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Sonus Networks, Inc. (SONS)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Second Quarter 2014 Results 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, Wednesday, July 30, 2014.

I would now like to turn the conference over to Patti Leahy, Vice-President, Investor Relations. Please go ahead, ma'am.

Patti Leahy
Head-Investor Relations, Sonus Networks, Inc.

Thank you and good morning. Welcome to Sonus Networks second quarter 2014 financial results conference call. Joining me on the call today are Ray Dolan, President and Chief Executive Officer and Mark Greenquist, Chief Financial Officer.

Today's press release and supplementary financial and operational data have been posted to our IR website at sonus.net and submitted to the SEC. A recording of this call and a transcript will be available on our IR website after the call. During our prepared remarks, we will be referring to a presentation with supporting information. Please take a moment to locate this on the IR webpage.

As shown on slide two, please note that during this call we will make forward-looking statements regarding items such as future market opportunities and the company's financial outlook. Actual events or financial results may differ materially from these forward-looking statements and are subject to various risks and uncertainties including without limitation, economic conditions, market acceptance of our products and services, the timing of revenue recognition, difficulties leveraging market opportunities, the impact of restructuring activities, and our ability to realize the benefits of acquisitions.

A discussion of these and other factors that may affect future results is contained in our most recent for Form 10-Q filed with the SEC and in today's earnings release both of which are available on our website. While we may elect to update or revise forward-looking statements at some point, we specifically disclaim any obligation to do so.

During our call, we will be referring to certain GAAP and non-GAAP financial measures. A reconciliation of the non-GAAP to comparable GAAP financial measures is included in our press release issued today as well as in the Investor Relations section of our website.

So, with that, it's now my pleasure to introduce the President and Chief Executive Officer of Sonus, Ray Dolan.

Raymond P. Dolan

President, Chief Executive Officer & Director, Sonus Networks, Inc.

Thank you, Patti, and good morning, everyone. I'm pleased to report another strong set of results for the second quarter of 2014, which met or exceeded all of our guidance metrics. Please turn to slide four of the presentation.

I'll review the highlights from the quarter including our financial results, commercial traction and continued progress returning excess capital to shareholders. I'll then provide some context around the organizational changes contained in today's press release, before turning it over to Mark for a more detailed discussion of our financial results and outlook.

Turning to slide five, total revenue grew 9% compared to the second quarter of last year, which sets us up nicely to deliver the 10% top-line growth we're targeting for 2015. This quarter, our growth-related revenue was up 34% year-over-year, which was driven in large part by the early success of our newest product, the SBC 7000. The channel was also a strong contributor to our results, representing 29% of product revenue, the highest contribution from the channel to-date.

Enterprise was 20% of product revenue, also a nice driver of our growth this quarter. The difference between these two metrics, 29% and 20%, would tell you that the channel is getting traction with Tier 2 and Tier 3 service providers, which is very encouraging.

Gross margins trended in the right direction this quarter, up 40 basis points versus the second quarter of 2013. Operating margins also showed a nice 160 basis point improvement year-over-year. This resulted in a non-GAAP profit of $0.02, ahead of our guidance and marks the fifth straight quarter of profitability for the company.

We ended the quarter with approximately $150 million in cash. I'm very proud of our team for delivering these solid financial results which position us well to deliver on the full-year guidance outlined in today's press release.

To that point, I'd like to provide a quick comment on our revenue guidance before moving on to additional highlights. As noted in today's press release, our full year revenue guidance of $300 million remains unchanged. It also takes into account the potential that a large order originally expected to score this year is now likely to score in 2015.

Based on our experience, carriers can let up a little on their spending in the third quarter before reaccelerating in the fourth. This general trend coupled with the likelihood for further capacity requirements on this particular project being pushed into next year is included in our revenue guidance in the second half of 2014.

The implication of this timing to our growth-related revenue this year is about $10 million which otherwise would have been incremental to our annual growth-related revenue guidance of $168 million this year. Mark will take you through more details on our guidance in just a moment.

Let's turn to our second quarter commercial highlights on slide six. As I mentioned, the SBC 7000 was a nice part of our Q2 results, contributing just over $5 million. This is especially impressive since the product only began shipping late in the quarter.

We're very pleased with the market's response to this product which we believe is technically well ahead of anything else in the market today. It's already been selected by multiple Tier 1 service providers from a variety of geographies as well as a leading North American call center provider. This month, we also received JITC certification on our SBC 5K, a major milestone for the company. JITC stands for Joint Interoperability Test Command and it's the organization which oversees the test and certification of products eligible to support the military's need for IT products.

We already had JITC certification on our low-end SBC which we bought from NET and called the SBC VX and we're expecting additional certification on the SBC 7000. I'm optimistic that these certifications will broaden our market opportunity with the Federal Government over time.

Let me now talk about customer growth which was also strong this quarter. In Q2, we recognized revenue from almost 800 customers including those that we integrated after a full quarter of PT in our results. This is terrific progress as we diversify into the high-volume, smaller deal size in the channel.

We are also making important progress on the high-end of the market. Since we get asked from time to time about our progress, selling it to the world's top service providers, we've calculated our penetration of the top 50 global service providers. We estimate that over 40% of the top 50 global service providers are buying our growth related products today.

We still have a lot opportunity to win more global service providers and we're making good progress. In fact, I'm pleased to report that we had another new Tier 1 win this quarter in Asia-Pac for SIP trunking services. That brings us to six new Tier 1s we have won in the last four quarters with four of those being outside of North America.

Turning to slide seven, you can see the dramatic increase in our customers this quarter. Among these nearly 800 customers were 227 brand-new customers, of which almost all purchased growth-related products. The channel is really starting to gain momentum and should be an increasingly important driver going forward.

