be unexpectedly reduced; and
- we may incur losses because a high percentage of our operating expenses are expected to continue to be fixed in the short-term.

Our business, operating results and financial condition could be materially and adversely affected by any one or a combination of the above.

***We expect that a majority of our revenues will be generated from a limited number of customers and we will not be successful if we do not grow our customer base.***

To date, we have shipped our products to a limited number of customers. We expect that in the foreseeable future, the majority of our revenues will continue to depend on sales of our products to a limited number of customers. Three, four, one and three customers each contributed more than 10% of our revenues for the first quarter of fiscal 2004, and fiscal 2003, 2002 and 2001, which represented an aggregate of 67%, 57%, 42% and 60% of total revenues. Our future success will depend on our ability to attract additional customers beyond our current limited number. The growth of our customer base could be adversely affected by:

- customer unwillingness to implement our new voice infrastructure products or renew contracts as they expire;
- potential customer concerns with selecting an emerging telecommunications equipment vendor;
- delays or difficulties that we may incur in completing the development and introduction of our planned products or product enhancements;
- further deterioration in the general financial condition of service providers, including additional bankruptcies, or inability to raise capital;
- new product introductions by our competitors;
- failure of our products to perform as expected; or
- difficulties we may incur in meeting customers' delivery requirements.

The loss of any of our significant customers or any substantial reduction in orders or contractual commitments from these customers could materially adversely affect our financial condition and results of operations. If we do not expand our customer base to include additional customers that deploy our products in operational commercial networks, our business, operating results and financial condition could be materially and adversely affected.

***The market for voice infrastructure products for the new public network is new and evolving and our business will suffer if it does not develop as we expect.***

The market for our products continues to evolve. In particular, wireless, cable and broadband access networks are emerging to become important markets for our products. Packet-based technology may not become widely accepted as a platform for voice and a viable market for our products may not be sustainable. If this market does not develop, or develops more slowly than we expect, we may not be able to sell our products in significant volume.



***If we do not anticipate and meet specific customer requirements or if our products do not interoperate with our customers' existing networks, we may not retain current customers or attract new customers.***

To achieve market acceptance for our products, we must effectively anticipate, and adapt in a timely manner to, customer requirements and offer products and services that meet changing customer demands. Prospective customers may require product features and capabilities that our current products do not have. The introduction of new or enhanced products also requires that we carefully manage the transition from older products in order to minimize disruption in customer ordering patterns and ensure that adequate supplies of new products can be delivered to meet anticipated customer demand. If we fail to develop products and offer services that satisfy customer requirements, or to effectively manage the transition from older products, our ability to create or increase demand for our products would be seriously harmed and we may lose current and prospective customers.

Many of our customers will require that our products be designed to interface with their existing networks, each of which may have different specifications. Issues caused by an unanticipated lack of interoperability may result in significant warranty, support and repair costs, divert the attention of our engineering personnel from our hardware and software development efforts and cause significant customer relations problems. If our products do not interoperate with those of our customers' networks, installations could be delayed or orders for our products could be cancelled, which would seriously harm our gross margins and result in loss of revenues or customers.

***Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that may have an adverse effect on our business.***

Large telecommunications providers have substantial purchasing power and leverage negotiating contractual arrangements with us. These customers may require us to develop additional features and require penalties for failure to deliver such features. As we seek to sell more products to this class of customer, we may be required to agree to such terms and conditions, which may affect the timing of revenue recognition and amount of deferred revenues and may have an adverse effect on our business and financial condition.

***We may face risks associated with our international expansion that could impair our ability to grow our revenues abroad.***

International revenues, primarily attributable to Asia and Europe, were 29% of our revenues for the quarter ended March 31, 2004, and we intend to continue to expand our sales into international markets. This expansion will require significant management attention and financial resources to successfully develop direct and indirect international sales and support channels. In addition, we may not be able to develop international market demand for our products, which could impair our ability to grow our revenues. We have limited experience marketing, distributing and supporting our products internationally and, to do so, we expect that we will need to develop versions of our products that comply with local standards. Furthermore, international operations are subject to other inherent risks, including:

- greater difficulty collecting accounts receivable and longer collection periods;
- difficulties and costs of staffing and managing international operations;
- the impact of differing technical standards outside the United States;
- the impact of recessions in economies outside the United States;
- unexpected changes in regulatory requirements and currency exchange rates;
- certification requirements;

- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences; and
- political and economic instability.

