

SONUS NETWORKS Q4 AND FULL YEAR 2012 RESULTS

EARNINGS CONFERENCE CALL PREPARED REMARKS

PATTI LEAHY

Thank you and good afternoon everyone. Welcome to Sonus Networks' fourth quarter and year end 2012 operating results conference call. Thank you for joining us today.

As a reminder, a recording of this call will be available on our website at sonus.net. Also, for your convenience, we will post today's prepared remarks on our IR website shortly after the call.

Speakers on the call today are Ray Dolan, Chief Executive Officer, and Moe Castonguay, Chief Financial Officer. Todd Abbott, Executive Vice President of Strategy and Go-to-Market is also here to address questions at the end of our prepared remarks.

Please note for purposes of Safe Harbor provisions that during this call we will make projections and forward-looking statements regarding items such as future market opportunities and the company's financial performance. Actual events or financial results may differ materially from these projections or 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 benefits from the NET acquisition. A discussion of these and other factors that may affect 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, unless required by law.

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.

It's now my pleasure to introduce the Chief Executive Officer of Sonus, Ray Dolan. Please go ahead, Ray.

RAY DOLAN

Thank you, Patti, and good afternoon everyone.

I'm pleased to report that Sonus made significant progress this past year in our journey to transform our business into an SBC-centric company. As I discussed with you during our quarterly calls throughout 2012, we focused on four key metrics that we believe are foundational to our success. Those metrics were: SBC Momentum, Channel Momentum, New Customer Growth and Operational Execution. I'll briefly address each one in turn.

First, SBC momentum. We delivered outstanding results with our SBC products, gaining significant share and posting year on year growth of approximately 80% for SBC product revenue including NET and 64% excluding NET, both of which significantly outpaced the overall market rate of growth. In Q4 2012, Sonus' preliminary share of the SBC service provider market should be in the low 20's, up from just under 3% in the first quarter of 2011.

Our overall product mix also shifted substantially during 2012. For the full year, 44% of our product revenue was derived from our SBC business, which is up from 25% in 2011. We expect this metric to be north of 60% for full year 2013. Obviously, we expect this metric to be influenced both by the decline in our legacy business as well as by the increase in our SBC business. But our guidance today of SBC product revenue which is projected at 1.7x our Trunking product revenue in

2013, makes it clear that we believe that Sonus is firmly positioned as an SBC company.

The second key metric we laid out was Channel momentum. Again, we made considerable progress in 2012. We launched our global channel program, Sonus Partner Assure and have now recruited and trained over 30 Select Channel Partners, which is well ahead of our original target of 20.

In concert with Sonus Partner Assure, we dramatically expanded our channel-ready products, both organically and through the NET acquisition. We now have the broadest portfolio of channel-centric SBCs, from the 5000 series to the SBC 2000 and SBC 1000 that are all purpose-built to the needs of enterprise customers seeking to reduce network complexity and add capability by moving to SIP-based communications.

While on the topic of the NET acquisition, let me provide an update on the status of our integration efforts. This business has delivered on our expectations and, as we said at the time of announcing the transaction, we continue to expect it to be accretive to EPS in 2013. I am as confident as ever that the NET acquisition was the right thing to do to accelerate our SBC strategy and our efforts to address the enterprise segment. The NET team brings strong knowledge of the enterprise market and is a key enabler of continued growth in Microsoft Lync deployments -- essential drivers for the next leg of our SBC growth story. The acquisition also brought a hybrid SBC product which has proven to be very strategic to the US government as it seeks to secure its network. These are capabilities and skills which would have otherwise taken us many months, if not years, to build on an organic basis, and we expect they will make a material contribution to our financial results in 2013.

The third key metric we laid out last year was new customer growth. This metric is important as it speaks to our ability to leverage our products to diversify our customer base and add more SBC revenue into the mix. We made great progress,

adding 29 new SBC 5000 and 9000 based customers in 2012, a 38% increase from last year. Including NET, we added 180 new customers in the fourth quarter, 130 of which were SBC customers.

We are also pleased to confirm a significant recent SBC customer deployment, and that is Verizon. To help support their IP network growth, Verizon selected Sonus as part of its global SIP Carrier Interconnect Platform. This customer has deployed the Sonus SBC 9000 as a pure SBC platform. We feel proud of the tremendous progress we have made in winning new SBC customers, while also expanding relationships with our existing customers.