Turning to slide eight, we've shown you a nice progress we've made in reducing the concentration of our top five customers. Our top five customers this quarter represented 40% of revenue which is down from 47% in Q2 2013 and down from 66% in Q1 of 2012. This statistic can fluctuate a little quarter-to-quarter given the project nature of some of our carrier customers, but the trend is clearly moving in the right direction. We had one 10% customer this quarter which was AT&A at 20% of revenue.

As required by SEC reporting rules for 10% customers, we've included all affiliates of AT&T in this revenue calculation including resellers. This quarter, AT&T Business Services represented 3.5% or close to $3 million of our Q2 revenue, up from just over $1 million in revenue last quarter as they are becoming an increasingly strategic reseller of our products.

On slide nine, we've summarized the status of our share repurchases to-date. So far, we have repurchased 42.4 million shares at an average price per share of $3.37. This has been accomplished through our stock buyback program as well as the underwritten offering in the first quarter led by Goldman Sachs. Approximately $32 million remains available for future repurchases. We bought back about 15% of our total shares outstanding and it substantially reduced the concentration of our top two shareholders. Today, no shareholder owns more than 10% of our outstanding shares.

This summarizes the highlights of the quarter. But before handing back off to Mark, I'd like to take the opportunity here to provide some context around the leadership changes announced in today's press release. Let me start by saying that I'm grateful to work with such a dedicated and talented team at Sonus. We've made tremendous progress over the past few years transitioning Sonus to the healthy growth business that we are today.

My goal in making these organizational changes is simple, to pick the pace and drive even faster growth and greater profitability. Tony Scarfo has assumed the role of EVP, Product Management and Corporate Development. Tony has been with us for nearly three years, most recently in the role of EVP, Technology Development. He has been instrumental in helping Sonus establish clear technology leadership in a number of important areas most notably in video as well as SDN NFV.

We were the first company to deliver our entire SBC portfolio on software and we now stand ready to enable the cloud architectures of the future. We have an integrated, global development team that leverages our technology strength in all major geographies. In Tony's new role, he's perfectly positioned to blend his technical knowledge with the market requirements of our customers.

Kevin Riley, our current CTO has taken over the day-to-day leadership of the engineering organization and he now reports directly to me. Kevin has more than 20 years of experience in software development and engineering and has been instrumental in our efforts to drive an industry-leading technology roadmap including the award-winning software SBC and the SBC 7000.

Todd Abbott has stepped down as our Executive Vice President of Strategy and Go-to-Market, but will remain with the company in an advisory role until mid-October. He will assist with the transition of his responsibilities to Tony Scarfo as well as the new interim sales lead, Mike Swade. Todd has been an integral part of our transformation for more than three years and I personally thank him for his service. He has driven our efforts to create a more standardized, scalable set of products.

He has also been a driving force behind the creation of our channel program which has helped to extend our market presence into the enterprise. Mike Swade has assumed the role of Interim Senior Vice President, Worldwide Sales and Marketing. Mike joins Sonus in May and brings extensive experience in leading global sales and marketing in the communications sector. He has been leading the North America sales team since joining and he will continue to do so in this interim role. Mike has held executive roles at Yorktel, Polycom, Lucent and Avaya.

Once again, these changes are intended to accelerate our progress as we continue to build a world-class profitable growth business at Sonus. So with that, I'd now like to invite Mark to provide his commentary on the details surrounding our second quarter results and outlook. Mark?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

Thanks, Ray. Ray provided a good summary of our second quarter results so I'll skip the next couple of slides which are there for your reference. The takeaway, as he said, is that we met or exceeded all of the metrics we guided to last quarter and have set ourselves up nicely to deliver the full year.

So, let's take a quick look at slide 13 which provides the quarterly breakdown of our growth versus legacy revenue, both actual for Q1 and Q2 and what's expected in Q3 and Q4. Before going into our outlook, you may notice that there is a difference in the first quarter split between growth and legacy versus what was reported last quarter, so I want to take a minute to explain this before moving on.

In short, our growth-related revenue should contain the solutions we provide which enable next-generation networks such as SIP and 4G/LTE. Those products primarily include session border controllers and diameter signaling controllers. Our legacy-related revenue should contain those solutions which support older networks, such as TDM or 3G and those legacy products primarily include Trunking and SS7 Signaling.

So, for the purpose of investor discussions and to try to keep it as simple as possible, we're moving to the general terminology of growth versus legacy. It's clear that the drivers of our growth revenue are evolving, so it was important to expand the way we look at our growth-related revenue which brings me to the topic of Q1 revenue. The total Q1 revenue we reported of $70.7 million has not changed. However, the mix between growth and legacy has changed.

$6.6 million that we originally attributed to legacy revenue in Q1 should have been attributed to growth-related revenue instead. And in Q2, $3.3 million that we did not contemplate at the time we provided guidance should have been considered as part of our growth-related revenue instead of legacy. This pertains only to one customer in the first and second quarter of 2014 and it's not currently expected to impact our results in our third or fourth quarter.

Let me provide a bit more color as to why we chose to reassess this revenue. If you'll turn to slide 14, you can see a clear change in the purchasing pattern of this particular customer. This chart shows you the volume of total GSX chassis purchased by this customer for their VoIP network going back over the past 10 years.

The unusual spike in volume in the first half of 2014 caused us to look closer into the use case for this customer since it was very unusual to be adding GSXs in such high volumes when our customers are transitioning to all IP networks. Upon closer review, we found that the customer was adding capacity to their VoIP network in order to facilitate a faster transition to all IP which allows them to offer more valuable IP services to their customers.

Our products in the first and second quarter of 2014 were purchased in order to facilitate this transition and hand off traffic to an all IP network. While we cannot name the customer, they have provided independent verification in their own reported results which shows a clear correlation with our observation.