***We may not become profitable.***

We have incurred significant losses since inception and, as of March 31, 2004, had an accumulated deficit of \$805.5 million. We have not achieved profitability on an annual basis and may incur additional net losses in future quarters and years. Our revenues may not grow and we may never generate sufficient revenues to sustain profitability.

***The unpredictability of our quarterly results may adversely affect the trading price of our common stock.***

Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate. Generally, purchases by service providers of telecommunications equipment from manufacturers have been unpredictable and clustered, rather than steady, as the providers build out their networks. The primary factors that may affect our revenues and results include the following:

- fluctuation in demand for our voice infrastructure products and the timing and size of customer orders;
- the cancellation or deferral of existing customer orders or the renegotiation of existing contractual commitments;
- the failure of certain of our customers to successfully and timely reorganize their operations, including emerging from bankruptcy;
- the length and variability of the sales cycle for our products;
- the timing of revenue recognition and amount of deferred revenues;
- new product introductions and enhancements by our competitors and us;
- changes in our pricing policies, the pricing policies of our competitors and the prices of the components of our products;
- our ability to develop, introduce and ship new products and product enhancements that meet customer requirements in a timely manner;
- the mix of product configurations sold;
- our ability to obtain sufficient supplies of sole or limited source components;
- our ability to attain and maintain production volumes and quality levels for our products;
- costs related to acquisitions of complementary products, technologies or businesses;
- general economic conditions, as well as those specific to the telecommunications, networking and related industries; and
- the application of complex revenue recognition accounting rules to our customer arrangements.

As with other telecommunications product suppliers, we may recognize a substantial portion of our revenue in a given quarter from sales booked and shipped in the last weeks of that quarter. As a result, delays in customer orders may result in delays in shipments and recognition of revenue beyond the end of a given quarter.

A significant portion of our operating expenses is fixed in the short-term. If revenues for a particular quarter are below expectations, we may not be able to reduce operating expenses proportionally for the quarter. Any such revenue shortfall would, therefore, have a significant effect on our operating results for the quarter.

We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is likely that in some future quarters, our operating results may be below the expectations of public market analysts and investors, which may adversely affect our stock price.

***We are entirely dependent upon our voice infrastructure products and our future revenues depend upon their commercial success.***

Our future growth depends upon the commercial success of our voice infrastructure products. We intend to develop and introduce new products and enhancements to existing products in the future. We may not successfully complete the development or introduction of these products. If our target customers do not adopt, purchase and successfully deploy our current or planned products, our revenues will not grow.

***If we do not respond rapidly to technological changes or to changes in industry standards, our products could become obsolete.***

The market for packet voice infrastructure products is likely to be characterized by rapid technological change and frequent new product introductions. We may be unable to respond quickly or effectively to these developments. We may experience difficulties with software development, hardware design, manufacturing or marketing that could delay or prevent our development, introduction or marketing of new products and enhancements. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies or the emergence of new industry standards could render our existing or future products obsolete. If the standards adopted are different from those that we have chosen to support, market acceptance of our products may be significantly reduced or delayed. If our products become technologically obsolete, we may be unable to sell our products in the marketplace and generate revenues.

***If we fail to compete successfully, our ability to increase our revenues or achieve profitability will be impaired.***

Competition in the telecommunications market is intense. This market has historically been dominated by large companies, such as Lucent Technologies, Nortel Networks and Siemens, all of which are our direct competitors. We also face competition from other large telecommunications and networking companies, including Cisco Systems, some of which have entered our market by acquiring companies that design competing products. Because this market is rapidly evolving, additional competitors with significant financial resources may enter these markets and further intensify competition.

Many of our current and potential competitors have significantly greater selling and marketing, technical, manufacturing, financial and other resources. Further, some of our competitors sell significant amounts of other products to our current and prospective customers. Our competitors' broad product portfolios, coupled with already existing relationships, may cause our customers to buy our competitors' products or harm our ability to attract new customers.

To compete effectively, we must deliver innovative products that:

- provide extremely high reliability and voice quality;
- scale easily and efficiently;
- interoperate with existing network designs and other vendors' equipment;

- provide effective network management;
- are accompanied by comprehensive customer support and professional services; and
- provide a cost-effective and space efficient solution for service providers.

