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Ribbon Communications, Inc. (RBBN)

Q3 2018 Earnings Call

CORPORATE PARTICIPANTS

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Michael Latimore

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Analyst, D.A. Davidson

Matthew Galinko

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Ribbon Communications' Third Quarter 2018 Earnings Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded, today, Tuesday, October 30, 2018.

I would now like to turn the conference over to Sara Leggat, Head of Investor Relations. Please go ahead madam.

Sara Leggat

Head-Investor Relations, Ribbon Communications, Inc.

Good afternoon, and welcome to our third quarter 2018 financial results conference call. On the call with me today are Fritz Hobbs, President and CEO; and Daryl Raiford, CFO. Today's press release and presentation have been posted to the Investor Relations section of our website. A recording of this call will be available on our website shortly after the call.

I'd like to remind you that during this call, we'll be making forward-looking statements. Such statements are based on current expectations, forecasts and assumptions regarding the company's business, financial results, growth and opportunities in the marketplace that include risks and certainties that could cause actual results to differ materially from the statements discussed today.

Any forward-looking statements are qualified in their entirety by cautionary statements contained in the company's most recent Annual Report on Form 10-K and its other SEC filings. The company assumes no obligation to update any forward-looking information presented. Unless otherwise indicated, all results discussed are on a non-GAAP basis. Statements about profitability refer to adjusted EBITDA. A reconciliation of GAAP to non-GAAP results may be found in our press release and within the IR section of our website.

And with that, let me turn the call over to Fritz.

Franklin W. Hobbs

President, Chief Executive Officer & Director, Ribbon Communications, Inc.

Thank you, Sara, and good afternoon to everyone on the call. I'll give a brief overview of our third quarter 2018 highlights, the status of our integration of Sonus and GENBAND, and lastly an update on our strategic initiatives. I'll then turn the call over to Daryl who will discuss in more detail our financial performance this past quarter and our outlook for the full-year 2018.

I'm very pleased with our third quarter financial results, which validate the momentum we have built. We benefited from solution sales to key customers, both in North America and internationally, demonstrating the depth and breadth of our product offering as well as our extensive global customer base. We remain focused on reducing our cost structure and improving operational efficiencies, which has delivered another quarter of both year-over-year and sequential improvement in our profitability.

Third quarter non-GAAP total revenue was \$159 million, which included approximately \$10 million of revenue from the acquisition of Edgewater that closed in August 2018. Our non-GAAP adjusted EBITDA was \$29 million, a 45% increase from the second quarter 2018. Again, I view these as very solid results, and Daryl will take you through the details in just a moment.

Over the last nine months, I've addressed what we describe as our 1-plus-4 strategy, namely, an immediate near-term priority to complete the GENBAND-Sonus integration in order to capture the value of the cost savings within our P&L. And our four strategic pillars are: first, investing in our core products; second, leveraging our global scale; third, expanding into adjacent markets; and fourth, M&A opportunities and ecosystem opportunities.

Turning to our integration progress. The large bulk of the Sonus-GENBAND integration efforts were completed this summer. We have gained considerable efficiencies and have operationalized nearly \$100 million of cost savings. I'm pleased with our integration results and still anticipate seeing improvements in our cost structure continuing through 2019.

We're excited to have Edgewater Networks join the Ribbon team, as it brings us some outstanding new products, positions us deeper in the enterprise Edge space and offers us opportunities for international expansion. Edgewater integration activities have commenced. We've already combined certain key sales systems, and now our Ribbon team is quoting and fulfilling Edgewater product orders to Ribbon customers. We've also begun investments in expanded sales and marketing capabilities for the Edgewater product family.

I would now like to take a moment to highlight a few achievements from the past quarter that demonstrate the strong progress we have made in our strategic pillars as we focus on capturing market opportunities.

First, in terms of our strategy to invest in our core products. We continue to execute well in our traditional service provider market, while we gain traction for our core products in our targeted enterprise verticals. For example, during the third quarter, fixed network transformation projects continued globally. In the U.S., we continued a large fixed network transformation project for a Tier 1 service provider, and we are less than halfway through their estimated 10-year project.