So, to be clear, we're not suggesting all GSX revenue is growth related. The typical use of our gateway is to hand off to TDM where the customer has no benefit of IP services. In that case it's clearly still supporting a legacy network and it's considered legacy revenue. However, by handing off to IP the customer does benefit from having IP services. And this is the simple but important difference between use cases and the reason we consider this revenue to be growth-related revenue instead of legacy.

As I said, we're not currently forecasting this type of revenue to score again in Q3 or Q4 from this customer. But in the future, it could as they or other service providers more aggressively transition their networks to all IP and Sonus with our broad product portfolio is very well positioned to help them do this.

Let's turn now to our guidance for the remainder of this year on slide 15. For the third quarter, we expect between $70 million and $73 million of total revenue. Of this, approximately $39 million to $41 million is expected to be growth related revenue. And as Ray said, this revenue guidance considers large order that we originally expected to score in 2014 is now more likely to score next year.

For the third quarter, we expect gross margin of 65% to 66% and OpEx of $44 million to $45 million. This leads to our expectation for non-GAAP profit of $0.01 based on approximately 249 million diluted shares outstanding. We've also provided the implied Q4 guidance for revenue and EPS for your convenience.

Our full year 2014 total revenue guidance of $300 million remains unchanged from the original annual guidance provided on our February call. Given the potential timing associated with the Tier 1 order we mentioned, we are leaving growth-related revenue guidance at $168 million for the year instead of increasing it by the difference of about $10 million that Ray noted in his opening remarks.

We are raising our full year non-GAAP EPS guidance to $0.07 from our previous guidance of $0.05 based on the strength of our first half performance and a strong expected finish to the year. Again, this is based on our backlog, strong funnel and history in dealing with carrier customers.

Let's now spend a little time on slide 16, which admittedly is a very busy chart but addresses important questions that Patti and I often get from investors. So, we think it will be useful for you to have this data in black and white.

The questions that this chart attempts to answer are how fast is your legacy business declining and how fast is your growth-related business growing? To answer this, you need to separate the legacy product revenue from the legacy services revenue in particular because the trajectory for each of those components is very different.

Look at the gray bars first. The solid dark gray bar is legacy product revenue. This is the part of our business which has been declining the fastest and until this year was masking much of the momentum happening in our growth-related businesses.

We assume in 2014 that it will decline between 16% and 19% which is broadly in line with historical trends. The legacy services revenue, which is the light gray bar, is much more stable because this is essentially supporting and maintaining an installed base of more than $1.5 billion. So, we're seeing slow single-digits declines in that business.

This revenue is typically under contract a year in advance, so we do have reasonably good visibility here. Looking at the growth business, the green bars on the bottom. The product and services, more or less grow in tandem, where services represent plus or minus 25% of the total growth related revenue. You can see our assumption for 29% growth from 2013 to 2014 for the growth business, which again is higher than the aggregated market growth from various industry analysts of 20% this year, and roughly in line with the five-year CAGR we outlined at our Analyst Day of 25% to 30%.

The final point I want to make on this slide and this is critical to underpinning our 2015 targets is that our growth-related revenue in 2014 is expected to be north of 50% of total revenue. You've seen slide 17 before, which illustrates the turnaround that's taking place at Sonus. There is nothing new here other than the increased EPS guidance for the year that I noted a moment ago. The takeaway is that we're starting to see the potential of our operating leverage clearly emerge, which brings me to my final slide, slide 18.

We still expect 2015 to be the beginning of double-digit revenue growth and operating income margins, and are specifically targeting 10% revenue growth and 10% operating margins for 2015 as we laid out for you at our Investor Day back in March.

So with that, we'd now like to open it up to questions. Kelly, could you please give everybody instructions on how to ask a question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of James Kisner with Jefferies. Please proceed with your question.

James M. Kisner
Analyst, Jefferies LLC

Q

All right. Thank you, guys.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Hey James

James M. Kisner
Analyst, Jefferies LLC

Q

So my first question – great. So on the channel strength; could you give us a little more color on what is driving that? I'm just wondering if there is a big chunk of Lync growth in there or is it just broad SIP trunking adoption? Is it both? Can you just give any kind of color on the channel strength?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure, James. Thanks. It's Ray and it is both. We had continued strength in the Lync environment, as we see that globalizing nicely. We saw it in all of our theaters. We've also seen the service providers as a channel and the adoption of SIP trunking accelerate not only in North America but we've seen some really good progress in Europe and especially good progress in Asia Pac. So, I think those trends are very favorable to continued channel expansion as a percentage of our revenue.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yeah, James, and I would just add, like three other things it's been pretty well-documented that there is some disruption in the channel based on some actions that one of our competitors have taken and I think we're benefiting from that with expected – we've been working on that over the first half of the year and I think we're starting to see some results from that.

I think the second thing is Ray mentioned the JITC certification, so that's not impacting current results. But I would expect going forward as we get the entire product portfolio from low, mid up to high certified, we're going to be an excellent partner for channel partners that focus on the government space, I'd expect to see continued momentum there.

And then as Ray mentioned, not only are the service providers becoming more important channels but we've actually been working for some time on trying to develop, especially internationally, channels that can then get us to Tier 2, Tier 3 opportunities that we probably wouldn't really be able to get to with the direct sales force, and we've started to see some traction there.

So that's why you see the channel at 29% being quite a bit above what enterprise was in the quarter which was really around 20% of product revenue. And so as a result of that increasing gap is really that channel directed at Tier 2, Tier 3 service providers are finally starting to kick in and get some traction.