If we are unable to compete successfully against our current and future competitors, we could experience price reductions, order cancellations, loss of customers and revenues and reduced gross profit margins.

***Because our products are sophisticated and designed to be deployed in complex environments, they may have errors or defects that we find only after full deployment, which could seriously harm our business.***

Our products are sophisticated and are designed to be deployed in large and complex networks. Because of the nature of our products, they can only be fully tested when substantially deployed in very large networks with high volumes of traffic. Some of our customers have only recently begun to commercially deploy our products and they may discover errors or defects in the software or hardware, or the products may not operate as expected. If we are unable to fix errors or other performance problems that may be identified after full deployment of our products, we could experience:

- loss of, or delay in, revenues;
- loss of customers and market share;
- a failure to attract new customers or achieve market acceptance for our products;
- increased service, support and warranty costs and a diversion of development resources; and
- costly and time-consuming legal actions by our customers.

***Because our products are deployed in large, complex networks around the world, failure to establish a support infrastructure and maintain required support levels could seriously harm our business.***

Our products are deployed in large and complex networks around the world. Our customers expect us to establish a support infrastructure and maintain demanding support standards to ensure that their networks maintain high levels of availability and performance. To support the continued growth of our business, our support organization will need to provide service and support at a high level throughout the world. If we are unable to provide the expected level of support and service to our customers, we could experience:

- loss of customers and market share;
- a failure to attract new customers in new geographies;
- increased service, support and warranty costs and a diversion of development resources; and
- network performance penalties.

***We have experienced changes in our senior management, which could affect our business and operations.***

Since April 2004, we have made significant changes in our senior management team. We have hired a President and Chief Operating Officer and a new Vice President of Finance, Corporate Controller and Chief Accounting Officer. We presently are in the process of recruiting a new Chief Financial Officer. Because of these recent changes, our management team may not be able to work together effectively to successfully develop and implement our business strategies and financial operations. In addition, management will need to devote significant attention and resources to preserve and strengthen relationships with employees, customers and the investor community. If our new

management team is unable to achieve these goals, our ability to grow our business and successfully meet operational challenges could be impaired.

***If we fail to hire and retain needed personnel, the implementation of our business plan could slow or our future growth could halt.***

Our business depends upon highly skilled engineering, sales, marketing and customer support personnel. Any failure to hire or retain needed qualified personnel could impair our growth. Our future success depends upon the continued services of our executive officers who have critical industry experience and relationships that we rely on to implement our business plan. None of our officers or key employees is bound by an employment agreement for any specific term. The loss of the services of any of our officers or key employees could delay the development and introduction of, and negatively impact our ability to sell, our products.

***If we are subject to employment claims, we could incur substantial costs in defending ourselves.***

We may become subject to employment claims in connection with employee terminations. In addition, companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. These claims may result in material litigation. We could incur substantial costs defending ourselves or our employees against those claims, regardless of their merits. In addition, defending ourselves from those types of claims could divert our management's attention from our operations. If we are found liable in connection with any employment claim, we may incur significant costs that could adversely impact our financial condition and results of operations.

***We depend upon contract manufacturers and any disruption in these relationships may cause us to fail to meet the demands of our customers and damage our customer relationships.***

We rely on a small number of contract manufacturers to manufacture our products according to our specifications and to fill orders on a timely basis. Our contract manufacturers provide comprehensive manufacturing services, including assembly of our products and procurement of materials. Each of our contract manufacturers also builds products for other companies and may not always have sufficient quantities of inventory available to fill our orders or may not allocate their internal resources to fill these orders on a timely basis. We do not have long-term supply contracts with our manufacturers and they are not required to manufacture products for any specified period. We do not have internal manufacturing capabilities to meet our customers' demands. Qualifying a new contract manufacturer and commencing commercial scale production is expensive and time consuming and could result in a significant interruption in the supply of our products. If a change in contract manufacturers results in delays in our fulfillment of customer orders or if a contract manufacturer fails to make timely delivery of orders, we may lose revenues and suffer damage to our customer relationships.