Additionally, we expanded capacities on deployed SBCs and gateways at two other North American Tier 1 service providers. Similarly, we saw expansion at multiple service providers in EMEA for our products and solutions. We

also saw strong demand for SBCs and application servers out of the government vertical, both in the U.S. and Canada across multiple agencies.

Turning to the financial vertical, we saw two large global banks replace their incumbent SBC vendor with Ribbon SBC solutions in order to strengthen their call center applications. Notably, one of the customers is using our industry-leading virtualized software-based SBC, SWe, as it moves to IP-based communications.

Finally, we also saw continued expansion of our SBC deployment at large North American cable provider, as well as capacity orders for our SBCs at Bandwidth, which is a software company focused on communications for the enterprise.

Second, we continue to leverage our global footprint in our large installed base. For example, TELUS, an SBC customer based in Canada utilizing GENBAND's SBCs deployed our Ribbon virtualized software-based SBC, the SWe software. We expect roughly 20 large former GENBAND SBC customers to transition to Ribbon portfolio in a relatively short period of time, and we project more than half of them to be transitioned through mid-2019.

Next in Asia, a major wireless Tier 1 provider that we highlighted earlier this year, again in the third quarter, significantly expanded its network capacity with our softswitches and media gateways. Lastly, we benefited from a large order for our softswitch and media gateways products from Optus, a major service provider in Australia. This former GENBAND customer also plans to deploy our Ribbon SBC 7000 product illustrating our cross-sell abilities delivered by the merger.

Now, I'd like to update you on Ribbon Protect and Kandy, both of which encompass our third initiative, which is to expand into adjacent markets and related applications. In terms of Ribbon Protect, our first customer deployment with Softbank went smoothly, and we recognized approximately \$1 million of revenue in this past quarter. We expect the expansion business from this customer in 2019. We also signed a large U.S. university as our second Ribbon Protect customer. Our Ribbon Protect pipeline continues to grow and numerous customers are trialing the Ribbon Protect product.

We continue to make progress with Kandy. We signed a contract with a large U.S. service provider for Kandy's White Label CPaaS solutions to enable embedded communications for its Enterprise customers. In addition, we booked an incremental order during the third quarter from a large North American car rental company, who has deployed Kandy at over 300 locations. And we're also excited that their European deployment is underway.

In summary, I am very pleased with our accomplishment this past quarter. 2018 is proving to be a year of solid performance as we have stayed focused on capturing market opportunities, completing integration work and driving exceptional profitability. I'm very proud of our employee teams across all levels that we successfully met the challenges we've encountered.

At the same time, we've executed against our four ongoing strategic priorities and continue to focus on building a solid business emphasizing profitability. I'm looking forward to a strong finish in our fourth quarter of 2018.

With that, let me turn the call over to Daryl.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

Thanks, Fritz, and hello, everyone. I'm going to review our non-GAAP financial results for the third quarter 2018 and then provide commentary on our outlook for the remainder of the year. The slides within the Investor

Relations section of our website has the details regarding our historical financial performance. Our reporting framework is consistent with what we have presented in prior periods. I'd encourage you to access these materials from our website.

As a reminder, when I refer to non-GAAP in conjunction with the financial metric, these financial metrics exclude the effects of purchase accounting and other items detailed in our earnings materials. Our non-GAAP financial metrics are reconciled for you at the end of today's press release and our earnings presentation, both of which are available in the Investor Relations section of the website.

Now turning to the third quarter. Ribbon has strong financial results with higher-than-expected non-GAAP revenue and adjusted EBITDA. Demand for our products exceeded projections, resulting in better revenue linearity over the year than we had originally anticipated.

As Fritz mentioned, we successfully completed the acquisition of Edgewater Networks in August. The incremental revenue and earnings post close are included in our consolidated third quarter financial results. I'm going to take time to address both the operating results of Ribbon's business excluding the effect of Edgewater and our consolidated non-GAAP results including Edgewater, so that you can fully appreciate Ribbon's third quarter performance. Going forward, we do plan to rapidly unify this business in the fourth quarter and won't report Edgewater separately.