James M. Kisner
Analyst, Jefferies LLC

Q

It's interesting that you guys are talking about the channel business in Asia and Europe. I mean it seems like SIP trunking has obviously been a much stronger adoption in North America. That is where it has sort of been led. I mean are we seeing kind of a change in the environment around SIP trunking and unified communications in those regions?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah, James. I think we are. It's still at such small numbers, probably single digits in both those two other global theaters that it's a little early to call a major turn. But it feels like that's what we're going through. And it makes sense because it's been several years since the smartphone has changed enterprise communication through BYOD. The app layer is intuitive, the cloud has gotten scale. There's a lot of enabling capabilities.

And now, you have some fairly large players, in particular Microsoft through their Lync environment and Cisco's entrance into the cloud that are really starting to duke it out. BroadCloud is starting to emerge as a major player, white labeled inside of some service providers. So there is a lot of important ingredients that are starting to drive that SIP trunking. If we continue to see those play out for another couple of quarters, I think we'll be able to call the turn later this year or early next year.

James M. Kisner
Analyst, Jefferies LLC

Q

All right. So, thank you and one final question. Just on the order pushout in 2015, can you kind of give us any color there? Would we be correct to assume it is in North America? Is this related to just CapEx exercise? Any kind of color on the pushout of the large order would be helpful. Thank you.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah. James, it is in North America. We can't name the customer, but it's just – I think it is standard seasonality and timing of CapEx drawdown. And I also think that as we're moving more towards software-related products, it's easier for folks to wait until like almost just-in-time purchasing. So I think we accurately forecast this into next year and we'll continue to get visibility on it as it plays out.

James M. Kisner
Analyst, Jefferies LLC

Q

Thank you very much.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

I was just going to add that this is a reasonably big project that we're working on. We've actually already scored revenue on that project with the incumbents. So we're highly confident, we're going to get this revenue eventually in 2015.

James M. Kisner
Analyst, Jefferies LLC

Q

Great.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

It's really a timing issue.

James M. Kisner
Analyst, Jefferies LLC

Q

All right. Thanks very much.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Thank you, James.

Operator: Our next question comes from the line of Subu Subrahmanyan with Juda Group. Please proceed with your question.

Subu Subrahmanyan
Analyst, The Juda Group

Q

Thank you. I had two questions.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Hi, Subu.

Subu Subrahmanyan
Analyst, The Juda Group

Q

Hi. The first question is just on the growth revenue side with the way you have increased some of the allocations towards growth revenue for the first half, left it relatively unchanged. Is the entire difference essentially the $10 million order that you had expected happening in the third quarter which gets pushed out from an annual perspective. That's my first question.

And second question, if you look at your revenue number remaining unchanged, obviously with that $10 million allocation, legacy must have done somewhat better than you expected, and it shows in some of the growth numbers versus the close to 30% decline you had expected in past years. So I am wondering if the trend in legacy is a little bit more of a gradual decline than you had expected before.

Raymond P. Dolan A
President, Chief Executive Officer & Director, Sonus Networks, Inc.

So, on the legacy, I think we've talked about this before. We think on the product side, it is going to be about a 20% decline year-over-year going forward. We think that's kind of the average trend line. Your observation is correct. I think this year; it might be a bit less than that. I mentioned that in my remarks that we think it's going to be more in the order of 16% to 19%.

But we don't think we're seeing anything there that's causing us to think differently about kind of a longer-term trend line. We think it's – again, the legacy can be very deal-specific. It is going to be a bit better this year, but I would not read anything into that. We still think that that kind of 20% decline year-over-year is more or less what it's going to average. It has been at that rate for the last couple of years and we think it's going to continue at that rate.

Patti Leahy A
Head-Investor Relations, Sonus Networks, Inc.

On the product side.

Raymond P. Dolan A
President, Chief Executive Officer & Director, Sonus Networks, Inc.

Yeah, exactly. Thanks. Does that answer your question?

Subu Subrahmanyan Q
Analyst, The Juda Group

Yes, I was just wondering from the growth product side, given despite that $10 million reallocation, the full-year number is unchanged, is the delta pretty much that one deal which you had expected to score in the third quarter now being a 2015 factor?

Raymond P. Dolan A
President, Chief Executive Officer & Director, Sonus Networks, Inc.

Yeah, that's exactly right. I mean, as we've talked about, we think we're getting a lot of traction on the growth side, not only through the channel but we've also won another Tier 1 over in Asia-Pac and again on the 7K introducing that and having it immediately contribute a few million dollars to revenue is being great.

But we do have one narrow problem which was the push out of this order and it is a relatively large piece of business being about $ 10 million. Like I said we're highly confident, we're going to get that revenue because we've won the deal, we are the incumbent and we've even actually scored revenue on that project, but we thought it was going to be in 2014. It looks more likely now it's going to be in 2015.

Subu Subrahmanyan Q
Analyst, The Juda Group

Great. And my other bigger picture question is just in terms of carriers and what they're doing in terms of their architectural changes, some of them have been public about it. Are you seeing any impact on near-term spending versus how they are thinking more strategically? And the other CapEx question is, seems to be that this year especially in the U.S. seems to be a little bit more first-half loaded versus the average year. And I wonder if you're seeing any kind of changes in buying patterns in general from your large carrier customers?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes, thanks Subu. We have, it's possible that this push-out is that same first half, second half phenomenon since it is North America-based, but I think it's more project-specific than it is the secular trend of service provider spending. However, we've tried to take all of that into account in our third quarter guide and our fourth-quarter guide, because in our results for the last three, four years we've seen the same kind of pattern of strong first half, a little weak Q3, and then a comeback in Q4. So we've tried to pattern that in our results and our guide.

