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Sonus Networks, Inc. (SONS)

Q4 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Sonus Networks Fourth Quarter 2015 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 Tuesday, February 16, 2016.

I would now like to turn the conference over to Mark Greenquist, CFO of Sonus Networks. Please go ahead, sir.

Mark T. Greenquist
CFO, CAO & Treasurer

Thanks. Good morning, everyone. Welcome to Sonus Networks Fourth Quarter and Full-Year 2015 Financial Results Conference Call. Joining me on the call today is Ray Dolan, President and Chief Executive 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 the transcript will be available on our IR website after the call.

During our prepared remarks, we will be referring to a presentation with supporting information. Please take a moment to locate these documents as well on our IR website.

As shown on slide 2, please note that during this call, we will be making forward-looking statements regarding items such as future market opportunities and the company's financial outlook. Actual events or financial results may differ materially from these forward-looking statements, and are subject to various risks and uncertainties, including without limitation, economic conditions, market acceptance of our products and services, the timing of customer purchasing decisions and revenue recognition, difficulties leveraging market opportunities, the impact of restructuring activities, and our ability to realize the benefits of acquisitions.

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

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

So with that, let me turn it over to Ray Dolan, President and Chief Executive Officer of Sonus. Ray?

Raymond P. Dolan
President, Chief Executive Officer & Director

Thank you, Mark, and welcome to everyone on today's call.

Let's turn to slide 4 for the highlights of the fourth quarter. I'm very pleased to report our solid fourth quarter and full-year 2015 financial results. As you saw from today's press release, these results were in line with, and in many cases better than, our expectations in a number of key areas as it relates to our operating performance. Our fourth quarter of 2015 revenue was at comparable levels to the fourth quarter last year. In fact, we were only $500,000 shy of last year's fourth quarter revenue.

Also, we continue to strengthen and deepen our customer relationships. While we had no 10% customers for the fourth quarter of 2015, one of our historical 10% customers was just below this threshold. Also, strong bookings momentum continued from our third quarter into our fourth quarter 2015. As a result of our solid bookings performance in both the third and fourth quarters, our product book-to-bill ratio was above one for the second half of 2015, as well as for the full-year fiscal 2015. And this gives us confidence in our first quarter 2016 revenue outlook.

We also saw continued improvement in our gross margins. Specifically, we had record high non-GAAP gross margins in the fourth quarter of 71.4% compared to 70% in the third quarter of 2015 and 68.9% in the fourth quarter of last year. These gross margin improvements were driven primarily by favorable product mix trends that we discussed with you on prior earnings calls.

While we anticipate that gross margins will be sequentially lower in the first half of 2016 versus this most recent performance, we continue to believe that we'll be able to drive further year-over-year gross margin improvements due to the continuation of projected favorable products mix trends, as well as our continued cost containment efforts.

Finally, our good performance on revenue and gross margins combined with our continued efforts to reduce our cost structure drove excellent bottom-line performance. Our fourth quarter earnings per share exceeded the guidance we provided back in October and was our highest reported diluted quarterly earnings per share in the past five years at $0.23 per share. This was the result of a truly outstanding effort on the part of the entire Sonus team, and we're thrilled to end what was admittedly a tough year for us on such a high note.

Turning now to slide 5, you'll get a better view of why I believe we ended on a high note in the fourth quarter. As you can see, we experienced a very challenging first half of 2015 as a large number of customers pushed out their spending plans into the back half of the year. At that time, we quickly developed and executed the restructuring plan which was substantially completed by the end of the second quarter.

Concurrently, we focused on achieving a significant improvement in our revenue in the second half of 2015. And I know that there was a lot of skepticism regarding our second half revenue ramp; I heard that firsthand. However, we remained confident that Sonus' industry-leading technology and solutions were aligned with the technology strategies of our customers, and we believe that Sonus would continue to be a strategic vendor to our customers as their spending ramped back up.

Indeed, that is exactly what happened, as you can see from the upper-left quadrant of this slide, which shows how our revenues in the third and fourth quarters of 2015 recovered back to levels consistent with our 2014 revenue performance.

You can also see on this slide the continued year-on-year improvements that we're able to generate on gross margins, operating margins and diluted earnings per share. The operating leverage that we created through our first half cost reduction efforts benefited us in the second half as our revenue recovered.

As I mentioned previously, gross margins were favorably impacted by improved product mix as new products like the SBC 7K were in high demand. Our second half 2015 revenue and gross margins rebounded, and we realized significant year-over-year gains in operating margins and earnings per share.

I'm proud of how this team responded to the challenges that we faced in early 2015, and we're all gratified to see how the hard work has paid off in the strong fourth quarter results that we're announcing today.

I'll now hand it off to Mark to discuss our results in more detail. Mark?

Mark T. Greenquist
CFO, CAO & Treasurer

Thanks, Ray. As a reminder, gross margin, operating expenses, operating income and earnings per share 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 turning to slide 7, total revenue of $76.3 million exceeded our guidance of $73 million to $75 million. As Ray mentioned, this was just $500,000 lower than what we generated in our fourth quarter of 2014. It is also worth noting that the customer mix and geographic mix were also quite similar to what we experienced in the fourth quarter of 2014. In short, this most recent quarter continue to the trends that we observed in our third quarter of 2015 and represented what we consider to be a return to a more normal spending pattern by our key customers, especially in North America.