Our third quarter 2018 non-GAAP financial results were as follows. Total consolidated non-GAAP revenue was \$159 million. Edgewater non-GAAP revenue was \$10 million. Therefore, Ribbon's business, excluding Edgewater, delivered non-GAAP revenue of \$149 million, which was an increase of \$4 million or 3% as compared with second quarter 2018. This Ribbon non-GAAP revenue excluding Edgewater of \$149 million benefited from higher demand for both our network transformation solutions, which comprise combinations of softswitches, media gateways, application servers and other technologies, as well as our Session Border Controller products.

Our service provider customers led the way across the globe in the United States, Canada, Europe and Asia Japan with AT&T and Verizon, both greater than 10% customers.

We also experienced improved demand in our Enterprise SBC products. With the acquisition of Edgewater, we consider ourselves well positioned in the enterprise Edge segment. Enterprise sales grew to 31% of our GAAP product revenue this quarter, and we believe our recent market positioning will allow us to take advantage of this segment's expected future market growth.

Consolidated non-GAAP adjusted EBITDA was \$29 million. Ribbon's business, excluding Edgewater, delivered non-GAAP adjusted EBITDA of \$28 million, a 40% improvement over the \$20 million we reported in the second quarter of 2018. We're very pleased with our profitability for the quarter, which benefited from strong revenue coupled with accelerated cost structure savings.

Consequently, our first nine months results were ahead of projections for fiscal 2018. Consolidated non-GAAP earnings per share was \$0.21. Our non-GAAP earnings per share, excluding Edgewater, was \$0.20 which was an increase of \$0.06 or 43% as compared to the second quarter 2018.

Now turning to the balance sheet. Cash and investments were \$43 million as compared with \$55 million at the end of the second quarter of 2018. For the third quarter of 2018, cash used in operations was \$1 million. The use of cash in operations was primarily the result of \$8 million of restructuring, acquisition and integration expense

that was recorded over that same period offset by working capital improvements. We project less than \$4 million of restructuring and integration expense will be incurred in the fourth quarter of 2018.

In addition to cash from operations, we used cash of \$46 million, net of received cash balances for the Edgewater acquisition. Revolver borrowings were \$58 million at the end of September, reflecting a use of financing for the Edgewater acquisition and our undrawn availability was \$42 million under our revolver.

Now, I would like to move to our updated 2018 outlook, which includes Edgewater's contribution. On the strength of our first nine months, we are raising our full-year 2018 guidance to better reflect expected demand and the modest accretion we expect from the Edgewater acquisition. In terms of revenue, based on our view of market conditions in the service provider space and our opportunity pipeline, we are raising our projection of full-year 2018 consolidated non-GAAP revenue to approximately \$610 million, which includes approximately \$20 million of revenue expected to be contributed by Edgewater.

Likewise, we now expect full-year 2018 consolidated adjusted EBITDA to exceed \$80 million. Importantly, based on our current outlook, we now believe we will end 2018 at an adjusted EBITDA exit velocity above \$110 million.

In summary, we were delighted with these figures. They showed that Ribbon is winning in the market and that we're executing on the strategies we described to you nearly a year ago. We're focused on delivering a strong fourth quarter. And we look forward to speaking with you all again following year end in February next year.

That does conclude our formal remarks. I want to thank you all for your continued support of Ribbon. At this time, I'd like to turn the call over to the operator for questions. Operator, we are now ready for our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we have a question from the line of Mike Latimore with Northland Capital Markets. Please go ahead.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Yeah. Great. Thanks. Excellent quarter there. Great results. Just wanted to clarify. So, Edgewater contributed \$10 million to the third quarter, and you're saying it'll contribute \$20 million for the year. Is that right?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Yes. That's our current view.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Okay. I guess, I mean, it contributed \$10 million for half a quarter. So, what would be the change [ph] where it'd be (16:47) \$10 million for a full quarter, I guess?

Franklin W. Hobbs

President, Chief Executive Officer & Director, Ribbon Communications, Inc.