With regard to their architectural changes and whether it's giving them any short-term impact. I don't believe so, but as we've said in prior calls, there are times where as they are moving to NFV and SDN especially when people go to Domain 1.0 and then Domain 2.0 there is a lot of flux in the spending patterns of these large operators as they are moving to the cloud.

I think that's a real opportunity for us long-term and short-term impact, I don't see it as a major issue or a blip, but they are bidding out their cloud architectures right now. You've seen a lot of VoLTE false starts and then slowdowns as people are really trying to think about what is it that they're really trying to accomplish with VoLTE? Are they just trying to move voice over from 3G and 2G to LTE or are they trying to enable real-time communications in one unified pipe that is both fixed and mobile and driving to fixed mobile convergence through small cell.

So this is a time of tremendous flux. I haven't seen it impacting the short-term financials for us or the purchasing pattern. But it is opening up a lot of opportunity and that's tremendous for Sonus all right? Because we've moved to software before anybody else in this space, we've leveraged our real-time communication skills that come out of the gateway business and we're opening up our access to these large projects which over time is going to be a very healthy source of growth for us.

Subu Subrahmanyan
Analyst, The Juda Group

Q

That's helpful. Thank you.

Operator: Our next question comes from Mike Latimore with Northland Capital. Please proceed with your question.

Mike Latimore
Analyst, Northland Capital Markets

Q

Great, thanks a lot. It sounds like most of the channel revenue relates to UC and SIP trunking. I guess if you were to look at the total revenue amounts, what percent do you think derives from those types of categories?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

I think you're right, Mike. It's very high from the standpoint of the channel revenue.

Mike Latimore
Analyst, Northland Capital Markets
Q

I guess, I was thinking in terms of total revenue, the amount that might derive related to UC and SIP trunking.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Yeah. Well, the channel revenue is 29%. I'd say a very large percentage of that is obviously UC and SIP trunking. As to how much of the service provider piece, it's probably more than half, but I don't have a specific number in mind.

Mike Latimore
Analyst, Northland Capital Markets
Q

Great. And then on the pushout, what application is being envisioned there? Is that a interconnect or a SIP trunking, or what is the application?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

It is interconnect as well as some work in the wireless space right now and we'll get into that, I think, over the coming quarters as we get deeper into that project.

Mike Latimore
Analyst, Northland Capital Markets
Q

Yeah. And then on the, I guess, change to growth related from legacy, and that one customer using a GSX to go to an all IP network, is that sort of an unusual application of GSX? I would think other service providers might use a GSX to help move to an all IP network as well. I guess what is unique here?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.
A

Well, I think the unique thing is, as we said, when we look at the use case and what's really driving the purchasing decision versus why they would have been purchasing this equipment in the past is what makes us conclude that this is – something has changed in the first half of this year. It's driven a big spike up in these purchases. It is related to really supporting the customer's growth in this area and it is important strategy for them as well.

And so, again, when we look at it and we look closer at it, we concluded this really has more to do with the growth side of our business, the growth side of our customer's businesses and the particular product that they're using to enable that, not only does it have to do with the fact that the products got the capability to support their needs but it is – they are one of our long-standing customers and so therefore they would potentially tend to use this equipment versus let's say some of the more recent SBC products that we've introduced.

Mike Latimore
Analyst, Northland Capital Markets
Q

Got it. And then just last question, the number of new customers was up a lot. I would imagine a lot of that is related to the enterprise, but yet the enterprise data is about 20% of revenue. So can you sort of clarify that? It seems to me that enterprise revenue might have moved up a little bit with that much new customer count.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Well, so a couple of things going on there. As we mentioned that reflects us bringing the PT customers into the fold. So we got a little bit of help there but it also does represent the increase in channel revenue. So, I think, one is correlated to the other, the more success we continue to have with the channel, the more we're going to drive new customer acquisition and while you're absolutely right a lot of it has to do with enterprise. Part of it also has to do with the phenomena that we were talking about where we're finally starting to see our strategy to try to use channel to get to Tier 2 and Tier 3 service providers kicking in as well. So it's a little bit – I mean, I don't want to overstate that but it's a little bit beyond just the enterprise space.

Mike Latimore
Analyst, Northland Capital Markets

Q

Great. Thanks. Nice quarter.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Thanks.

Operator: Our next question comes from Dmitry Netis with William Blair & Company. Please proceed with your question.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Yeah. Thanks. So just kind of again on this large order, gentlemen, it is now slated for 2015. Could you give us the timing? Is that the first half, Q1, Q2? How are you thinking about that? That would be great, thanks.

.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah. Dmitry, I would call it first half. That's our visibility right now and we hope as early as possible in the year. But we'll just follow the lead of the customer as they transform these networks.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Okay, great. And then on the Diameter sales, can you tell us how much of revenue have you recognized from that function?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yeah, we didn't really score any revenue in Diameter in the second quarter. We had bookings but we didn't score the revenue. The revenue from those bookings will come in the second half of the year. And as we've been discussing, we continue to think that that is going to be relatively small this year.

In the guidance that we provided and have stuck to – we had roughly $15 million of total revenue being contributed by PT with only $3 million of that being Diameter and I think that as we look at what's happened to-date and what we expect over the second half of the year, those still seem to be reasonable numbers.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Right. So the SS7 side, the legacy side of PT, is that kind of linear throughout the four quarters of this year, or are you seeing decline or deceleration of that business?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

No. They don't – I mean, they have a similar type of seasonality that we would see where the fourth quarter is probably going to be the best quarter we have there and it's kind of trending along as we would've expected in Q1, Q2 and Q3.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Okay, great. And then I have to ask another question on the GSX reclass. If I remember, you guys always included GSX in your SBC number since it had this dual functionality, both the trunking and the SBC. So I don't know when have you start sort of reclassifying per kind of customer deployment, customer application. Has it always been the case, or you have just recognized revenue from the platform per se? I'm just trying to get some color around that, if you could help us understand better.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

So, I think you're alluding to the SBC 9000...