***We and our contract manufacturers rely on single or limited sources for supply of some components of our products and if we fail to adequately predict our manufacturing requirements or if our supply of any of these components is disrupted, we will be unable to ship our products.***

We and our contract manufacturers currently purchase several key components of our products, including commercial digital signal processors, from single or limited sources. We purchase these components on a purchase order basis. If we overestimate our component requirements, we could have excess inventory, which would increase our costs. If we underestimate our requirements, we may not have an adequate supply, which could interrupt manufacturing of our products and result in delays in shipments and revenues.

We currently do not have long-term supply contracts with our component suppliers and they are not required to supply us with products for any specified periods, in any specified quantities or at any set price, except as may be specified in a particular purchase order. In the event of a disruption or delay in supply, or inability to obtain products, we may not be able to develop an alternate source in a timely manner or at favorable prices, or at all. A failure to find acceptable alternative sources could hurt our ability to deliver high-quality products to our customers and negatively affect our operating margins. In addition, reliance on our suppliers exposes us to potential supplier production difficulties or quality variations. Our customers rely upon our ability to meet committed delivery dates, and any disruption in the supply of key components would seriously adversely affect our ability to meet these dates and could result in legal action by our customers, loss of customers or harm to our ability to attract new customers.

***If we are not able to obtain necessary licenses of third party technology at acceptable prices, or at all, our products could become obsolete.***

We have incorporated third-party licensed technology into our current products. From time to time, we may be required to license additional technology from third parties to develop new products or product enhancements. Third party licenses may not be available or continue to be available to us on commercially reasonable terms. The inability to maintain or re-license any third party licenses required in our current products or to obtain any new third party licenses to develop new products and product enhancements could require us to obtain substitute technology of lower quality or performance standards or at greater cost, and delay or prevent us from making these products or enhancements, any of which could seriously harm the competitiveness of our products.

***Our ability to compete and our business could be jeopardized if we are unable to protect our intellectual property or become subject to intellectual property rights claims, which could require us to incur significant costs.***

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be harmed.

In addition, we have received inquiries from other patent holders and may become subject to claims that we infringe their intellectual property rights. Any parties asserting that our products infringe upon their proprietary rights could force us to license their patents for substantial royalty payments or to defend ourselves and possibly our customers or contract manufacturers in litigation. These claims and any resulting licensing arrangement or lawsuit, if successful, could subject us to significant royalty payments or liability for damages and invalidation of our proprietary rights. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling, incorporating or using our products that use the challenged intellectual property;
- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or
- redesign those products that use any allegedly infringing technology.

Any lawsuits regarding intellectual property rights, regardless of their success, would be time-consuming, expensive to resolve and would divert our management's time and attention.

***Any investments or acquisitions we make could disrupt our business and seriously harm our financial condition.***

Although we have no current plans or agreements to do so, we intend to consider investing in, or acquiring, complementary products, technologies or businesses. In the event of future investments or acquisitions, we could:

- issue stock that would dilute our current stockholders' percentage ownership;
- incur debt or assume liabilities;
- incur significant impairment charges related to the write-off of goodwill and purchased intangible assets;
- incur significant amortization expenses related to purchased intangible assets; or
- incur large and immediate write-offs for in-process research and development and stock based compensation.

Our integration of any acquired products, technologies or businesses will also involve numerous risks, including:

- problems and unanticipated costs associated with combining the purchased products, technologies or businesses;
- diversion of management's attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have limited or no prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

We may be unable to successfully integrate any products, technologies, businesses or personnel that we might acquire in the future without significant costs or disruption to our business.

***We face risks related to securities litigation and investigations that could have a material adverse effect on our business, financial condition and results of operations.***

We have been named as a defendant in a number of securities class action and derivative lawsuits and are the subject of a formal investigation initiated by the SEC. We are generally obliged, to the extent permitted by law, to indemnify our current and former directors and officers who are named as defendants in some of these lawsuits. Defending against existing and potential litigation relating to the restatement of our consolidated financial statements will likely require significant attention and resources of management. Regardless of the outcome, such litigation and investigation will result in significant legal expenses and may also negatively affect our relationships with our customers and our employees. If our defenses are ultimately unsuccessful, or if we are unable to achieve a favorable settlement, we could be liable for large damage awards that could have a material adverse effect on our business, results of operations and financial condition.

