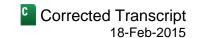


18-Feb-2015

# Sonus Networks, Inc. (SONS)

Q4 2014 Earnings Call



### **CORPORATE PARTICIPANTS**

Patti Leahy

Vice President, Investor Relations

Raymond P. Dolan

President, Chief Executive Officer & Director

Mark T. Greenquist

Chief Financial Officer

### OTHER PARTICIPANTS

Theodore Joseph Moreau

Barrington Research

James M. Kisner

Jefferies LLC

Jess I. Lubert

Wells Fargo Securities LLC

Dmitry G. Netis

William Blair & Co. LLC

Mike Latimore

Northland Securities, Inc.

Scott S. Thompson

Wedbush Securities, Inc.

Matt Robison

Wunderlich Securities, Inc.

### MANAGEMENT DISCUSSION SECTION

**Operator**: Ladies and gentlemen, thank you for standing by and welcome to the Sonus Networks Fourth 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, February 18, 2015.

I would now like to turn the conference over to the Vice President of Investor Relations, Ms. Patti Leahy. Please go ahead.

### Patti Leahy

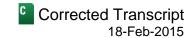
Vice President, Investor Relations

Thank you and good morning. Welcome to Sonus Networks fourth quarter and full year 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 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. So, please take a moment to locate this on our IR website.

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

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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 our future results is contained in our most recent 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 and the reconciliation of those measures have included in our press release issued today.

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

Thank you, Patti, and good morning, everyone. Let me turn to slide four for the framework of our prepared remarks today. I'll start with a discussion of the financial and operational progress the company has made since our turnaround began in earnest about four years ago.

Mark will take you through the results of the fourth quarter and provide our outlook for Q1 and the full year. I'll wrap-up our remarks with a discussion of the key areas of our strategy and the opportunities we're focused on in 2015 and then, we'll open it up for your questions.

Turning to slide five, you'll see a familiar framework that I've used throughout my time leading Sonus. I'm pleased to report that solid progress continues in every major area. We continue to attract some of the best talent in the industry across all layers of the company. Our focus to hire the best and brightest is accelerating as we move into 2015.

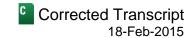
I'll talk more about the Treq acquisition later when discussing our strategy and we'll introduce the term we now use as dynamic WAN optimization. I think it's important enough to pause here and explain what I mean by dynamic WAN optimization. With current WAN optimization, the goal is to groom traffic to maximize throughput across the statically partitioned network.

With dynamic WAN optimization, that partitioning is driven by higher layer policies and the network response to meet the needs of the application. This is the very essence of SDN where software defines the network rather than the network requiring any application to adapt.

Having led the industry in the drive to SDN NFE, Sonus now has software capabilities that span policy, signaling, session and dynamic WAN optimization. This positions Sonus to lead the march to Cloud 2.0, which is the real-time cloud. We have the best product portfolio in the industry, hardware or software, to lead this transition.

Our sustained focus on process improvements is paying off. Our products are now simpler, easier to install and upgrade, and they run with a single common software code base. I've received consistent feedback from our customers regarding our continued improvements in quality and ease of use.

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And the benefits of this focus are also showing up in improved financial performance. We're growing revenues, increasing margins and driving earnings and cash flow growth. We've made substantial progress and will continue to find ways to drive our complexity and accelerate our performance.

Collectively, these efforts have culminated in the seventh consecutive quarter of non-GAAP profitability for the company. We're very proud of these results. When I joined Sonus in 2010, we had cut costs to a level of breakeven profitability, but we did not have a clear strategy to drive growth. As a team, we concluded that we needed to invest. We made the tough decision to temporarily bring the company back into the red in 2012 in order to fund our growth engine.

In 2013, we delivered on our commitment to be profitable on a non-GAAP basis for the full year. In fact, our initial guidance was to be breakeven to slightly positive and we outperformed this expectation.

In 2014, we again outperformed the annual earnings target we set with the Street. This collective commitment and hard work over the past few years has established a very solid foundation to drive further operating leverage in 2015 and beyond, while continuing to invest in the R&D necessary to lead our industry forward.

Let's turn to slide six for some of the specific highlights in 2014 as compared to the full year 2013. We grew total revenue by 7%, which was underpinned by very strong growth of over 50% in the channel and strong customer growth of nearly 40%. We drove improvements in non-GAAP gross margin and operating income of about 400 basis points each. This progress resulted in almost 200% increase in net income.

Slide seven captures the strategic shift from what had been an exclusive direct sales focus into service providers to what is now a much broader strategy, embracing both direct and channel sales into service providers as well as the enterprise market. You can see the dramatic customer growth that has emerged and is now accelerating.

Slides eight and nine illustrate our transition from a company with the majority of its revenue in a declining market to a company with the majority of its revenue in growth markets. On slide eight, we show that more than two-thirds of our total product revenue for full year 2014 is growth-related. On slide nine, you can see that more than half of our total company revenue, including product and services, is now growth-related.

Said another way, our legacy business is now less than half of our total revenue and less than one-third of our product revenue. Presuming these trends continue, and we expect that they will, this map creates a tailwind that should drive even better top line growth in 2015.

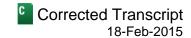
Turning to slide 10, you see the tremendous progress we've made moving gross margins from 60% in 2012 to over 67% in 2014. This progress has been made by both attacking our cost structure and productivity on the services side and moving our products to become more standard-based and less customized.

We will work relentlessly to keep driving these results to industry-leading margins. The market trends are in our favor as the world moves increasingly to software and as our customers continue to increase the density of their network performance.

Our OpEx story is also trending very favorably, which is shown on slide 11. While we continue to invest significantly on growth, the scale benefits are allowing our OpEx as a percent of revenue to decline modestly.

Increasing scale, increasing gross margin, and declining OpEx as a percent of revenue are all contributing to increasing profitability, which you see on slide 12. As I said, we're reporting our seventh consecutive quarter of profitability with an outlook of sustained profitability as we move forward.