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Correct.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

...which is a hybrid product and could contain either trunking licenses or SBC licenses and therefore we could just look at the product and see basically how we would allocate it, whether it'd to trunking or to SBC. In this case, the customers bought a product that again, contributes to the rollout of these IP services. They don't necessarily have SBC licenses, they have SIP licenses in them, so they're supporting SIP

And again, I'll just go back to the – when we look at the use case for why they're buying this and if you look at the charts you can see that obviously something changed in the first half of 2014 versus what the purchasing pattern had been before. When we went back and looked at that, we concluded that they're actually using them somewhat differently than what they had originally purchased them for.

It's again, supporting roll-out of – and a continued expansion of this business for them, which is a growing business and it's important strategy for them. And so, this product is playing a key role in doing that. So again, we concluded that it really is more growth-related business versus what we would consider legacy which would be essentially the care and upkeep of old networks declining overtime.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Was that customer buying the 9000 or was it something else? Was it some other function or platform?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

No, they have – as we mentioned it was the GSXs so it's the 9K chassis.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

The 9K. Okay, thank you. Then last question, any thought of a new buyback authorization, guys?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Nothing to report or talk about at this time.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

We still have substantial amount of buyback authorization left, Dmitry, so I think you should expect us to just continue to draw that down as we've stated in prior calls.

Dmitry G. Netis
Analyst, William Blair & Co. LLC

Q

Great. Thank you. Keep up the good work, gentlemen.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Thank you.

Operator: Our next question comes from Ryan Hutchinson with Pacific Crest Securities. Please proceed with your question.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

Hey, good morning, guys.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Hi, Ryan.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

So to follow up on the last question, I just want to be clear on this. So you reiterated the $168 million. Can you just give us color on what the expectation is for any additional GSX revenue that should be incorporated into that number?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yeah, as we said, we don't expect to see any in Q3 and Q4. We think, we think that – this particular project that we've been working on for this year, what we've seen in the first half is going to do it. And then we'll see what transpires next year.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

All right. Then I have two small ones. Just in terms of thinking about AT&T for the back half, any expectations there? Would they drop below 20%?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yeah. As we said last quarter call and I think, we think the same thing. They have been north of 20% customer in the first and second quarter. I would not expect that in second half of the year.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

Got it, okay. And then just in terms of thinking about the diversification here on the top five customer trends. Over time, how do we think about that as a percentage of revenue as you guys diversify the customer base and that is it from me? Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Y Yeah. So, Ryan, as we said we're down in a 40% range, I would hope that it would stay there and potentially trend lower. It is a volatile number, especially as we have seasonality in our total revenue.

An important project can spike as a percentage of 70 that wouldn't spike as a percentage of 90 in a higher volume quarter. But with all that said, I would hope that it would trend down into the 30%'s and then it would probably stay there because we are still predominantly a service provider business, as the majority of the spend in communications for the foreseeable future will be with service providers and those are going to be project driven and they're going to be concentrated in any one quarter.

The goal though would be to roll that concentration quarter-to-quarter so that it moves around the globe as these projects are drawn down. So that our goal would be as SIP trunking globalizes, our total results globalize as well. Our other theaters start to grow as a percent and our customer concentration comes down a little bit from the 40% that is at, but it's been major progress to get it from the 60%'s down to the 40% where it is today.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

I mean, it's as Ray just said it's

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

Yeah. But is sounds like in – go ahead, sorry

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

No, I was just going to say, as Ray just said, I mean, it's clearly our intention to try to have that number trend lower. I think the progress that we're making on channel helps. I think the progress that we're making on getting new Tier 1 customers helps. I would say that it's extremely difficult if not impossible to predict what it's going to be in any one quarter, but I think you should expect the trend line to continue to slowly go down.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

Right, but it sounds like in the near-term, I mean with the back half and with the order delay and AT&T coming below 20%, that you can still hit the $300 million number and then that could change in 2015. But in the near-term, you have got some pretty good customer diversification.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yes, agree with that.

Ryan Hutchinson
Analyst, Pacific Crest Securities

Q

Okay, great. Thank you.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Thanks.

Operator: Our next question comes from Paul Silverstein with Cowen. Please proceed with your question.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Yeah. Ray, can you hear me okay?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes, I can.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Hey, Paul.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

How are you doing, Paul?

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Hey, a couple questions, if I may. First off, I know it is early in Diameter Signaling for you, but can you share with us how many Diameter Signaling customers you have at this point, as we try to look forward?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

I don't have that number off the top of my head, Paul, but it's probably a handful of customers.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Okay.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Just to give you ballpark, okay?

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Appreciate it. Any thoughts on where gross margin can go in terms of peak level long-term?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Well, I've been reluctant to call a number, but what I've said is we should trend towards industry leadership and the only reason I don't want to put a specific number on it is that, I think it's hard to predict where that will go, but we are going more software centric, we're definitely moving towards a more standards-based product, which allows us to get some of the cost structure from customization out of our – and as we get to higher volumes, my guess is we should trend into the 70%s and where it goes from there. It's more of an industry level issue from there than it is a Sonus specific issue. But we still got some work to do from trending in the mid-60%s to trending into the 70%s

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Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Okay. I assume in terms of the price environment, price is always coming down. I assume the rate of change has not changed meaningfully one way or the other?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

That's correct, and I do believe that SIP adoption and global traffic growth and playing in the real-time control playing side, as opposed to the commodity best efforts IP traffic in the cloud are always, for us, to continue to grow and grow margin.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Okay. Ray, correct me if I am wrong, but early on when you all first got into the SBC market, you were pricing somewhat aggressively, understandably, in order to gain territory. Is that no longer the case in terms of pricing? Does your SBC pricing look more like what ACME used to show in terms of 80%s. Can you give us any sense for that?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

When you say 80%s, do you mean margins?