***The limitations of our director and officer liability insurance may materially harm our business and financial condition.***

Our director and officer liability insurance policies provide only limited liability protection relating to the securities class action and derivative lawsuits against us and certain of our officers and directors. If these policies do not adequately cover expenses and certain liabilities relating to these lawsuits, our financial condition could be materially harmed. The facts underlying the lawsuits and SEC investigation have made director and officer liability insurance extremely expensive for us, and may make this

insurance coverage unavailable for us in the future. Increased premiums could materially harm our financial results in future periods. The inability to obtain this coverage due to its unavailability or prohibitively expensive premiums would make it more difficult to retain and attract officers and directors and expose us to potentially self-funding any potential future liabilities ordinarily mitigated by director and officer liability insurance.

***Management's time and effort expected to be spent to respond to the SEC investigation may adversely affect our business and our results of operations.***

We have received a formal order of private investigation from the SEC. Our management will spend considerable time and effort cooperating with the SEC in its investigation. The significant time and effort expected to be spent on this SEC investigation may adversely affect our business, results of operations and financial condition. We may incur substantial costs in connection with the investigation including fines and significant legal expenses.

***We may seek to raise additional capital in the future, which may not be available to us, and if it is available, may dilute the ownership of our common stock.***

In April and September 2003, we completed public offerings of 20,000,000 and 17,000,000 shares of our common stock resulting in the dilution of our existing investors' percentage ownership of our common stock. In the future, we may seek to raise additional funds through public or private debt or equity financings in order to:

- fund ongoing operations and capital requirements;
- take advantage of opportunities, including more rapid expansion or acquisition of complementary products, technologies or businesses;
- develop new products; or
- respond to competitive pressures.

Any additional capital raised through the sale of convertible debt or equity may further dilute an investor's percentage ownership of our common stock. Furthermore, additional financings may not be available on terms favorable to us, or at all. A failure to obtain additional funding could prevent us from making expenditures that may be required to grow or maintain our operations.

***Our stock price has been and may continue to be volatile.***

The market for technology stocks has been and will likely continue to be extremely volatile. The following factors could cause the market price of our common stock to fluctuate significantly:

- the addition or loss of any major customer;
- changes in the financial condition or anticipated capital expenditure purchases of any existing or potential major customer;
- quarterly variations in our operating results;
- changes in financial estimates by securities analysts;
- speculation in the press or investment community;
- announcements by us or our competitors of significant contracts, new products or acquisitions, distribution partnerships, joint ventures or capital commitments;
- sales of common stock or other securities by us or by our stockholders in the future;
- securities and other litigation;



- announcement of a stock split, reverse stock split, stock dividend or similar event;
- economic conditions for the telecommunications, networking and related industries; and
- worldwide economic instability.

***Sales of a substantial amount of our common stock in the future could cause our stock price to fall.***

Some stockholders who acquired shares prior to our IPO or in connection with our acquisition of TTI hold a substantial number of shares of our common stock that have not yet been sold in the public market. Further, additional shares may become available for sale upon the conversion or redemption of our convertible subordinated note. Sales of a substantial number of shares of our common stock within a short period of time in the future could impair our ability to raise capital through the sale of additional debt or stock and/or cause our stock price to fall.

***Provisions of our charter documents and Delaware law may have anti-takeover effects that could prevent a change of control.***

Provisions of our amended and restated certificate of incorporation, our amended and restated by-laws and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We do not currently use derivative financial instruments. We generally place our marketable security investments in high-quality credit instruments, primarily U.S. Government obligations and corporate obligations with contractual maturities of less than one year. We do not expect any material loss from our marketable security investments and therefore believe that our potential interest rate exposure is not material. We have no current material exposure to foreign currency rate fluctuations, though we will continue to evaluate the impact of foreign currency exchange risk on our results of operations as we expand internationally.

**Item 4. Controls and Procedures**

Our current management, with the participation of our principal executive officer and co-principal financial officers, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 240.13a-15(e) and 240.15d-15(e) of the Securities Exchange Act of 1934) as of March 31, 2004, which included an evaluation of disclosure controls and procedures applicable to the period covered by the filing of this periodic report. As noted below, we have identified material weaknesses in our internal controls and procedures, as they existed as of March 31, 2004.