A

Well, there is some sequencing. The Edgewater business and the Enterprise business doesn't experience quite the non-linearity that the service provider business does. That's just based on our current view and based on our current view of the American reseller market. We are beginning to invest and taking the products globally through the Ribbon global distribution, but we're not projecting a great deal of revenue scored in the fourth quarter for that.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Okay. Got it. And so, it sounds like you're effectively increasing your core revenue guidance by about \$10 million or so? Is that right?

Franklin W. Hobbs

President, Chief Executive Officer & Director, Ribbon Communications, Inc.

A

That is correct. Yes, sir.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Okay. Great. And on that core business, I mean, do you expect sort of broad-based demand again? It seems like it's fairly broad based in the third quarter. I mean, similar kind of broad-based trends in the fourth quarter?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

We do. We do. Based on what we're experiencing in terms of market condition and as I said, our opportunity pipeline, we do experience it to be across our solution-based in SBCs and a reasonably relative percentage of service provider to Enterprise mix in the fourth quarter.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Got it. And then, as you sort of integrated the GENBAND acquisition and cut cost, I mean roughly how much revenue would you say you sort of lost this year by either shutting down projects or discontinuing a product? And then, does that normalize again in the first quarter next year?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

We haven't really tried to categorize how much revenue that is from a year-over-year basis. We did truly diminish our former GENBAND legacy SBC sales in terms of trialing the Sonus SBC product. We do see some traction with that with the trialing. And then as we, as Fritz said in his remarks, we expect some through mid-2019 some good transitions of large former GENBAND account to the SBC 5000/7000 product. So that's really where we are on that.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Got it. And then just last one on the – I think, you said that Kandy won a U.S. service provider, I believe, in the third quarter from CPaaS. I guess, what's the end application look like there? Is the service provider going to offer like an API to developers or what's the kind of end service that this service provider would offer using Kandy?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

That is correct. That's exactly the APIs through the CPaaS platform will be offered to the Enterprise customers of the service provider.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Okay. Great. Thanks a lot. It looks great.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Well, thank you. Thank you very much. Appreciate it.

Operator: [Operator Instructions] We have a question from the line of Mark Kelleher with D.A. Davidson. Please go ahead.

Mark Kelleher

Analyst, D.A. Davidson

Q

Great. Thanks for taking the questions. Great quarter. Just to go back to some of the timing of the acquisition of Edgewater. What's the linearity look like in the revenue? Was that linearity skewed toward the back of the quarter?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

In a typical Enterprise business – within the Edgewater business, the linearity within the quarter does have more than half in the latter part of the quarter versus the first half? That appears to be the historical performance of the business.

Mark Kelleher

Analyst, D.A. Davidson

Q

Okay, great. And then just some clarity on the GENBAND integration project that seems to be winding down. What's left there? Is that pretty much complete?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

As Fritz said, we're very pleased. We did complete the large bulk of our integration activities in the summer. We still have some administrative, legal and tax and infrastructure work to do primarily in our foreign territories, where we legally still have two legal companies in various countries across Europe that are in the process with our legal organization of being legally merged and will file final tax returns and wind up things like that along the way through the summer of next year. That's just kind of the normal cycle and timing, but in terms of the large balkanize we set of our activities, we're very pleased that we've completed.

Mark Kelleher

Analyst, D.A. Davidson

Q

Okay. And Edgewater side, you had some very good results on the top line. You said it was kind of across all your products. Is there something particular that was going on in the quarter that or is it just normal variability with the service providers or was there some particular product that was doing particularly well in the quarter?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Geographically, Q3 had – it had nice contributions across the multiple theaters that I mentioned. The customer segmentation was very nicely mixed across the service provider in the SB account. And we saw expansion within our client base as well as taking on some new customers, particularly in SBC products. So, it was broadly based and it was across again the network transformation business, which as a solution is a combination, various combination of our products, the softswitch, media gateways, application servers and the like and our SBC products.

Mark Kelleher

Analyst, D.A. Davidson

Q

Yeah. Okay. Great. Thanks.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Thank you.