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

I apologize. Yes, I was referring to gross margin, my apologies.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah. So we're not at product gross margins in the 80%s yet Paul, but we'll take it if it comes our way. I don't think that it's much a function of pricing, as it is just deployment densities. So while it may have been your perception, it was never mine that we were driving adoption through pricing. We were definitely allowing people to make rational decisions at low densities and anticipating that as they drove more software content that we would improve our margins and we're seeing that in our results.

So I don't think we're necessarily a price-based competitor or ever have been. We try to drive to value add pricing, but as we compete and try to dislodge someone, we'll be aggressive as we need to be so that we can look at something over the entire life cycle of the deal.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Yeah Paul, I mean, I would just add that I think obviously, when you're trying to break into someplace new and it's a competitive RFP process, I mean, it's obviously you are more aggressive there. Once you are the incumbent and you have proven your worth, the business is more profitable. So, I think we're in an envious position in a sense that we do have a good base of customers. We got a good margin that we're working of it and frankly we can pick our battles and have the ability to be aggressive to break into new customers without it kind of tilting our results. And so, I frankly think that that's a big advantage that we have and we'll continue to kind of use that tool going forward.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Ray, on your point about the densities, does it follow that the 7000 with its much greater capacity, that that would have a naturally – all other things being constant would have a higher margin relative to the lower volume products, lower capacity products?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

That's a good assumption, Paul. It's over the life of like how they purchase it, right. I mean, if they're buying – if the initial purchase of the 7000 is coming at relatively the same density of what that initial purchase on a 5000 would be, I don't know that the margin profile is going to be all that markedly different. The advantage, Paul is that then over time as they add capacity, the 7000, because of its much higher capacity has the ability to support a much greater number of capacity adds and that's really where the margin differential is and so, again I'm, I'm kind of going on for too long. But the point being that with the higher capacity, 7000, over the life of the purchase and as they fill up the box, it's going to be a more profitable piece of business for us even though the initial deal might not be that different.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Got it. Two more quick ones if I may. First, Ray, are you also sharing with us – and I apologize if I missed it, but the enterprise service provider split on SBC?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

We didn't do it on SBC. We did it on total revenue and the enterprise is 20% of total revenue at the product base. Channel is 29%, it was in my script.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

All right. Can you share with us what the split is on SBC now?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Go ahead, Patti.

Patti Leahy
Head-Investor Relations, Sonus Networks, Inc.

A

Yeah, the enterprise was at 27% from the growth products.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

So the enterprise was 27% of SBC revenue? I appreciate that, and last question.

Patti Leahy
Head-Investor Relations, Sonus Networks, Inc.

A

Products, product revenues, yeah.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Thank you, Patti. Last question, Ray, did you share with us a number in terms of any quantification progress with respect to the VoLTE? I know it is still early, but with respect to the VoLTE opportunity?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah. I'm happy to talk about it, Paul, it's not to quantify it but strategically I love where we're at and here is why. We're in a lot of discussions. I'm not going to get into the trial aspects as you can remember that from years ago, it wasn't very constructive. But in those discussions, first, it's important to understand why people are doing it. They're not just moving voice from 2G to 3G, they're trying to really open up a broader suite of real time communications. Otherwise, they're not going to get incremental revenue.

I think real-time video and in this case I'm talking like Skype, FaceTime type of video applications are going to be one of the drivers of that. It's early days but that's where it's looking. So if you think about this problem simply and I think of it simply, I'll articulate it as quickly as I can this way. I think of LTE as basically mobile Ethernet all right. That was the goal, to make it look like a wire.

So now what you've got is in LTE, you've got a native IP link all of the way out to the mobile host if we call it a handset, but it is basically a computer all right. The radio portion is shrinking, what's left are two major tasks, mobility management which is really the domain of the big wireless players, we're not going to play there for at least the foreseeable future, although small cells may in fact change architectures and we're tracking that.

And then the second piece is managing IP flows in a congested network. That is our bread and butter. So as the LTE market moves to embrace managing real time flows over that, and as fixed mobile convergence drives further, there is a huge opportunity for Sonus to leverage our policy assets, our interworking assets and get embedded into those LTE solutions.

Now, the reason that it's early days is that used to be viewed as an IMS play and IMS has been a promise unfulfilled, largely in the wireless space for at least five years. Then it was in SBC play and to a certain extent, it is, but it's really evolving with STN into a Cloud architecture and I think we've got a great chance as early as next year to start really driving some major progress in VoLTE as VoLTE moves into really UC over LTE.

That's what we've been saying for years. We've said it's not in our results for this year, it won't be material, at least, for this year, but we think it will be material as early as next year. I hope that's good enough answer to your question, we'll keep you posted as we make progress.

Paul J. Silverstein
Analyst, Cowen & Co. LLC

Q

Thank you.

Operator: Our next question comes from Ted Moreau with Barrington Research. Please proceed with your question.

Theodore Joseph Moreau
Analyst, Barrington Research Associates, Inc.