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Slide 13 sums up these trends over the past three years. We expect to continue to see the results move up and to the right this year and beyond.

Now, I'd like to hand it over to Mark to go into more detail on the quarter and provide our outlook.

### Mark T. Greenquist

Chief Financial Officer

Thanks, Ray. In the interest of time, I'll limit my comments this morning to our fourth quarter results as compared to the fourth quarter of 2013. Our full year results can be found in the press release issued this morning. Gross margin, operating expense, operating income, net income and EPS are all discussed on a non-GAAP basis and have been reconciled for you at the end of today's press release and presentation.

So let's move straight to slide 15 for a closer look at the quarter. Revenue in Q4 was up around 1% compared to the fourth quarter of 2013. Product revenue and growth-related revenue were each up around 2%.

As we explained in our preliminary results issued on January 8, we did not see the level of budget flush that we thought was possible in the fourth quarter, given the broader market CapEx constraints, particularly in North America. This was the primary reason our revenue came in at the lower end of our projected range.

We achieved record gross margin performance in the quarter of 68.9% and while OpEx came in slightly ahead of our guidance, we were still able to drive operating margins to close to 10%. And this performance gives us a great foundation for delivering on the 10 and 10 framework we laid out almost one year ago at our Investor Day in San Francisco.

Net income of \$7.3 million was up approximately 8%, which on a post reverse split basis translated to \$0.15 per share. At the end of the fourth quarter of 2014, we had just under 1,200 employees and around 50 million fully diluted shares outstanding on a post-split basis.

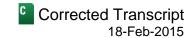
Let's turn to slide 16 for our outlook. As I mentioned during our last earnings call, I said we would likely move away from providing growth revenue guidance as a subset of total revenue and would simply provide total revenue guidance going forward. Ray provided the data behind this decision, which demonstrated that over two-thirds of our product revenue was derived from growth-related revenue in 2014 and we expect this percentage to be even higher in 2015.

As a result, it's now less meaningful to distinguish between growth and legacy versus simply discussing product, maintenance and services revenue going forward. We'll continue to provide color on product, geographic and sales channel trends in our actual results that drive our growth so that you know where the business is gaining the most traction.

Now, looking at Q1, we expect revenue to be approximately \$74 million. I would point out that our first quarter is more back-end loaded than the past few years, but the revenue is also far more diversified.

In short, we're not dependent upon a single large deal in the quarter. Instead, we have a number of good-sized deals in our funnel that we expect to close over the next few weeks. We see this as a healthy sign of our business and customer base continuing to diversify and becoming less concentrated, as we have discussed with you on previous calls.

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We expect full year revenue growth to around \$326 million to \$330 million. And I'll talk more about our revenue assumptions in a moment. We expect growth margin of between 67% and 67.5% in Q1. And for the full year 2015, we believe we should be able to add at least another point of margin expansion on top of the 67% we achieved in 2014.

We expect OpEx of \$47.5 million to \$48 million in Q1. And for the full year, we would expect that OpEx as a percentage of revenue should decline by about a point compared to 2014.

EPS for Q1 is expected to be around \$0.03 based on 50.5 million diluted shares outstanding. And I should note, this forecast takes into consideration about \$2 million of incremental expenses in the first quarter of 2015 related to the Treq assets, which we acquired last month.

Full year EPS should be in a range of \$0.54 to \$0.58 based on 51 million diluted shares outstanding. And this forecast also takes into consideration a total of around \$8 million of incremental expenses related to the Treq business. But as we stated at the time we announced the transaction, we expect Treq to be EPS neutral to our business in 2015. We expect to be able to offset this investment either through incremental revenue growth or OpEx savings elsewhere in our business.

Now, I'd like to discuss some of the assumptions that we are making in the revenue outlook we have provided today. So let's turn to slide 17. Looking at the major revenue drivers this year, our SBC 7K continues to disrupt the market. We are getting extremely good traction with Tier 1's, large MSOs, contact centers, and large enterprises in North America and international.

In fact, we realized more than \$15 million of revenue from the 7K in the first six months since it was launched, which bodes very well for the full year of 2015. Also, our channel revenue has grown significantly since its launch back in 2012. It contributed 27% of our product revenue in 2014, up almost 20% from prior year and from a standing start in 2012, prior to the acquisition of NET and the launch of Sonus Partner Assure.

We expect the channel to continue to contribute strongly to our revenue growth again this year. In addition, we expect to realize a full year's benefit from the signaling business acquired from PT in late February of 2014. And in line with prior years, we expect to see modest growth in maintenance and services.

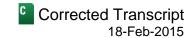
Finally, as I mentioned previously, we believe there is potential upside to our outlook from the Treq acquisition. However, we're still early days on that acquisition. So, it's too soon to size the potential impact on 2015 revenue.

I'd now like to provide some perspective on the seasonality of our business. If you look back over the past three years, you will see a clear pattern in our results, which shows that Q4 has been the strongest revenue quarter followed by Q2 as the second strongest. Q1, on the other hand, is typically the weakest and Q3 typically falls somewhere in between Q1 and Q2 levels. We would expect a similar trend in 2015, which is slightly different than how the consensus estimates currently line up.

Slide 18 provides the breakdown of maintenance and services as disclosed in our quarterly filings. The historical CAGR over this period for maintenance and services revenue growth is around 3% per year. Professional and other services has been roughly flat and maintenance has grown modestly, as maintenance on our newer SBC products has offset modest declines on the older products. Looking at 2015, as I said, we expect a similar rate of growth overall for maintenance and services.

Turning now to slide 19. Our balance sheet is solid with approximately \$148 million in cash and no debt as of year-end 2014. During the year, we generated about \$30 million in cash from operations. And we are now

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consistently generating positive cash flow, which positions us with the flexibility to build organically, continue to make opportunistic growth acquisitions and/or to fund our ongoing share buyback program.

We have repurchased approximately 9 million shares to date, which represents about 16% of total shares outstanding since the buyback began. We bought these shares at an average price per share of \$17 and have approximately \$23 million available for future repurchases.