In connection with the restatement of our consolidated financial statements for the years ended December 31, 2002 and 2001 and the nine months ended September 30, 2003, as described in our Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended December 31, 2003, we and Ernst & Young LLP, our independent auditors, identified and reported to our audit committee significant internal control matters that collectively constitute "material weaknesses." These internal control matters, any one or more of which may individually or together constitute a material weakness, include: insufficient contract review and documentation; inadequate supervision and review within the finance and accounting department; inadequate segregation of duties; insufficient supporting documentation for and review of account reconciliations; lack of adequate controls over cash receipts; lack of adequate technical accounting expertise; insufficient equity review procedures and documentation; flawed foundations for accounting estimates; and inadequate quarterly and year-end financial statement close and review procedures.

Based on the evaluation of the effectiveness of our disclosure controls and procedures as of March 31, 2004, which included an evaluation of the effectiveness of our disclosure controls and procedures applicable to the periods covered by the filing of this periodic report, and subject to the information set forth in this Item 4, our principal executive officer and co-principal financial officers have concluded that our disclosure controls and procedures were inadequate, as further described in this Item 4. Subsequent to March 31, 2004, and up to the filing date of this report, we implemented a detailed reconstruction of the accounting records in support of the financial statements contained herein utilizing experts in accounting, appraisals and other consultants under the direction of new financial management.

During the fiscal quarter ended March 31, 2004, we initiated an independent investigation into conduct of certain employees and terminated two employees, including the individual who then was our controller, for breach of our Code of Business Conduct and Ethics, communicated to senior management and other key personnel the importance of our Code of Business Conduct and Ethics and adherence to the requirements set forth in it and communicated to employees about the availability of our formal reporting system for employees to identify potential concerns or ethical issues on an anonymous basis. These changes have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 240.13a-15(f) and 240.15d-15(f) of the Exchange Act). During 2004, through the filing date of this report, we began implementing additional changes to our infrastructure and related processes that are reasonably likely to materially affect our internal control over financial reporting. These measures include the following:

- We have hired a President and Chief Operating Officer and a new Vice President of Finance, Corporate Controller and Chief Accounting Officer as well as other personnel into our finance and accounting organization who have expertise in financial controls and reporting, to improve the overall quality and level of experience in our finance and accounting organization. We are actively recruiting other senior level members of the finance and accounting organization, including a Chief Financial Officer and Director of Internal Audit.
- We have made, and will continue to make, changes in our finance and accounting organization to provide clearer segregation of responsibilities and supervision with regard to, among others, account reconciliations and documentation supporting our quarterly and annual financial statements.
- We are implementing an enhanced quarterly financial review process, which will include a formal closing meeting each quarter chaired by the chief accounting officer and attended by a cross-section of senior financial management.
- We are establishing a cross-functional bids and proposals group to manage customer contract negotiation, review and implementation and assess related revenue recognition implications.
- We have initiated additional training of our sales and marketing organizations regarding revenue recognition rules and best practices.

With the assistance of our advisors, we plan to take additional steps to strengthen our internal controls, including expansion of our transaction approval procedures to include the involvement of sales and service personnel and the implementation of a formal contract review procedure; implementation of processes to improve communication among our various functional groups, which include sales, manufacturing, customer support, engineering, accounting, and legal, during the contract negotiation and implementation phases; implementation of an internal audit function; and improved operating controls and reporting processes.

Based on the changes and improvements made since January 1, 2004, our management, including our principal executive officer and co-principal financial officers, believes that as of the date of this filing, our disclosure controls and procedures (1) were designed to ensure that material information

relating to our company, including our consolidated subsidiaries, is made known to our principal executive officer and co-principal financial officers by others within those entities, and (2) given the late filing of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2004, are not yet effective but have improved since March 31, 2004 in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. We currently are designing and implementing a new controls environment to address the material weaknesses described above. While this design and implementation phase is underway, we are relying on extensive manual procedures, including regular reviews and the significant utilization of outside accounting professionals, to assist us with meeting the objectives otherwise fulfilled by an effective controls environment. We expect to establish and implement a system and policy-based set of controls. While we are completing the design and implementation of our controls environment, there remains risk that the transitional controls on which we are currently relying will fail to be sufficiently effective. We also note, however, that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our control systems, as we develop them, may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

The certifications of our principal executive officer and co-principal financial officers required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 are attached as exhibits to this Quarterly Report on Form 10-Q. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in internal control over financial reporting, referred to in paragraph 4 of the certifications. This Item 4 should be read in conjunction with the officer certifications for a more complete understanding of the topics presented.