Q

Great, thank you, and congrats on a nice quarter, guys. So it sounds like this $10 million order that was pushed out is heavily software piece of business. So I'm imagining that the margin profile there should be towards the higher end of your growth products view. Can you give us some perspective on the margin profile there, and could that bring up your overall gross margins into the range that you saw maybe in Q1?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes. So Ted, this is Ray. It is heavy on the software side as our most second and third draw-downs of these large projects is, they tend to be more software centric after an initial deployment of software and hardware. As a result, it is a higher margin than our aggregate product margins and it will help us from the standpoint of overall profitability as we expand these projects.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

I think Ted, it's Mark. It will be tough to say whether it's going to happen over a single quarter next year or whether it's going to be multiple quarters and please keep in mind that we're talking about $10 million on a relatively large business. So while I think your characterization of it is correct, I'm not so sure that in any particular quarter it's really going to move the needle that much, but it certainly would be positive because, you're right, this would be revenue that would come with a margin that's above our average.

Theodore Joseph Moreau
Analyst, Barrington Research Associates, Inc.

Q

Okay, sounds great. And then since we're talking about software a little bit here, is there any way to provide any kind of I guess sizing of the overall business for Sonus? And to what extent the software contributes today versus maybe how big software could be in the future, like, is there a way to give it percentage terms? Are we like 50% of the business is software or 25% or something like that, and then how high can we go?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

So it's a good question. It's one that we're certainly interested in looking at more. I think when we look at it now and of course, it's key in terms of like how you're defining it, I would say it's under 50% now and probably frankly if I look at it like pure software, it's probably closer down to more like a quarter. But, I think we really need to do more work with regard to how we're defining it and so that we can be clear to you and give you some more precise numbers going forward.

And I do think we – our intention would be to do so because we've said on numerous times that we do think that this is going to be a key driver of the business and profitability going forward. But, like, right now, it's not a huge driver and it's a little premature to get into the specifics. But I would like to think that as we go into the next year, we can talk a little bit more intelligently about that and give you some more insight into how we think that's trending over time and what we think the impact is going to be.

Theodore Joseph Moreau
Analyst, Barrington Research Associates, Inc.

Q

Okay, that would be great. Then finally on the new 7000 product, were you anticipating these very strong sales right at the end of the quarter there and then how does the 7000 introduction impact the growth trajectory of say like the 5200?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah, Ted. This is Ray. So, we brought in the general availability date for the 7K, which was originally going to be early Q3. We brought that up because of the strong interest that we saw throughout the quarter and a couple of our large customers wanted to standardize around that because it has a tremendous amount of benefits including high density and 10 gig interfaces which opens up the video opportunity. So, it starts to future-proof networks that are looking to explore video revenue in a real time sense.

As far as whether it cannibalizes the 5K, I don't think it does. I think it's a natural migration for people that have been using the hybrid 9K to move over to the 7K chassis and to continue to drive large peering projects and to drive large service provider network growth projects. We're also starting to see some large enterprise embrace this because to the extent they have very large densities in some of the Fortune 50. Some of them are interested in the 7K.

So, I don't think it's going to cannibalize the 5000 series. I think it's going to operate on the high end and it's very, very competitive. We were pleased that it crushes the competition on all the major metrics out there. So that when we get into labs, one of the things that I am detecting is that what used to be sales cycle times that were much longer we now get into a side-by-side bake-off and demonstrate clear open water on a number of technical attributes and get more quickly through the lab process and into the sales cycle.

Theodore Joseph Moreau
Analyst, Barrington Research Associates, Inc.

Q

Sounds great. Congrats again. Thanks guys.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Thank you Ted.

Operator: [Operator Instructions] Our next question comes from [ph] Steve Cohen with Provo Partners (59:57). Please proceed with your question.

Q

Hi, two questions. First, on Tier 1 customers, I guess over the last four quarters or so you have spoken about I guess something on the order of seven Tier 1 wins. I was wondering if you could give some more color how many of those overlap with the 7000 wins; geographic split, when they might score into revenue, etc.? And second question is with the channel up to 29% of product revenue, where do you see that going in the long run? It seems like it's already trending higher than what you were looking for when you first launched the project 12, 18 months ago.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

So, [ph] Steve (01:00:45) this is Ray. The Tier 1s we announce six so far this year, they're in all the large theaters. What I'm encouraged is that we're starting to see some take up in Asia-Pac but we've also seen all around the world as SIP trunking starting to evolve. So, that's our comment on the Tier 1s. It wasn't 7K related although there was some 7 K content in a couple of those Tier 1s, but it was principally just continued expansion in the 5000 series as we continue to penetrate there.

On the channel revenue of 29% of total product, I'm really pleased. I don't expect it to continue to grow too much more from there but I'd take it if it came because I'm hoping that we can continue to grow both sides of the business. And as the channel grows, the service provider grows because a lot of this is related. The service provider SIP trunking market feeds into the enterprise market. To the extent we see continued growth in the Tier 2, Tier 3 and that comes through the channel or to the extent we see growth in the government business and that comes through the channel.

Some of those would be potential sources of higher percentage of revenue that comes in through the channel. But I'm really pleased with where we are right now at $30 million and I'll take higher and if came lower based on growth in the service provider side of the business, that would be fine with me too.

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Also just to add [ph] Steve (01:02:11), I think with regard to the six or seven Tier 1s that you're mentioning, I mean none of the historical business with them was 7 K. The 7 Ks business that we did in the second quarter was – that we did with a Tier 1 service provider that was a prior customer and not a new customer. But as Ray said, in the second half of the year definitely expect and actually know that at least off the top of my head, at least one of those new Tier 1 wins that we had is going to be taking some 7 Ks in the second half of the year.

Q

Okay.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Any further questions operator?

Mark T. Greenquist
Chief Financial Officer, Sonus Networks, Inc.

A

Any further questions operator?

Operator: We have no further phone questions at this time. I'll turn it back over to you Ray Dolan.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

Thank you very much, Kelly. And thank you all for participating on this call, for your continued support to Sonus. We look forward to sharing our results for the second half of the year as they evolved. Enjoy your summer, folks. Talk to you soon.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your line.