Corrected Transcript

01-Mar-2018

Ribbon Communications, Inc. (RBBN)

Q4 2017 Earnings Call

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Mark Kelleher
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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing-by. Welcome to the Ribbon Communications' Fourth Quarter 2017 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, Thursday, March 1, 2018.

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

Sara Leggat
Investor Relations Contact, Ribbon Communications, Inc.

Thanks Lynn. Good morning and welcome to our fourth quarter and fiscal year 2017 financial results conference call. On a call with me today our Fritz Hobbs, President and CEO and Daryl Raiford, CFO.

Today's press release and supplemental data have been posted to our IR website at ribboncommunications.com. A recording of this call and a transcript will be available on our IR website shortly after the call.

Please note that during the call, we'll be making forward-looking statements regarding items such as business strategy, 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 customer purchasing decisions, revenue recognition, our ability to successfully integrate GENBAND and Sonus, difficulties leveraging market opportunities and the impact of cost containment efforts.

The discussion of these and other factors that may affect our future results is contained in each of Ribbon Communications' latest annual, quarterly and current reports filed with the SEC, and in today's earnings release, all of which are available on our IR website.

Additionally, many risks and certainties could cause actual results to differ materially from these forward-looking statements. 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'll be referring to certain GAAP and non-GAAP financial measures. Reconciliation of historical non-GAAP measures to comparable GAAP financial measures are included in our presentation on our website and in our earnings press release issued today.

With that, let me turn it over to our President and Chief Executive Officer, Fritz Hobbs

Franklin W. Hobbs

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

Thank you, Sarah and good morning to everyone on the call. Late October 2017, we completed the merger of Sonus and GENBAND, which transformed our business. We rebranded our company as Ribbon Communications, which signified our role as an innovative technology provider, positioned to meet the growing demand for secure, real-time communications.

I'm encouraged by the future outlook for Ribbon, as we are well-positioned to lead the network modernization trends for both service providers and enterprises. In December 2017, I became the CEO of Ribbon. I believe, I can leverage my prior executive experience of driving transformational change and generating significant long-term shareholder value.

During my first few months at Ribbon, the extended management team and I have been focused on reviewing our go-to-market strategy, evaluating our product portfolio and driving integration activities and related cost synergies. I'm very impressed at the level of talent that has come together to create Ribbon.

The executive teams surrounding me, starting with David Walsh, GENBAND's former CEO, Daryl Raiford, our CFO and former CFO of GENBAND, is made up of industry veterans with deep domain expertise, representing a balanced mix of the best of both companies. We retained key management such as Mike Swade to lead sales, Patrick Joggerst to lead marketing and business development. Additionally our operations and services are led by Steven Bruny, a highly experienced industry executive. Kevin Riley who has overseen the successful SBC product development efforts at Sonus is our current CTO and we welcome Tony Scarfo back to the Ribbon team in January to lead our combined products and R&D functions.

Susan Villare, formerly Interim CFO for Sonus, leads our Financial Planning and Treasury and John McCready continue to lead Strategy and Corporate Development. This is an exceptional team. I'm also very pleased with the combined company's performance to the end of the year. We made solid progress on operationalizing costs synergies, which have now begun to contribute to profits going forward.

I'd like to update you on our integration progress. After that, I'll give you an overview of our strategic initiatives to capture market opportunities and thoughts on 2018. I'll then turn the call over to Daryl who will discuss fourth quarter and full year results in detail as well as our 2018 financial outlook.

Our top priority in the near-term is to swiftly complete our merger integration process and capture cost synergies. In fact, we've already operationalized annualized cost savings exceeding our $50 million target we set at the time of the merger announcement. We are also intensely focused on cost discipline and efficiencies across the whole organization beyond these merger cost synergy targets.

It's important to point out that while we are thoughtfully optimizing costs, we remain focused on customer satisfaction and believe our customers will continue to positively benefit from our expanded depth and reach of the combined teams.

Now, I'd like to talk about our strategic initiatives and market opportunities. Ribbon's increased scale, global footprint, expanded product offerings and longstanding position in our combined customer base, gives the company a much stronger competitive and operational advantage than if either company remained independent. In addition to the integration work that is already well underway, our strategy is focused in four key areas.

First, we will continue to invest in our core products and solutions to lead our customers into the next phase network modernization. We heavily invested in virtualizing our product portfolio ahead of the competition and we'll continue to invest to drive our market leadership position. The transition to virtual networks opens opportunities for us to potentially displace existing vendors.

Our recent Verizon virtualization deployment which displaced an incumbent has led to several other important initiatives within Verizon and other Tier 1 carriers. We're evaluating options to sunset certain less significant product offerings that are not aligned with our strategic direction, are not meaningful contributors to our profitability. This will allow us to more effectively and efficiently deploy capital to growth areas.