Franklin W. Hobbs

President, Chief Executive Officer & Director, Ribbon Communications, Inc.

A

Thank you.

Operator: We have a question from the line of Matthew Galinko with National Securities. Please go ahead.

Matthew Galinko

Analyst, National Securities Corp.

Q

Hey, good afternoon, guys. Appreciate you taking my question. I was hoping you could talk about the pipeline build for Ribbon Protect. It sounds like you're commercializing it fairly effectively after your Softbank deal, but just what does that look like going forward particularly into 2019, if not guiding to it, just do you see that becoming material and how do you feel about that product today?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Well, right now, clearly, the revenue contribution for Ribbon Protect in the third quarter being \$1 million from our one customer, is not material. We don't expect it to reach a material level in the very near term, which we would judge it being 5% of our total revenue. We are pleased that we signed our second customer, the large university in the United States. And as Fritz mentioned, we are trailing with a number of customers. We expect that order book to build over time, but again within the very near-term, we would not think that it would reach a level of a "materiality" against the consolidated company.

Matthew Galinko

Analyst, National Securities Corp.

Q

Got you. Maybe if I could ask it another way. And at what point do you kind of see maybe that business or the software business as a whole kind of paying its way and becoming a contributor on a margin basis?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Well, the good news is that that is a contributor on the margin basis, that's a all-software product. The margins are very sound. There's not a great deal of future development that's necessary to improve that product. And so the product that GA [ph] that's (24:51) in the market right now, we feel very good about it in terms of the contribution.

The question really is more around the ability to scale – to increase the volume of that. And it's still early, it's still early and we're speaking with a number of our customers. We benefit from being an incumbent and having a large installed base with a number of global service providers, where we believe this product could benefit them and protect them from certain threats that attacks the voice network. So, while it's early days. It's not about the margin as much as it is about volume.

Matthew Galinko

Analyst, National Securities Corp.

Q

Got it. All right. Thank you.

Operator: We have a question from Mike Latimore with Northland Capital Markets. Please go ahead.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Hey, yeah. Just a couple other quick ones here. Can you give any color on the mix within product of SBC versus softswitch gateway, whether SBC was the majority or minority of the product revenue?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

We don't really comment on terms of the product mix within our product revenue itself. I think it's fair to say though that SBC was not a majority of our \$78 million of product revenue in the quarter.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Okay. And then on the recent Optus announcement, it looks like they're using Kandy for kind of a mobile unified communications service for small business, I believe. Can you mention like who the competition was on that?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

There was no competition. We did have a press announcement yesterday, we're very pleased with that. Optus is a long established customer with a treasured relationship here at Ribbon. We're thrilled that we're able to provide the Kandy product to them. They're undertaking a very interesting initiative with their Optus Loop Live. We think that that has some ability to replicate and move to other customers and other service providers than that with similar needs. So, we'll be looking to explore that. But in terms of what Optus is doing with the Optus Loop Live product and our underpinning and empowering it, we're just very delighted with that.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

And then just lastly, Microsoft Teams, can you maybe just give a little color on whether that's driving your Enterprise business? And is that something that is a good sort of good tailwind for you guys or is it sort of status quo?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

So, we remain one of two in terms of Microsoft Teams. And there is some – the demand profile for SBCs in that space is moving along as we would have expected with them six months ago. We are very happy that when Fritz cited the two large U.S. based global banks taking on the Enterprise SBC products to expand the capabilities of their call center applications that's in conjunction with Microsoft Teams. And we're very happy about that sort of relationship in that ecosystem connection with the Teams product.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Yeah. Okay. Great. Thanks a lot.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

A

Thank you.

Operator: I believe that's all the time we have for questions. I'll now turn the call back to the speakers for their closing remarks or presentation.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications, Inc.

Well, thank you, everyone, for your attention to Ribbon's third quarter conference call. We do look forward to speaking with you again with the conclusion of the fourth quarter and we'll be back with you in February. Thank you, again.

Operator: Ladies and gentlemen that concludes the call for today. We thank you for your participation and ask that you please disconnect your lines.

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