This year, we also took a number of actions in response to shareholder feedback, including eliminating our shareholder rights plan or poison pill, which had been in effect since 2008. And in addition, we enhanced our payfor-performance practices, instituted share ownership guidelines applicable for our non-employee directors, Chief Executive Officer and other Section 16 reporting officers, and adopted a formal clawback policy with respect to our executive incentive compensation.

So with that, I'll now turn it back to Ray. Ray?

### Raymond P. Dolan

President, Chief Executive Officer & Director

Thanks, Mark. Let's turn to my final slide, slide 21 and I'll conclude by discussing two major areas of focus for 2015. First and foremost, we will continue to drive improved operating leverage. The combination of our projected revenue growth coupled with steady gross margin expansion and OpEx discipline should result in operating income margins of 10% and earnings growth north of 50% this year. With that solid foundation now in place, we continue to invest to drive industry level transformation. Four key areas stand out, video, VoLTE, cloud, and security.

Let's take them in order and I will tie them together at the end. First, video is becoming an increasingly important driver of revenue growth for all service providers, including both traditional telcos and the emerging web-scale players. Consumer and business video adoption is accelerating. These trends were highlighted recently at CES.

At Sonus, we saw indications of these trends several years ago and we launched our SBC 7000 roughly a year ago with the industry's highest density platform that also has a 10 gig interface necessary to enable video at massive scale.

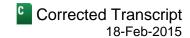
As Mark highlighted in his comments, we are already seeing excellent adoption and migration to these platforms as our customers future-proof their networks with a platform built for scale across the entire UC suite.

Second is Volte. I'm pleased to share with you that Sonus is already the core policy engine in a Tier 1 Volte network. You'll hear more about our Volte capabilities at Mobile World Congress and we'll share more as the year progresses.

Third is virtualization. Sonus has led the industry through virtualizing every major area of the new cloud-based communications architecture, policy, signaling, session, and most recently, dynamic WAN optimization. While others are talking about virtualization and playing in one or two of these areas, Sonus has commercially launched an entirely new software stack for the real-time cloud.

And finally, we come to the issue of securing cloud-based communications. Network security was at one time solved with firewall surrounding an enterprise, while workers and data remain physically inside the enterprise. As workers became increasingly mobile, VPNs were created to tunnel into the walled garden, allowing secure remote access.

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More recently, the data itself and many workloads and applications have migrated to the cloud. These trends are accelerating. The very nature of network security is changing dramatically.

Security at the network layer is now moving up the stack to become an essential part of the call flow in [ph] NaaS or Network-as-a-Secure-Service (19:51). Sonus is leading this evolution. This strategic implication of this leadership for Sonus can't be overstated.

Let me tie this all together. Our recent acquisition of Treq gives us a unique source of competitive differentiation. This dynamic WAN optimization technology in combination with policy, session and signaling provides a number of strategic benefits. Of course, it help service providers and enterprises provision capacity on demand and to find policy down to the application user level so that they can intelligently ramp and deploy latency sensitive traffic like video and UC. And they do this while they're optimizing their network infrastructure. Network utilization can go roughly from 30% of their WAN assets today to 80% as we've demonstrated in used cases with State Street Bank and Pacnet.

The economic benefit is critical since WAN costs are exploding, as enterprises move both data and applications into the cloud. CIOs face the dilemma. Either overprovision the network to address burstiness, or fit QoS/QoE or stay in old MPLS architectures for their real-time traffic. MPLS costs can be more than 50 times more expensive than DIA depending on the deployment model. These trade-offs significantly erode the entire economic benefit of the cloud that were driven by better scale for storage and compute.

Clearly, the communications architecture needs to adapt to deliver the scale benefits to the cloud as it embraces the needs of real-time. But IT-like network economics are just part of the picture. The next-gen cloud architecture also must deliver telco like resiliency and security.

SBCs secure the network by protecting networks at their borders against denial or service attacks. You could say then that Sonus has always been in the security business. SBCs also have a unique advantage based on where they sit in the stack to play a critical orchestration role for security on an end-to-end basis.

Through the interplay with policy, signaling and dynamic WAN optimization, SBCs can ensure that only authorized users gain access to specific applications and data regardless of location or the modality of access. While additional security measures will be enforced, such as application layer encryption, this new end-to-end security is emerging per call flow to enforce network layer security.

At Sonus, we plan to passionately lead the industry forward in this mission to ensure that Cloud 2.0 can deliver a truly secure real-time communications that are affordable to the mass market and can be delivered profitably by service providers in the decades to come.

Thank you for your attention this morning. This concludes our prepared remarks and I'd now like to open the call for your questions. Operator?

### QUESTION AND ANSWER SECTION

**Operator**: Thank you [Operator Instructions] Our first question comes from the line of Ted Moreau with Barrington Research. Please proceed.

### Theodore Joseph Moreau

Barrington Research

Thank you very much, and good work on executing on strong results again, guys. Just – you're reiterating your 10% growth expectations for 2015, with Q1 expected to grow 5%, and you talked about the seasonality in Q2 and Q4. Is there anything specific that you're seeing from your customers, or is it just kind of – and if you are – I mean can you talk about that, or is it just kind of just broader market growth that you're seeing?

### Mark T. Greenquist

Chief Financial Officer

So, Ted, it's broader market growth. And the main reason why we were sort of making a point on the seasonality was because what we're noticing is that the consensus estimates are kind of off what we expect and what we've seen in the prior two years.

So I don't want to kind of read more – have you read more into that for us making a point to discuss the seasonality. It was really just to give folks a heads-up that 2015 should look a lot like 2013 and 2014 with regard to seasonality and some people's estimates really weren't aligned with that. That's all.

#### Theodore Joseph Moreau

Barrington Research

Okay. And to what extent – I mean, so thank you for providing the SBC 7K revenue. To what extent is that – do you think that SBC 7K, is that going to be the leading driver of revenue growth for 2015?