Our second initiative is to expand into adjacent markets and related applications. For example, we've leveraged our science and technology to develop our cloud based initiatives, namely CPaaS, branded as Kandy and Security which we branded Ribbon Protect and introduced it during this week's Mobile World Congress. The rapid market adoption of embedded CPaaS applications presents a significant market opportunity for Ribbon.

In addition, we see an opportunity for a security initiative driven by the increasing focus from service providers and enterprises on fraud, security and network. Third, we will leverage our global customer footprint and strong installed base to expand our business.

Today, we have over a 1,000 customers globally, including the largest telecom service providers and enterprises in the world. We plan to utilize our expanded reach to drive cross-selling opportunities. In addition, a significant contributor to our revenue comes from network transformation projects where we should benefit as our large installed base moves to the next phase of network modernization.

And fourth, we plan to leverage our financial scale to pursue certain acquisitions, strategic relationships and alliances that will advance our strategy and create shareholder value. We will look for desired relationships that can leverage our scale in global sales footprint to accelerate our cloud based initiatives and/or drive significant financial leverage.

Our customers count on us as their trusted partners to help them move to virtualization and cloud. We believe we are in early innings of a secular shift to virtualization and Ribbon is focused on gaining market share and expanding our market leadership. I believe 2018 is an important transition year for Ribbon.

We face a challenging marketplace, we are intently focused on completing the integration and progressing with our four key strategic initiatives. We continue to believe that overall market conditions will remain challenging, especially in our home market of North America. On a macro level, we anticipate a pause in carrier spending as certain service providers evaluate their path to network modernization and we have customer consolidation in the market. We expect 2018 revenue to be lower than 2017 pro forma revenue. Given these dynamics, we intend to focus on building a solid business, emphasizing profitability.

As such our focus is on adjusted EBITDA, which we expect to be approximately $75 million in 2018 or an increase of 66% from pro forma 2017. Going forward, we do not intend to manage the business quarter-by-quarter, rather we will build a solid operating foundation from which to grow.

I'll now turn the call over to Daryl to discuss our financial results and 2018 outlook in more detail. Daryl?

Daryl E. Raiford

Chief Financial Officer, Ribbon Communications, Inc.

Thanks, Fritz, and good morning everyone. I'm going to review our non-GAAP financial results for fourth quarter and full-year 2017 and then turn to commentary on 2018. As a reminder, our non-GAAP financial results are reconciled for you at the end of both of today's press release and our earnings presentation. Both are available on our Investor Relations website. Our full-year results include 12 months of Sonus operations and two months of GENBAND operation.

When I refer to non-GAAP in conjunction with a financial metric, these financial metrics exclude the effect of purchase accounting and other items detailed in our earnings materials. I will also use the term pro forma, which means the combination of the respective results of Sonus and GENBAND as if combined at the beginning of the period presented.

Overall, we had a very exciting quarter with the launch of Ribbon Communications on October 27. Beginning immediately post close, our sales team began to aggressively promote the value proposition of Ribbon's secure real-time communications software, hardware and cloud native solutions. Our merger integration plans kicked-off in earnest immediately and we made substantial progress. And importantly, Ribbon's fourth quarter revenue, gross margin and earnings metrics exceeded the guidance we provided externally during our third quarter earnings call on both a standalone and a combined basis.

On a non-GAAP basis, our fourth quarter 2017 total revenue was approximately $170 million, gross margin was 61%, operating expenses were $80 million, earnings per diluted share was $0.27 and adjusted EBITDA was $28 million. The acquisition of GENBAND was immediately accretive to Ribbon.

For the full-year 2017, on a non-GAAP basis, total revenue was $353 million, gross margin was 66%, operating expenses were $202 million, diluted EPS was $0.51 and adjusted EBITDA was $41 million.

Our fourth quarter non-GAAP revenue benefited from stronger-than-expected session border controller sales. Favorable revenue mix, coupled with higher than previously projected revenue, led to a stronger gross margin.

Turning to the balance sheet. Cash and investments were $83 million at the end of Q4. Cash and investments decreased by $48 million as compared to the end of September 2017 due to the acquisition of GENBAND, which was a use of net cash of $43 million. We were essentially cash breakeven from operations this past quarter with earnings from operations used to fund capital expenditures, integration and acquisition related items.

In the fourth quarter, we amended and expanded our existing credit facility, which now allows for borrowings up to $100 million plus a $50 million uncommitted accordion. At the end of December, we had $20 million outstanding on the revolver and undrawn availability of $80 million.

Now, I'd like to turn to our 2018 outlook.