The final metric was operational execution. Simply put, this means that we do what we say we will do. Clearly, the macro environment was challenging for us and many others in the industry. Our SBC results demonstrated substantial share gains, but we fell short of our forecasts for the Media Gateway business. As we told you on our last call, we expect the current trend to continue into 2013. To be precise, legacy product revenue was down 26% in 2012 to \$86 million and we are forecasting it to be down 30% in 2013 to \$60 million.

Throughout 2012, we took decisive actions to reduce our cost structure, including restructurings in August and again in December. We believe that these actions position us to continue to drive innovation, invest in key partnerships, and meet our commitment of reaching non-GAAP profitability for the full year 2013.

Taken together, I believe our results against these four key metrics, with the added strategic value that NET brings to Sonus, and the discipline we have instilled around our cost structure have laid the foundation for our success in 2013 and beyond.

I'll conclude my prepared remarks in a moment with our expectations for this coming year. But first, I'll turn it over to Moe to discuss our results and our outlook in more detail.

Moe Castonguay

Thank you, Ray, and good afternoon everyone.

On a previous call we committed to providing key statistics for both Sonus and NET, separately and combined for Q4. Supplementary financial and operational data has been posted to the website for your convenience.

Total revenues for the fourth quarter were \$75.1 million; consisting of \$65.2 million from Sonus and \$9.9 million from NET. Combined total revenue compared to \$57 million in the third quarter and \$74.3 million in the fourth quarter 2011.

Total SBC revenue, including products and services, was \$26.1 million in the fourth quarter, \$25.4 million in the third quarter and \$22.5 million in the fourth quarter of 2011. One customer contributed greater than 10% of revenue in the fourth quarter and that was SoftBank.

Our top five revenue customers represented 45.4% of revenue this quarter, up from 41.3% in the third quarter and down from 54.9% in the fourth quarter of last year.

We reported revenue from 504 customers in the fourth quarter, including 132 from Sonus and 372 from NET. This compares to 403 customers in the third quarter including 132 from Sonus and 271 from NET.

Looking at revenue geographically, domestic revenue accounted for 51% in Q4, versus 76% in Q3 and 67% in Q4 of 2011.

Before I go into further details on our financials, I would like to point out, that the following are non-GAAP numbers that exclude stock-based compensation, write down of prepaid royalties, acquisition costs, restructuring charges, amortization of

intangible assets and depreciation resulting from the write up of NET assets under purchase accounting.

The fourth quarter 2012 GAAP results include a \$7.1 million write down of prepaid royalties on products that we do not believe we will generate revenue from in future periods. This write down was charged to product cost of goods sold. We have eliminated this charge from our non-GAAP results as we don't consider it to be part of our normal operations.

Total gross margin for the fourth quarter was 59.0%, consisting of 59.6% for Sonus and 55% for NET. Combined gross margin compared to 58.1% in the third quarter and 64.1% in Q4 2011.

Product gross margin for the fourth quarter was 61.4%, compared to 66.3% in Q3 and 71.2% in Q4 of last year. The current quarter gross margin was affected by a lower margin legacy transaction that was booked in a prior year.

Service gross margins for the fourth quarter were 55.3%, compared to 46.4% in Q3 and 51.8% in Q4 of last year.

Total operating expenses for the fourth quarter were \$42.0 million, consisting of \$36.0 million for Sonus and \$6 million for NET, reflecting an entire quarter of NET expenses. The combined operating expenses compared to \$38.6 million in the third quarter and \$41.4 million in Q4 of last year.

Consolidated headcount at the end of the quarter, was 1,093 which includes 128 NET employees vs. a total of 1,095 last year. This reflects the ongoing streamlining of operations.

Our net income for the quarter was \$1.8 million, compared to a net loss of \$6.3 million in the third quarter and net income of \$5.4 million in Q4 2011.

We ended the year with total cash and investments of \$279.6 million.

Our DSO for the quarter was 82 days, as compared to 74 days in the third quarter and 64 days in Q4 of 2011. The increase in DSO in the quarter was attributable to a higher percentage of revenue being billed in the last month of the quarter, as compared to previous periods. We expect DSO to return to the 70's next quarter.