#### Mark T. Greenquist

Chief Financial Officer

Yeah, actually, yeah, we do. As we said, we had a very good first six months for that product and we're going to have all 12 months this year. And even in the first quarter, it's looking very good. So I expect that definitely, as I said in my remarks. It was the first thing I mentioned. There's a reason for that. We expect that to be the main driver of growth year-over-year from a product perspective.

#### Theodore Joseph Moreau

Barrington Research

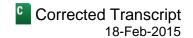
Okay, great. And then – yeah, go ahead.

### Raymond P. Dolan

President, Chief Executive Officer & Director

[ph] It's Ray Dolan (25:25) here. The 7K just crushes the performance on the high end of the market. So, in our work with some of the Tier 1s, we're seeing some substantial open water in our evaluations between us and the market competition like two to one with regard to the density capabilities at the high end of the market, which is where the market is going.

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We're still going to continue to drive 1K, 2K on the edge and to a certain extent, 5K still drives a lot of business for us in the enterprise and in service providers. But that's a huge advantage for us on the high end and we plan on focusing and exploiting that. It also prepares the market for the move to video, which we do think is a 2015-2016 story, both in the web-scale players as well as in the service providers more generally.

Theodore Joseph Moreau  Barrington Research	Q
Okay, great. And then, given your gross margin guidance for Q1 and then also for 2015, so clearly you gross margin expansion throughout the year. So, I mean, is that all driven by the SBC 7K or are there you can push and pull on the cost line? Can you talk a little bit – or is it all like this kind of product m	other levers
Mark T. Greenquist Chief Financial Officer	A
Well, I mean, I think we're going to continue to work on the product gross margins and services gross that matter and we've made good progress over the last couple of years. So we'll push on that. But kir point, product mix also plays a big role in the gross margin story. And yes, I mean, the 7K is a very product being a new one. And if that's driving a lot of incremental growth and becoming a much high of revenue, that and other new products that we've got are certainly helping that overall gross margin	nd of to your ofitable er percentage
Theodore Joseph Moreau  Barrington Research	Q
Okay, great. I'll pass it along. Congrats and good luck, guys.	
Mark T. Greenquist Chief Financial Officer	A
Yeah. Thanks.	
<b>Operator</b> : Our next question comes from the line of James Kisner with Jefferies. Please proceed.	
James M. Kisner Jefferies LLC	Q
Thanks. So, I guess, a quick housekeeping. Did you guys disclose 10% customers, how many there we	ere in Q4?
Mark T. Greenquist Chief Financial Officer	А
There was one 10% customer and that was AT&T.	
James M. Kisner Jefferies LLC	Q
Okay, great. And one question on gross margin. Was there any SWe revenue in Q4, or do you expect the software-based SBC opportunities, are those kind of farther out? Just any perspective on the software?	-

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Corrected Transcript
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### Mark T. Greenquist

Chief Financial Officer

Go ahead.

A

### Raymond P. Dolan

President, Chief Executive Officer & Director

Yeah. So, James, it's Ray. Thanks for the question. The SWe revenue was, I'd say, so small it was immaterial, but it is strategic. And let me position it that way. What the world wants to know is, can you move to the new cloud architecture, which is predominantly software-based? And if you can, can you spin up multiple instances? And if you can, can you do them in multiple virtual environments? And so, as we look at big design wins into these Tier 1s, the SWe capability, which we announced actually a year ago, is a critical strategic lever.

Now, having said that, like we've said in the past, people are still buying the hardware instance in most of these SBCs, because the path to the cloud is going to take a few years to play out. Okay? So, it wasn't a big piece of our revenue. I don't expect it to be a big piece of our revenue.

Now, software more generally, where people add capacity to their existing deployments has – that is a software-like driver of margins and that's definitely then contributing and should continue to contribute to margin expansion in 2015. Does that answer your question?

### James M. Kisner

Jefferies LLC

Yes, it does. Thank you. So I'd love to talk a little bit more on this Tier 1 VoLTE. I think you said core policy engine win. I guess I'm wondering if you could provide any more detail on that? I guess how you sort of view VoLTE opportunities? I guess you're dividing it into interconnect access and, I guess, core policy engine. Could you just talk about the significance of that win, what it means for investors?

#### Raymond P. Dolan

President, Chief Executive Officer & Director

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Sure, James. So, I think it's a very significant design win and we're continuing to work with a number of Tier 1s on their VoLTE strategies around the world. I hope we have more news to report throughout 2015. People do look at the IMS architecture as well as an access versus interconnect SBC architecture more broadly, and many of them look at it slightly differently. So, this was our first instance where our policy engine, which has been deeply embedded in our gateway architectures was leverageable in this next-gen push to VoLTE.

I expect some more of those on the IMS side and I would expect some of them on the interconnect side for SBCs for sure. To the extent that service providers use SBCs on the access side as well for their VoLTE strategies, I would expect some wins there. And then, there'll be some Diameter wins for sure, as people look at roaming opportunities and peering opportunities between VoLTE networks because right now they do not roam VoLTE to VoLTE yet. But I would expect that as 2015 and 2016 play out, there'll be some opportunities for us there.

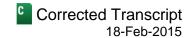
As to the significance of investors, I think it's yet another growth market that we're going to be exposed to and ultimately lead in. And so I think it has a very good contributor to our long-term value and it's a very high-margin opportunity for us.

James M. Kisner

Jefferies LLC



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Okay. That's helpful. And one last one. No good deed that goes unpunished, you gave us some detail on Q2 being bigger than Q3. Kind of wondering if you could help us at all on the magnitude of the step-up? I mean, are we talking about \$10 million? I think you had a \$10 million order that you thought slipped from Q4 into Q2. Perhaps that's part of it. But could you give us any help at all on sort of magnitude of the sort of Q2 jump?

Mark T. Greenquist

Chief Financial Officer

А

I mean, the only help I'd give you is that it's not going to be \$10 million. Won't be that high.

James M. Kisner

Jefferies LLC

Great. That's very helpful. Thank you.