Total Product revenue was $47.8 million, and total services revenue was $28.5 million in our fourth quarter. With regard to product revenue, we continued to see strong performance by our flagship SBC 7K product, and it's clear that this product is setting a new benchmark for high-end large service provider SBCs.

Our service revenues were down somewhat year-over-year primarily due to lower professional services revenue as our newer products are easier to install, and we are forecasting low-single digit service revenue growth in 2016 as compared to 2015.

Fourth quarter 2015 non-GAAP gross margin was 71.4%, which was almost a full percentage point above the top end of our guidance of 69.5% to 70.5%. The outperformance was largely due to favorable product mix as well as leveraging our reduced cost structure.

While our overall cost structure has come down, the better-than-expected revenue and gross margin performance in the fourth quarter was slightly offset by somewhat higher non-GAAP operating expenses of $42.6 million versus our guidance of $41 million to $42 million in the quarter. Nevertheless, our non-GAAP fourth quarter diluted earnings came in at $0.23 per share which was above our guidance of $0.18 to $0.21 per share, and as Ray mentioned, this was our highest quarterly earnings per share performance in the past five years.

Finally, we are extremely pleased with our strong cash flow performance in the fourth quarter. Cash and investments totaled $142.2 million at the end of the fourth quarter of 2015, an increase of $15.3 million compared to the end of our third quarter 2015. In addition to our solid earnings, we had strong cash collections in the fourth quarter of 2015 leading to a significant reduction in our accounts receivable and as such, days sales outstanding, which were reduced to 61 days in the fourth quarter of 2015 from 68 days in the third quarter.

Let's turn very briefly to slide 8 for a discussion of full-year 2015 results. Since I've already discussed the fourth quarter results, I'll just summarize the full year quickly. Total revenue for the full year was $249 million, gross margins were 67.8%, and the loss per share was $0.02.

Now let's turn to slide 9 for a discussion of our 2016 guidance. And before diving straight into the numbers for 2016, let me first give some context on how we see the beginning of this year shaping up. As Ray mentioned in his remarks, we saw continued good order flow in the fourth quarter after experiencing very strong bookings in the third quarter of last year. To date, that trend has continued in the first quarter of 2016. We have a robust funnel of opportunities, and we've already booked some key large orders for our first quarter of 2016. So in short, linearity in the first quarter has been good thus far.

Our funnel for the second quarter of 2016 is shaping up nicely as well. And while there's still a lot of work to do, we believe there will be a strong first-half spending environment this year. With regard to the second half of 2016, it's still really too early to tell, but our underlying assumption is that we should be able to perform at same or close to the revenue levels that we achieved in the second halves of both 2015 and 2014.

So specifically, we expect first quarter 2016 revenue to be between $58 million and $59 million, and for the first half of 2016, we expect revenue to be between $118 million and $120 million.

As I just mentioned, we feel that we have good visibility into these numbers due to the healthy level of backlog that we had as we entered the first quarter, the robust funnel of opportunities that we currently have, and the bookings that we've already closed in the first half of the first quarter of 2016.

With regard to the full-year 2016 revenue outlook, we have less visibility into our second half of 2016, but if the current trends that we're seeing persist, we believe it's very reasonable to expect the second half revenue to be consistent with the second half of 2015 revenue levels. As such, our full-year 2016 revenue outlook is between $255 million and $265 million.

First quarter non-GAAP gross margin is expected to be approximately 66.5%. As Ray mentioned in his remarks, we expect a sequential decline in first quarter 2016 gross margins versus what we just recorded in our fourth quarter of 2015. And this is normal quarterly pattern, as revenue is also expected to be sequentially lower in the first quarter of 2016, although the magnitude of the sequential gross margin drop is somewhat larger than what we would normally expect, and this is due to some specific lower margin business from which we anticipate will generate revenue in our first quarter. For the remainder of the year, we believe that our gross margins will improve due to favorable product mix and higher revenue.

Finally, non-GAAP OpEx for the first quarter is expected to be $39.5 million to $40.5 million, and as such, the first quarter of 2016 non-GAAP loss per share is expected to range between $0.03 and $0.01 based on 50 million shares outstanding. For the full-year 2016, we expect that non-GAAP diluted earnings per share will be $0.20 to $0.27 based on 50 million diluted shares outstanding.

So now, let me turn it back over to Ray for some closing remarks. Ray?

Raymond P. Dolan
President, Chief Executive Officer & Director

Thanks, Mark. Let's turn to slide 11 and I'll conclude by discussing our areas of focus for 2016. You may recognize this slide from 2015 as I have carried forward the same operating and strategic focus areas.

Operationally, we'll continue to focus on improving financial leverage. We expect to resume revenue growth in 2016, albeit single digits. We believe the combination of projected revenue growth coupled with steady gross margin expansion and OpEx discipline should result in healthy operating income and earnings growth in 2016. On a full-year basis, the core operating business is healthy, profitable, and generating solid cash flow.