Now I would like to provide more details for our outlook for the first quarter ending Friday, March 29 and fiscal year 2013. Going forward, as previously stated, we will provide only consolidated results for Sonus and NET as the integration of NET nears completion. I will remind you that the outlook is provided in the press release and on our webpage.

The total revenue outlook for the first quarter is anticipated to be between \$60 and \$62 million reflecting normal seasonality. Fiscal year 2013 revenue outlook is expected to be between \$267 and \$271 million.

Included in the first quarter outlook is anticipated total SBC revenue of \$26 - \$27 million.

The full year revenue outlook includes anticipated total SBC revenue (including products and services) of \$120 to \$124 million, reflecting year over year growth of approximately 40%.

Our expected annual SBC outlook, coupled with the anticipated decline in our legacy product revenue of roughly 30%, implies roughly \$60 million of legacy product revenue in 2013.

Turning to gross margins - For the first quarter, we expect total non-GAAP gross margins to range between 61 - 62%. For the full year we expect non-GAAP gross margins of 64 - 65%, reflecting continued streamlining of manufacturing and

service operations and lower component and subassembly costs, as well as a higher percentage of revenue from SBC solutions.

For the first quarter we expect non-GAAP operating expenses to be between \$45 - 46 million. We believe approximately \$1.5 million of the sequential increase in operating expense will be attributable to seasonal increases in payroll tax related issues. These seasonal expenses are expected to decrease by approximately \$1 million in our second quarter. First quarter operating expenses are expected to be the peak quarterly rate for all of 2013.

Total non-GAAP operating expenses for fiscal year 2013 are expected to be in the range of \$171 - 172 million. We believe the slight increase in operating expenses over 2012 will relate primarily to the full year effect of absorbing NET expenses of approximately \$23 million in 2013 versus the \$8 million included in 2012 expenses.

For the first quarter, we expect a non-GAAP loss per share of \$0.03 and for the full year we expect non-GAAP earning per diluted share of break-even to \$0.01.

Basic share count for the first quarter should be approximately 281 million and for the full year, diluted shares are expected to be approximately 285 million.

We expect to be cash flow positive from operations in 2013, with first quarter ending cash and investments being flat, quarter-over-quarter. We expect year-end cash and investments of approximately \$285 million.

With that said, I will now turn the call back to Ray to provide his concluding remarks.

Ray Dolan

Before we open up for questions, I'd like to provide some context for our 2013 guidance, and lay out our critical performance objectives to be addressed in our

quarterly calls. As I said in my opening comments, we made significant progress in 2012 towards our core goal to transform Sonus to an SBC-centric, profitable company. We are focused, and we have a plan to get there. But there's more work to be done.

The four themes that will guide us going forward are as follows:

First, continued SBC growth. The midpoint of our annual SBC guidance implies approximately 40% total SBC revenue growth this year, which again implies share gain, as it is well in excess of current market forecasts. To be clear, these results are expected to reflect our continued focus on the Service Provider market, while also establishing our presence in the enterprise SBC market. We plan to report these metrics separately each quarter in 2013.

Second, we expect to drive new customer growth, both with service providers and enterprise customers. We expect this to be achieved in part through our direct sales channel but primarily through Sonus Partner Assure. We will continue reporting new customers each quarter in 2013.

Our third key metric for 2013 is the percent of revenue we generate from the channel and from enterprise customers. We plan to disclose Channel-related and Enterprise-related revenue each quarter in 2013.

Finally, profitability. We are planning to drive Sonus to long-term, consistent profitability. Starting in 2013, we expect to be at least break-even to slightly positive on a non-GAAP basis for the full year, and we expect to begin generating cash from operations for the full year as well. Our approach will allow us to continue to invest as appropriate to ensure that we innovate and maximize market opportunities going forward. Our focus will be on revenue growth, margin expansion, and cost control. Some of our efforts in 2012 are already leading to improved margins in our services area, and we expect to see improvements in product margins as well over the course of 2013 as we continue the integration of

the former NET. As Moe mentioned earlier, Q1 should be the peak of our operating expenses for 2013, and we will continue to look for internal efficiencies going forward. As we deliver on this commitment, we will share our progress each quarter.

In closing, I'd like to thank you for your time today. I personally want to thank our team at Sonus for their tireless efforts in driving our success, and I want to thank our shareholders for their continued support. We are excited about the future of Sonus and look forward to sharing our progress with you each quarter.

With that, I'd ask the Operator to please open the call for questions.