**Operator**: Our next question comes from the line of Jess Lubert with Wells Fargo Securities. Please proceed.

Jess I. Lubert

Wells Fargo Securities LLC

Hi, guys. Thanks for taking my question. Can you touch on what drove the decline in deferred revenue? How much visibility you have to your at least 10% growth objective for 2015? And how a recovery in spending at some of the bigger U.S. Tier 1 accounts plays into that objective?

Mark T. Greenquist

Chief Financial Officer

А

Sure. So, first of all, I guess you're trying to get into like the backlog question and sort of book-to-bill and how much revenue do we have as we enter into a quarter already booked. And as we've mentioned before, that – it's become much more of a turns business over time. If you go back, I don't know, two, three years, there was much more backlog as we went into a quarter. That's much less so now. And you see much more – much higher percentage of the revenue being book shipped and revenued in the quarter.

And then, with regard to the deferred revenue, there's a portion of it that's just the usual run-off of maintenance as we go into the end of the year, and then we're rebooking those contracts. And then, in addition, I think we just had a number of deals hung up from a rev rec perspective that we were able to get cleared up by the end of the year. So, that's really all there was to it.

Jess I. Lubert

Wells Fargo Securities LLC

And then -

Raymond P. Dolan

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President, Chief Executive Officer & Director

So, Jeff, the second part of your question, this is Ray, is on the Tier 1 U.S. recovery. I'm assuming you're talking about the fairly high profile discussions been going on for the last six months at least amongst the top two Tier 1 telcos in the U.S. I expect that to just continue to play out over the course of this year, most likely leading to a back-end recovery. I don't think it has a material impact on us. And the reason is our exposure to both of those accounts and frankly, all the Tier 1s around the world is growing as a piece of the pie. So, what they're doing at the top doesn't matter to us as much as the fact that we get exposed to more of the spending.

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As folks move to cloud architectures, I actually think that's the only path that they can take because their CapEx has to fit into their capital allocation models and both of them have just been significantly at the spectrum auction. So there's a lot of pressure there. They've got to move to cloud architectures in order to get higher capital efficiencies. And that's where I think we can really, really help the industry. That's why I spent so much time in my prepared remarks focusing on that architectural strategy.

Jess I. Lubert

Wells Fargo Securities LLC

Q

Ray, can you touch on the pipeline of VoLTE opportunities you're working on? It sounds like in addition to the big deal, there's some others that could front the model over the course of the year. And when you think about the timing of those opportunities, is it really more the backend of 2015? And then 2016, when we see the revenue, or do you think VoLTE revenue can be material this year?

Raymond P. Dolan

President, Chief Executive Officer & Director



I do think it's probably the backend, Jess. VoLTE played out with some fairly big projects in prior years. They then got stalled for technology issues. And then, when they got launched, they got launched off of established frameworks.

We've got exposure to what you might call growth CapEx, as those drawdowns continue. And it'll really depend on the pace of the growth in the VoLTE market, which I do expect to happen this year and as a result, drive revenue this year, but I wouldn't call it early on. And frankly, until we get more visibility into it, I'd rather just leave it at that. But I am very excited about the fact that we're ready, we're strategic, and we're playing in that industry in a big way.

Jess I. Lubert

Wells Fargo Securities LLC



And then last one for me. I was hoping to dig into the Treq Labs opportunity a little further. But if I look at the earn-out opportunities for the acquired companies, it seems like they're based on some fairly healthy revenue assumption.

So, I was just hoping you might be able to help us understand the pipeline of transactions you're seeing in the market for those assets? How meaningful you think the acquired business can become over the next few years?

And perhaps, you can frame this opportunity relative to past acquisitions, which is network technologies and PT with respect to how you're thinking about the potential opportunities surrounding Treq Labs moving forward?

Raymond P. Dolan

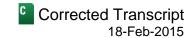
А

President, Chief Executive Officer & Director

Sure, Jess. I'll take a shot. And then, Mark, if you want to talk about the earn-out with any issues, please do? So – and Jess, since you asked me to frame it in the context of prior acquisitions, I'll do it that way. That's actually a really good way to do it.

This is our third acquisition on my watch. The first one being NET and think of that as a horizontal expansion to accelerate our approach down-market into the enterprise, get closer to the edge, and we integrated a great relationship with Lync, which has only become more strategic over the last few years.

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But again, that was a product-based issue and the products were distinct. 1K, 2K was completely separate from the 7K evolving out of the 5K and of course, we had the 9K for the gateway that which evolved into our first SBC.

PT was the acquisition of the signaling assets and it took us a good year to complete and virtualize the Diameter architecture, which now access an application on our SBC and we're starting to participate in the Diameter market much more in 2015.

As all of those moved into software and, of course, our policy engine moved into software, and our entire SBC suite moved into software, this acquisition of Treq I think of as a catalyst for us to get drive quickly into a new cloud architecture, and to actually become the intelligence in Cloud 2.0. So, I think it has the potential to be massively strategic, even though it might in fact be a small footprint in our revenue in 2015.

It's too early to call the turn on that. I think the metrics for our earn-out are out there and, Mark, you can talk to them if you'd like. But I think that the Treq assets really make SDN come to life for Sonus and for our customers, both in the enterprise, in the call centers, the data centers and in the service providers because this is the first time that we can go top to bottom and allow software to define the network. That is what SDN stands for.

So, when we saw Treq, what they had built was a very creative platform that was application-aware. It wasn't just an SDN controller. It was application-aware and it rendered open APIs up to policies so that it could allow for network manipulation from above. And that's why we bought it. They were struggling to scale, but they had caught a few large opportunities. And with our operating capability and with their technology, it was really a perfect marriage. So that's why we did it fairly quickly at the open this year and we expect to drive our strategy for the future. Mark, any further thoughts on earn-out?

#### Mark T. Greenquist

Chief Financial Officer

[indiscernible] (38:58)

### Raymond P. Dolan

President, Chief Executive Officer & Director

Jess, I don't know if you had any specific questions on the earn-out, but that's how I view it strategically.