## PART II—OTHER INFORMATION

### Item 1. Legal Proceedings

In November 2001, a purchaser of our common stock filed a complaint in the federal district court for the Southern District of New York against us, two of our officers and the lead underwriters alleging violations of the federal securities laws in connection with our initial public offering (IPO) and seeking unspecified monetary damages. The purchaser seeks to represent a class of persons who purchased our common stock between the IPO on May 24, 2000 and December 6, 2000. An amended complaint was filed in April 2002. The amended complaint alleges that our registration statement contained false or misleading information or omitted to state material facts concerning the alleged receipt of undisclosed compensation by the underwriters and the existence of undisclosed arrangements between underwriters and certain purchasers to make additional purchases in the after market. The claims against us are asserted under Section 10(b) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933 and against the individual defendants under Sections 11 and 15 of the Securities Act. Other plaintiffs have filed substantially similar class action cases against approximately 300 other publicly traded companies and their IPO underwriters which, along with the actions against us, have been transferred to a single federal judge for purposes of coordinated case management. On July 15, 2002, we, together with the other issuers named as defendants in these coordinated proceedings, filed a collective motion to dismiss the consolidated amended complaints on various legal grounds common to all or most of the issuer defendants. The plaintiffs voluntarily dismissed the claims against the individual defendants, including those of our officers named in the complaint. On February 19, 2003, the court granted a portion of the motion to dismiss by dismissing the Section 10(b) claims against certain defendants including us, but denied the remainder of the motion as to the defendants. Accordingly, the case proceeded against us on the Section 11 claims. In June 2003, a special committee of our Board of Directors authorized us to enter into a proposed settlement with the plaintiffs on terms substantially consistent with the terms of a Memorandum of Understanding negotiated among representatives of the plaintiffs, the issuer defendants and the insurers for the issuer defendants. The settlement contemplated by the Memorandum of Understanding is subject to a number of conditions including approval by the court. It remains uncertain whether and when the conditions will be met and the settlement will become final. We do not expect that the settlement contemplated by the Memorandum of Understanding would have a material impact on our business or financial results.

Beginning in July 2002, several purchasers of our common stock filed complaints in federal district court for the District of Massachusetts against us, certain officers and directors and a former officer under Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 (Class Action Complaints). The purchasers seek to represent a class of persons who purchased our common stock between December 11, 2000 and January 16, 2002, and seek unspecified monetary damages. The Class Action Complaints were essentially identical and alleged that we made false and misleading statements about its products and business. On March 3, 2003, the plaintiffs filed a Consolidated Amended Complaint. On April 22, 2003, we filed a motion to dismiss the Consolidated Amended Complaint on various grounds. On May 11, 2004, the court held oral argument on the motion, at the conclusion of which the court denied our motion to dismiss. The case is proceeding to class certification and discovery. We believe the claims in the Consolidated Amended Complaint are without merit and that we have substantial legal and factual defenses, which we intend to pursue vigorously. There is no assurance we will prevail in defending these actions.

Beginning in February 2004, a number of purported shareholder class action complaints were filed in the United States District Court for the District of Massachusetts against us and certain of its current officers and directors. The complaints assert claims under the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, relating to our announcement that it had identified issues, practices and actions of certain employees relating to both the timing of revenue recognized from certain customer transactions and other financial statement accounts, which could

affect its 2003 financial statement accounts and possibly financial statements for prior periods. Specifically, these actions allege that we issued a series of false or misleading statements to the market during the class period that failed to disclose that (i) we had materially overstated our revenue by improperly recognizing revenue on certain customer contracts; (ii) we lacked adequate internal controls and were therefore unable to ascertain our true financial condition; and (iii) as a result of the foregoing, our financial statements issued during the class period were materially false and misleading. Plaintiffs contend that such statements caused our stock price to be artificially inflated. The complaints seek unspecified damages on behalf of a purported class of purchasers of our common stock during the period from April 9, 2003, June 3, 2003 or June 5, 2003 through February 11, 2004. On June 28, 2004, the court consolidated the claims. We believe that we have substantial legal and factual defenses to the claims, which we intend to pursue vigorously. There is no assurance we will prevail in defending these actions.