Before I do so, I'd like to let you know that Ribbon has established its new guidance policy. Going forward, we will guide annual profitability, namely adjusted EBITDA for the full year. We do not generally intend to provide formal numeric guidance on a quarterly basis going forward. However, given our recent combination and market conditions, we do believe it is appropriate to provide commentary on our first quarter outlook today.

For the first quarter of 2018, we expect our revenue to be approximately 10% less than pro-forma first quarter 2017. However, we expect adjusted EBITDA to be essentially unchanged compared with pro-forma first quarter 2017, as we believe our initial synergies and cost improvements will fully offset the effect of our lower projected revenue.

At this time, we expect first quarter market conditions to persist through the remainder of 2018, resulting in an outlook for 2018 revenue to be lower by about 10% compared with pro forma 2017. Although, we believe these revenue challenges will continue through the year, it's important to point out that this does not dampen our bottom line outlook. We are aggressively focused on swiftly completing our merger integration activities and capturing this value and margin improvement in operating expense savings.

We were driving to deliver 2018 non-GAAP adjusted EBITDA of $75 million which as Fritz remarked, is an improvement of 66% compared with pro forma 2017.

We expect to return to revenue growth over time driven by share gains and virtualization, as well as benefiting from our growth initiatives in Unified Communications, CPaaS and Security. Meanwhile, our projected dramatic improvement in cost structure should position us well for adjusted EBITDA growth in 2019 and beyond.

With that I would like to turn the call back to Fritz for closing remarks.

Franklin W. Hobbs

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

Thank you, Daryl. In summary, while we faced near-term market challenges, I feel confident that both our market position and expanded global reach will allow us to take share and benefit from cross-selling opportunities over the long term. We'll continue to invest in our core products and new cloud based initiatives where we're being highly disciplined on our cost structure, driving cost efficiencies throughout the organization.

In addition, our balance sheet gives us the flexibility to further consolidate the market to drive both revenue growth and financial scale. Reflecting the achievements of Ribbon over the last three months, I personally want to thank all the employees of Ribbon for a solid fourth quarter 2017 financial results as it was indeed a very busy quarter, closing the merger, delivering on our guidance and commencing our integration and restructuring initiatives. All of us at Ribbon are excited about the future.

I would now like to ask the operator to open the call for questions and answers.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Dmitry Netis with William Blair. Please proceed.

Steven Sarver
Analyst, William Blair & Co. LLC

Q

Hi, guys. This is Steven Sarver in for Dmitry. So as you mentioned that you're still seeing challenges in North America, I guess, relating specifically to Verizon and AT&T. What're you expecting from those two customers in 2018?

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

A

Good morning, Steven. This is Daryl. How are you? It's good to speak with you. We do expect and specifically to Verizon and AT&T while we don't really speak to the customers to that much definition. We do expect some dampening of their demand in the near-term and at least the first half of 2018.

Steven Sarver
Analyst, William Blair & Co. LLC

Q

Okay. And then, just relating to the guidance, you said you expect the first quarter pressure to persist throughout 2018, are you guys taking more of a conservative sense and you don't have that much visibility, and you just want to be a little bit more conservative, or how do you feel about the rest of the year?

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

A

Well, Steven, I mean, frankly yeah, stepping back from a big picture, first we – you see the same companies in the space that we see bringing down their 2018 guidance. We're participating in the same space as these other companies. Second, you're reading the same marketing analyst reports that we're reading as well and our account managers are out with our customers every day gauging the buying behavior and hearing what they expect in terms of their purchasing patterns and their buying behavior and we're taking that into account.

And four, we have said that our intent is to transition the GENBAND SBC customer base to the Sonus SBC customer base and we believe that that is a good opportunity for us in the long-term, but in the near-term that does take some time to transition as Fritz said. And it takes a little bit of a time for the customers to certify that in their labs. So taking that all together from the space picture, from the market picture of what we're hearing from our customers, we do expect at least through the first half for it to persist and then we'll be watching the second half closely.

Steven Sarver
Analyst, William Blair & Co. LLC

Q

Got it. And then one more if I may just. Fritz, I was just wondering since you've taken over as President and CEO, has anything changed in the strategy after the merger close?

Franklin W. Hobbs
President, Chief Executive Officer & Director, Ribbon Communications, Inc.

A

No, I don't think so. I think, the opportunity that I've seen being exposed to this for the first time is, obviously, we have a very strong balance sheet. We've got a company that can generate earnings and cash. So, I think, the whole approach to looking at the world with some firepower behind us in the financial sense, I think is a very positive. It might be something we've emphasized even more than we might have three months or four months ago.