#### Jess I. Lubert

Wells Fargo Securities LLC

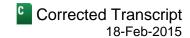
I mean, can you maybe just touch upon what the feedback has been from your existing customers, the opportunity to potential sell that into the base, as we look out into maybe beyond 2015 into 2016 from a revenue size? How this might scale between what we've seen so far for PT and NET?

#### Raymond P. Dolan

President, Chief Executive Officer & Director

Again, I'm reluctant to drive revenue numbers, it's early. But I can tell you that a consistent response is, wow. A consistent response from enterprise and from the service providers that are focused on enterprise and moving everything but layer 2 switching into the clouds is, wow, you can really do that. So we're working really hard to drive that. Whether or not it's going to be above or below the earn-out goals in 2015 is to be determined, but I think it's going to be a big part of our strategic impact on the industry in the future.

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Jess I. Lubert

Wells Fargo Securities LLC

Thanks, guys.

Raymond P. Dolan

President, Chief Executive Officer & Director

Sure.

**Operator**: Our next question comes from the line of Dmitry Netis with William Blair. Please proceed.

Dmitry G. Netis

William Blair & Co. LLC

Thank you. A couple of questions, guys, and some might be repetitive, so I apologize for that. But I wanted to zoom in again on the margin front. So, obviously, standout performance in the quarter. So if you were to rank the three drivers that kind of drove that performance, what were they? And as you look out into 2015, that extra point of margin that you're tacking on, what are some of the drivers again there, as far as the product versus services? How to think about the modeling kind of the ramp-up in the gross margin [ph] growth there? (40:51) Thank you.

Mark T. Greenquist

Chief Financial Officer

Okay. Yeah, so, Dmitry, I mean in Q4, I mean a lot of the margin improvement was the fact that there was a good portion of the revenue that came from expansion business, which is by its very nature higher margin. And that is consistent with what we've seen in prior Q4s and that's why you normally see Q4 gross margins to be higher than the average for the year. So I mean it was – it played out very much like what we have seen in previous Q4s.

And then just coming back to the point I was making now on 2015, as we said, we think that one of the prime drivers of revenue growth in 2015 is going to be the 7K. We think, as we said, product revenue is certainly going to grow at higher rates than the maintenance and services. And so as a result of that, you're just going to see, first of all, better mix in the sense of higher product revenue. And within that product revenue, you're going to see better mix with regard to the 7K.

So, I mean, I don't want to dismiss the fact that there's a lot of good work going on just improving individual product line margins and improving services margins. But from a macro level, a bigger picture level, we're having good favorable mix trends with regard to the revenue. And that's driving overall margin improvement in line with what we saw in 2014 and what we're expecting in 2015.

Dmitry G. Netis

William Blair & Co. LLC

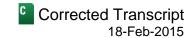
Okay. That's helpful, Mark. But it doesn't sound like that in Q4 you had much of an impact from 7K on the margin front. Is that right? [indiscernible] (42:45)

Mark T. Greenquist

Chief Financial Officei

Well, it certainly helped. I mean, you had none of it in Q4 2013 and Q4 2014. You had a healthy dose of 7K in the revenue. So that helped. But I think the thing that kind of took it above our prior expectations and guidance was

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even a little bit better mix on the capacity expansions, which come at very, very high margins. And so, that was the favorability that we saw in Q4.

Dmitry G. Netis

William Blair & Co. LLC

Okay. And then, moving down to the P&L just to kind of touch on the OpEx, obviously, you're layering a bit of \$2 million, I guess, in Q1 of incremental OpEx. If I did the math for the full year to wind up at that — with the gross margin guidance you gave and the EPS guidance, you'd be probably up another what \$16 million from 2014, somewhere in that range, \$14 million to \$16 million of OpEx. Is it tracking along with the revenue seasonality? Can you discuss how you're kind of thinking about the OpEx line, as you go through the year?

Mark T. Greenquist

Chief Financial Officer

Yeah. I mean, again, I expect OpEx seasonality to be similar to what we've seen in prior years. Q1 is usually a bit high and then it'll trend down, not only on an absolute basis but also as a percentage of revenue, obviously, because Q1 tends to be the low with regard to revenue in the year.

I think the point we were trying to make was we did 7% operating margins last year. We're shooting for 10% in 2015. We've made that clear. It's not all going to come through gross margin expansion. I think a good portion of it will, like we said, we think we can add at least another point of gross margins. So that would imply more than one point expansion, but we think we get part of it through just containing OpEx and driving that down as a percentage of revenue.

And as we said, we think that there's at least a point there as well. We'll have to see how the year pans out because we can pull levers to adjust the OpEx spend over the course of the year. So, I don't know exactly what the mix is going to be with regard to the incremental 300 basis points of operating margins that we're shooting for in 2015, but I know at least a good portion of it is going to be gross margin expansion. And then, with regard to the balance of it, we'll see whether we can drive better gross margin expansion or whether it's going to come a little bit more from OpEx. And that remains to be seen.

Dmitry G. Netis

William Blair & Co. LLC

Okay, great. And then last one – that was very helpful, Mark. And then the last one, I guess just – were there any Tier 1 customer wins this quarter, if you could update us on that front?

Mark T. Greenquist

Chief Financial Officer

No new ones this quarter, no.

Dmitry G. Netis

William Blair & Co. LLC

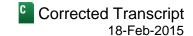
Okay. And then, I think just to kind of recap. I think on the SBC, you had about 22 of the top 50 service providers. And on the Diameter, you had two of the top Tier – two Tier 1 service providers. Is that still the right count to think about the products?

Mark T. Greenquist

Chief Financial Officer

Α

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Yeah. I don't think that there's – well, as we said, we didn't add any Tier 1s in Q4. So that should be unchanged from what we had reported back when we announced third quarter earnings.

Dmitry G. Netis

William Blair & Co. LLC

Okay. And then real quick, I missed the enterprise as a percent of product revenue. Can you give me that number, please?

Mark T. Greenquist

Chief Financial Officer

Yeah. Sure. As a percentage of product revenue, it was around 15%. So a little bit lower – again, a little bit lower than what we saw in the first three quarters, but again, similar pattern to what we saw in the previous year where fourth quarter, for whatever reason, tends to be a little bit lower with regard to enterprise as a percentage of product revenue. And as you would expect, you see like a higher concentration service provider business in that fourth quarter.