In February 2004, two purported shareholder derivative lawsuits were filed in the United States District Court for the District of Massachusetts against us and certain of its officers and directors, naming us as a nominal defendant. Also in February 2004, two purported shareholder derivative lawsuits were filed in the business litigation session of the superior court of Suffolk County of Massachusetts against us and certain of our directors and officers, also naming us as a nominal defendant. The suits claim that certain of our officers and directors breached their fiduciary duties to our stockholders and to the company. The complaints are derivative in nature and do not seek relief from us. However, we have entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors and may be obligated throughout the pendency of these actions to advance payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. We filed a motion to dismiss the state court cases and a motion to stay the federal action pending the outcome of the motion to dismiss in state court. On June 11, 2004, the state court held oral argument on the motion and took the matter under advisement. Discovery has been stayed pending the outcome of the motion to dismiss. We believe that we have substantial legal and factual defenses to the claims, which we intend to pursue vigorously. There is no assurance we will prevail in defending these actions.

In June 2004, we received a formal order of private investigation from the SEC. We are cooperating with the investigation. There can be no assurance as to the outcome of the SEC investigation. We may incur substantial costs in connection with the investigation including fines and significant legal expenses.

We have been contacted by third parties, who claim that our products infringe on certain intellectual property of the third party. We evaluate these claims and accrue for royalties when the amounts are probable and reasonably estimable. While we believe that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.





**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Hassan M. Ahmed, Chief Executive Officer and Chairman of the Board of Directors, of Sonus Networks, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q ("Quarterly Report") of Sonus Networks, Inc. (the "Registrant");
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Quarterly Report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
  - (b) *[Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];*
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
  - (d) Disclosed in this Quarterly Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: July 28, 2004

/s/ HASSAN M. AHMED

---

Hassan M. Ahmed  
Chief Executive Officer and Chairman of the Board of Directors (Principal  
Executive Officer)

---



QuickLinks

[EXHIBIT 31.1](#)

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Albert A. Notini, President and Chief Operating Officer, of Sonus Networks, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q ("Quarterly Report") of Sonus Networks, Inc. (the "Registrant");
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Quarterly Report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
  - (b) *[Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];*
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
  - (d) Disclosed in this Quarterly Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: July 28, 2004

/s/ ALBERT A. NOTINI

---

Albert A. Notini  
*President and Chief Operating Officer (Co-Principal Financial Officer)*

---

QuickLinks

[EXHIBIT 31.2](#)

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Bradley T. Miller, Vice President of Finance, Corporate Controller and Chief Accounting Officer, of Sonus Networks, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q ("Quarterly Report") of Sonus Networks, Inc. (the "Registrant");
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Quarterly Report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
  - (b) *[Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];*
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
  - (d) Disclosed in this Quarterly Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: July 28, 2004

/s/ BRADLEY T. MILLER

---

Bradley T. Miller  
Vice President of Finance, Corporate Controller and Chief Accounting  
Officer (Co-Principal Financial Officer)

---

QuickLinks

[EXHIBIT 31.3](#)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Sonus Networks, Inc. (the "Company") for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Hassan M. Ahmed, Chief Executive Officer and Chairman of the Board of Directors of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2004

/s/ HASSAN M. AHMED

---

Hassan M. Ahmed  
*Chief Executive Officer and Chairman of the Board of Directors (Principal  
Executive Officer)*

---

QuickLinks

[EXHIBIT 32.1](#)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Sonus Networks, Inc. (the "Company") for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Albert A. Notini, President and Chief Operating Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2004

/s/ ALBERT A. NOTINI

---

Albert A. Notini  
*President and Chief Operating Officer (Co-Principal Financial Officer)*

---



QuickLinks

[EXHIBIT 32.2](#)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Sonus Networks, Inc. (the "Company") for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Bradley T. Miller, Vice President of Finance, Corporate Controller and Chief Accounting Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2004

/s/ BRADLEY T. MILLER

---

Bradley T. Miller  
*Vice President of Finance, Corporate Controller and Chief Accounting  
Officer (Co-Principal Financial Officer)*

---

QuickLinks

[EXHIBIT 32.3](#)