Operator: Thank you. And our next question comes from the line of Mike Latimore with Northland Capital Markets. Please proceed.

Nick Altmann
Analyst, Northland Securities, Inc.

Q

Yeah. Hi guys, this is Nick Altmann on for Mike. Thanks for taking our questions. Just a couple regarding Kandy, can you guys just first talk about your plans for Kandy this year and maybe give some color on what additional services, you'll be adding?

Franklin W. Hobbs
President, Chief Executive Officer & Director, Ribbon Communications, Inc.

A

Yeah, this is Fritz, Nick. I'd like to have – Myk Konrad with us who is the Head of Customer Relations. He has a very good view on this, maybe he could speak to it. It's over my pay grade pretty quickly.

Mykola Konrad
Vice President, Marketing & Product Management, Ribbon Communications, Inc.

A

Hi, there, Nick. So, yeah, this is Myk Konrad, VP, Product Management, here at Ribbon. And from a Kandy perspective, I think, your question was around what new things we'll be adding? So I think you can expect us to keep putting out new features and functionality along the two lines that we've been talking about on Kandy. One would be on the UC as a service front, the other one on the CPaaS front.

And as, I think, first Daryl mentioned earlier, we do believe that there is a lot of upside for us on the CPaaS front going forward. So, hopefully, you'll be hearing about that over this next year.

Nick Altmann
Analyst, Northland Securities, Inc.

Q

Got it. Okay. And then just in terms of the go-to market strategy with Kandy, do you guys have any key distribution partners there and then, I guess, a follow-up just in regards to the CPaaS side of things? How much focus is on the developer channel?

Mykola Konrad
Vice President, Marketing & Product Management, Ribbon Communications, Inc.

A

So, we do have some key distributors that we are working with. We'll be announcing those more as they come to fruition. And from a developer perspective, obviously, to have a – to get really deep in CPaaS, you need more developers and we are working with ISVs on that, independent software vendors.

Nick Altmann
Analyst, Northland Securities, Inc.

Q

Got it. Thank you.

Operator: Thank you. [Operator Instructions] And our next question comes from the line of Mark Kelleher from D.A. Davidson. Please proceed.

Mark Kelleher
Analyst, D. A. Davidson & Co.

Q

Great. Thanks for taking the questions. Is it possible to break out the revenue contribution from GENBAND in the quarter, the two months?

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

A

Yes. It is possible. Good morning. Hey, it's nice to speak with you. The revenue contribution from GENBAND on a -- for the two months in the quarter was $92.4 million.

Mark Kelleher
Analyst, D. A. Davidson & Co.

Q

Okay. Great. And then I'm just trying to reconcile some previous comments that were made at the time of the deal announcement. Generally, the two companies and you correct me if any of this is wrong, that is why I'm saying it. But generally, the two companies were generating $25 million in EBITDA per year, the thought was you could put that together, you get $50 million and then get $50 million of cost savings to get to a $100. So, if you're giving guidance for $75 million, I'm just trying to – and you said you're ahead of schedule in these cost savings, I'm just trying to reconcile the $100 million to a $75 million. Is there something I'm missing in it?

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

A

Absolutely it's a good question. Our comments in May and June of last year and we maintained through all of 2017 was that we expected to end 2018 on an exit run-rate of $100 million of adjusted EBITDA. And we believe that we're fully on track for that. The $100 million is derived from as if all of the combination synergies that we're undertaking as of right now would have been in place at the first of this year, that yield is a $75 million, because they're not that – that yield is a $75 million adjusted EBITDA outlook, but it does correspond completely to the $100 million we had said for.

Mark Kelleher
Analyst, D. A. Davidson & Co.

Q

Great, that's very helpful. Very helpful there. And then you talked about the transformation of the GENBAND customers over to the Sonus architecture, is there more of a headwind there than you had been anticipating? What's the dynamic there in terms of sales impact?

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

A

Well no, it's not more than we're anticipating. We did say on October 30 and we've made the remarks before that subsequent to the merger announcement where Sonus was to acquire GENBAND, the GENBAND SBC sales demand did take a bit of a pause, which was natural if you're merging with an SBC company. We are working very aggressively, now since the merger is closed, to expose our world-wide GENBAND customer base to the Sonus SBC product line. We feel it's a very strong lineup, we're very excited about it but it does take some time to introduce that to get that into network planning and to get that certified and then into the platform.

Mark Kelleher
Analyst, D. A. Davidson & Co.

Q

Okay. Great. Thanks.

Operator: Thank you. And there are no further questions at this time.

Daryl E. Raiford
Chief Financial Officer, Ribbon Communications, Inc.

Well, thank you everyone. It was a pleasure speaking with you today. And we look forward to speaking with you in the future.

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