Dmitry G. Netis

William Blair & Co. LLC

Right. Okay, great. Keep up the good work, gentlemen. Thank you.

Mark T. Greenquist

Chief Financial Officer

Thank you.

Raymond P. Dolan

President, Chief Executive Officer & Director

Thanks, Dmitry.

**Operator**: Our next question comes from the line of Mike Latimore with Northland Capital Markets. Please proceed.

Mike Latimore

Northland Securities, Inc.

Great. Thanks a lot. I guess just on the enterprise segment there. Generally speaking, do you expect enterprise growth to be similar in 2015 to what you saw in 2014, or some acceleration or slowdown? How are you thinking about enterprise generally?

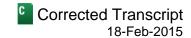
Mark T. Greenquist

Chief Financial Officer

So, I think we should see a little bit of an improvement. I mean, as we mentioned in the remarks, after we talked about the 7K, I mean probably the second biggest driver that we're seeing for revenue growth in 2015 is going to be continued expansion of the channel.

Now, as Ray mentioned, some of that's going to be channel to service provider, but I think a good portion of it is going to be channel into enterprise. And that's basically our 1K, 2K business and 5K.

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The other, I think, good thing that's going on is that we are actually seeing some interest from large enterprise in our 7000 product. I would say that when that product was conceived and launched, we generally thought that that was going to be a large service provider product, but we have actually seen interest in enterprises as well, especially in contact centers.

So to summarize, I think when we talked about channel growth, we're talking mainly about growth in enterprise, although, like I said, there is some service provider there, and we think that that's a big contributor next year. And then, we're obviously very, very bullish on our 7K product. Mostly service provider, but interestingly, also seeing that getting picked up by some large enterprises as well. That should also help enterprise as a percentage of product revenue as we go through next year.

Mike Latimore

Northland Securities, Inc.

Great. And then, did the performance of Treq acquisition hit its target for the year? And I guess separately you mentioned sort of full year signaling as a driver for 2015. By signaling, do you mean Diameter and SS7, or primarily Diameter?

Mark T. Greenquist

Chief Financial Officer

I think that signaling is both — when I talk about that, it's SS7 and Diameter. Although when we're talking about getting a full year of growth and getting some more traction out of the signaling business as we go into 2015, that's going to be mostly, if not all, a Diameter growth story because I think the SS7 business is going to be relatively flat year-over-year from that business.

Mike Latimore

Northland Securities, Inc.

Great. And did the acquisition hit its targets for the year?

Raymond P. Dolan

President, Chief Executive Officer & Director

Mike, this is Ray. Yes, it was close enough. I'd like to have seen it do more commercially. But certainly, technically, it accomplished all of our goals and allows us to position 2015 really nicely. So, we're going to drive that hard. I am really glad we own both the SS7 STP side as well as the Diameter side. There's a lot of interplay between those two. And a lot of the buzz you hear about things like Internet of Things, which is going to be a big driver in the next few years, a lot of that's going to play out on existing 2G, 3G networks and mobility, a lot of those signaling architecture is going to live for another decade. So, both of those pieces of that acquisition are playing nicely into our strategy.

Mark T. Greenquist

Chief Financial Officer

Yeah. I mean from a revenue perspective, we had said we didn't expect a huge amount and that was true. So we were pretty close. And then, from an EPS perspective, we said it was going to be mildly dilutive and actually it was closer to breakeven. So from a bottom line perspective, it actually did a little bit better. So...

Mike Latimore

Northland Securities, Inc.

Fair enough. Okay. Thanks. Good luck.

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**Operator**: Our next question comes from the line of Scott Thompson with Wedbush. Please proceed. Scott S. Thompson Wedbush Securities, Inc. Thanks for taking the question, guys. Let's start with just a quick number. Traditionally, we've heard about top five customers contributing a certain percent of revenue. Could we get that number for the quarter? Mark T. Greenquist Chief Financial Officer It was just under 30%, 27% actually to be precise in the quarter. Scott S. Thompson Wedbush Securities, Inc. Okay. So decent progress on diversifying the revenue streams from what we saw a year ago? Mark T. Greenquist Chief Financial Officer Yeah. Scott S. Thompson Wedbush Securities, Inc. Good work there. Mark T. Greenquist Chief Financial Officer Yes. Scott S. Thompson Wedbush Securities. Inc. Tell us a little bit about the – last quarter, we talked a little bit about the I'll call it sell-through versus sell-in. At AT&T, they were selling into some call center or enterprise applications. Was there continued patterns there this quarter, or was it a little more diversified? Mark T. Greenquist Chief Financial Officer Actually – so we mentioned that AT&T was a 10% customer in the quarter. I guess, we had kind of alluded – when we gave guidance, we sort of alluded to the fact that we didn't necessarily think that that was going to be the case and they ended up being a 10% customer. And again, kind of the differentiator there was the sell-through in the business services area. It wasn't as great as prior quarters, but it was probably just under \$1 million, which is good. And AT&T continues to sort of grow in significance as being a really strategic channel for us. So we were happy to see that.

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Corrected Transcript
18-Feb-2015

### Scott S. Thompson

Wedbush Securities, Inc.

Okay. That's good. Mid-last year, we talked about a large sale, I think it was maybe a service provider sale that would be pushed out into 2015. Can you give us an update on that opportunity and where it is? Do we still expect that in the first half?

Raymond P. Dolan

President, Chief Executive Officer & Director

Scott, it's Ray. I would probably call that in the second half and we'll give you an update on that on our next call.

Scott S. Thompson Wedbush Securities, Inc.

Okay, sounds good. One other question on the competitive environment. There seemed to be start-ups that seemed to be generating new product that want to focus on the SBC/DSC market in some way or form. Have you been seeing any of those guys pop up in the bidding process? Are they a real competitive threat? How do you perceive those types of guys in the market today?

Raymond P. Dolan

President, Chief Executive Officer & Director

I don't. I don't know who you're talking about specifically, Scott, but I don't consider us to have any major threat from start-ups in this space. In fact I don't think this is for the faint of heart and I don't think this is for new ideas. This is a scale game and it's an interplay between all those layers in the stack and I love our competitive hand.

Scott S. Thompson

Wedbush Securities, Inc.

Okay. So, having walked through those questions, the guidance for the full year, I guess it takes into consideration some of the lumpiness of some of the large top five customers as well. Do you think with the newly diversified revenue streams and everything you've done and executed on over the last year that that guide is pretty bulletproof, if you will, from some of the – some changes within some of those customers?

Raymond P. Dolan

President, Chief Executive Officer & Director

Well, we'll give you an outlook every quarter, Scott, but that's our guide at this point in time. And I wouldn't call anything bulletproof, ever. So appreciate the question. But we feel very comfortable that our view going forward, quantitatively and strategically, is very solid.

Scott S. Thompson

Wedbush Securities, Inc.

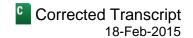
Okay. Thank you, guys.

**Operator**: Ladies and gentlemen, we have time for one last question coming from the line of Matt Robison with Wunderlich Securities. Please proceed.

Matt Robison

Wunderlich Securities, Inc.

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Hey, thanks a lot for taking my question. It's actually a little bit more than one, but I'll try to keep it quick. I got a question on deferred revenue, VoLTE, and then a little bit on some of your metrics. Can you comment – the deferred revenue, it looks like you still have a fair amount of maintenance agreements that you've recognized and didn't necessarily replace them because it dropped more than we've seen, I think, in a while. Can you comment a little bit about that?

And then, also the other question on the metrics. It's interesting to see the less mix of top five at the same time a larger percentage of your direct business. So those seem to be kind of – those wouldn't seem to correlate in that direction, so maybe if you could address that?

And then on the VoLTE, the question I have is, it sounds like policy engine is a wedge that you're using to get into that realm. And maybe, if you can comment on how you're positioning that versus an opportunity for SBC and VoLTE?

Mark T. Greenquist
Chief Financial Officer

Okay. So let me take the deferred revenue one first. So, if in my prior answer I led you to believe that there are maintenance contracts that rolled off and are not being replaced, then that's not what I meant to say. We have some maintenance agreements where the deferred revenue is being burned off over the year and then those will be replaced.

And as we said, we think that maintenance and other services is going to grow in line year-over-year in 2015 versus 2014. So there is – if somehow you took me to mean that there's some businesses disappearing and not coming back, then my bad. I did not mean to imply that.

And then, as I also said with regard to the deferred revenue, we did have some deals that were sort of hung up for rev rec reasons that we basically got cleared by the end of the year. So that's why you would have seen that go down a bit.

Matt Robison Wunderlich Securities, Inc.	Q
So that was rev rec or invoice ability?	
Mark T. Greenquist Chief Financial Officer	A
No, no, rev rec.	
Matt Robison Wunderlich Securities, Inc.	Q
Okay.	
Mark T. Greenquist Chief Financial Officer	A

We would have invoiced it and even in some cases collected the cash and we're just holding up the revenue

recognition for whatever reason.

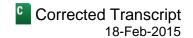
# Sonus Networks, Inc. (SONS) Corrected Transcript Q4 2014 Earnings Call 18-Feb-2015 Matt Robison Wunderlich Securities, Inc. But that would increase deferred revenue, wouldn't it? Mark T. Greenquist Chief Financial Officer Not if you're clearing those up and actually recognizing the revenue. Matt Robison Wunderlich Securities, Inc. I see. Okay. Mark T. Greenquist Chief Financial Officer And then, with regard to the top five, yeah, that percentage came off. I mean, part of it is, as we've said, we've been working on diversifying the customer base and we've had some success there. I think, however, it's also tied to this whole issue of what kind of budget flush we saw in the fourth quarter, and we saw less. The budget flush would normally come from some of our largest customers, and again, we saw less of that. We only had one 10% customer and that customer was just barely over 10%. So I think that those two phenomena are related. And I would suspect that as we go forward into 2015, you're going to probably see that percentage pop up again and be maybe not as great as it was in 2014, but closer to that than what it was in the fourth quarter of last year. Matt Robison Wunderlich Securities. Inc. It's surprising to see [indiscernible] (58:46). Raymond P. Dolan President, Chief Executive Officer & Director Yeah, Matt, this is Ray. Let me take your last piece on the policy and then go ahead and wrap this up because I'm mindful of the time. We've been on the call for an hour. Matt Robison Wunderlich Securities, Inc. [ph] Sure (58:56).

Yes, you're right in assuming that a policy engine is the wedge into VoLTE. It's by no means the only wedge, our SBC particularly to the extent that it's the 7K for video is a big price as well, because Voice over LTE is really just setting up all real-time over LTE and revenue, I think, is going to be a bigger story in the out years than even voice is. So I think you'll see more SBC going forward. You'll definitely see more Diameter going forward, as you see us play more strategically in the VoLTE space.

Raymond P. Dolan

President, Chief Executive Officer & Director

Q4 2014 Earnings Call



### Raymond P. Dolan

President, Chief Executive Officer & Director

To everybody on the call, thank you very much for your support and interest in Sonus over the last several years. This has been a large part of our turnaround story that we're now completing operationally and getting much more strategic in the industry. I'm very excited that what has been a UC story and opportunity is becoming more and more real. SIP is globalizing without a doubt. It's opening up the Unified Communications space to both fixed and mobility.

We're starting to see fixed-mobile convergence, which is going to be a big part of our story in a few weeks over in Barcelona at Mobile World Congress. And all modalities are going to look like Ethernet with a radio attached and they're all going to need flow control, which is the business fundamentally that Sonus is in. We're very, very excited about the opportunity to lead the industry forward.

Thanks for your time today. We look forward to seeing many of you in the market over the next few months.

Operator, I think we can shut down the call at this point in time.

**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 line. Have a great day, everyone.

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