Strategically, we will continue the investments that we've made over multiple years to help service providers, enterprises, and over-the-top web scale players to deliver on the promise of a secure cloud-based communication architecture. Given the significant confusion that exists in the marketplace regarding SDN, NFV, I thought I'd spend my closing remarks on how we anticipate though strategic trends playing out.

Taking these points in order, I'll start with video. First, we launched our SBC 7K in February, 2014. We saw the market moving to video requiring 10 gig interfaces, and we saw that interworking and transcoding would play a major role in UC video just like it had in its current UC voice offerings. It was a great investment decision, as our SBC 7K is now our flagship product and has been increasingly adopted by new customers. Our existing customers are migrating to this platform as they require 10 gig interfaces for scale and performance.

Our 7K scale is better than any SBC on the market, and the software load of our 7K forms the basis of our virtualization strategy at the session layer. So we invested where the puck was going, and we are future proofing our customers' networks as they continue to develop their overall virtualization timelines and strategies.

The second strategic area is VoLTE. This market has been slow to evolve, and part due to the complexities of handset issues and handover at mobile network borders. We saw early success in the policy application, and we've since been involved in bids for VoLTE interconnect. We've had limited success in the access edge given that large TAMs maintain the advantage of bundling products in broader mobility deployments. We expect the bundling approach to continue for the foreseeable future given the current supply chain structure, but we do expect that we can be successful at carrier interconnect.

That said, we've had good initial success in areas such as WebRTC and voice over Wi-Fi. Both of these access areas are emerging and we believe that we are well positioned. WebRTC allows service providers and enterprises to marry the world of secure HTTP to the world of SIP. A WebRTC Gateway and the associated SDK have become the latest real-time access technology in the service provider network.

I'm pleased to report that in 2015, Sonus launched a WebRTC solution that has been chosen for Verizon's enterprise WebRTC RFP. Similarly, the use of voice over Wi-Fi in carrier networks is growing. Sonus' partners, such as [ph] Tackqua (16:46), employ our SBC in their voiceover Wi-Fi solutions to provide security and authentication for voice and video. Additionally, our recent win in APAC is a voiceover Wi-Fi solution using the Sonus SPC.

The move to VoLTE also drives service providers to migrate their signaling networks from an SS7 base world to one based on IP. However, for many, this is a slow migration from 2G, 3G to 4G. Sonus provides a gradual migration option in our DFC 8000, which can function both as an SS7 SDP as well as a diameter router, effectively maintaining the existing service provider network as they move to an all-IP world.

With 2015 wins in key Tier 1 service providers in Japan and Korea, Sonus is well positioned to win additional signaling business with this mobile network transformation.

Now let me turn to virtualization, and hopefully provide some clarity to a few key acronyms that are gaining buzz in the networking space. First, networks need to be more agile so they can keep pace with the rate of change in the application layer. This requires a shift to software and this has been underway for several years. Network functions are being virtualized, and this process took on the term NFV or network function virtualization.

Once the functions are virtualized, SBN can be realized. Software-defined networks require a new control plane that allows the application layer to request secure bandwidth connections on an end-to-end basis across a number of networks. We believe this is the real opportunity in the next step of cloud-based communications.

Sonus has been investing over multiple years to virtualize every major area of the new cloud-based communications architecture: policy, signaling and session layers. Most recently through the launch of VellOS, we have added dynamic network optimization.

Finally, we come to securing cloud-based communications. Initially, network security [ph] was solved (18:55) with firewalls surrounding an enterprise, while workers and data remained physically inside the enterprise. As workers became increasingly mobile, virtual private networks or VPNs were created to tunnel into the walled garden, allowing secure remote access.

More recently, the data itself and many workloads and applications have migrated to the cloud. This trend is accelerating and therefore the very nature of network security is changing dramatically. Security at the network layer is moving up the stack to become an essential and contextual part of the network flow. This critical evolution is driving the design of Nextgen firewalls.

While all of these changes have been occurring to secure the data path, SBCs continue to secure the real-time network by protecting networks at their borders against denial-of-service attacks. SBCs also have a unique opportunity based on where they sit in the stack to help unify the orchestration role for securing both data and real-time flows on an end-to-end basis. And it's that opportunity that we will explore and develop going forward. We look forward to sharing our progress on this throughout 2016.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] One moment please for the first question. And our first question comes from the line of Jess Lubert with Wells Fargo Securities. Please proceed with your question.

Jess I. Lubert
Wells Fargo Securities LLC

Q

Hi, guys.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Hi, Jess.

Jess I. Lubert
Wells Fargo Securities LLC

Q

Thanks for taking my question. A couple of quick ones if I may? Maybe just first I didn't hear the breakout of growth versus legacy. Can you give us a sense of how the two segments performed and as we think about 2016, what your expectations are for the growth versus legacy portfolios?

Mark T. Greenquist
CFO, CAO & Treasurer

A

Sure. The gross revenue in total was $43.5 million, and legacy in the quarter was $32.8 million. So those were both up or – yeah, they were both up year-over-year and – well, the growth was up year-over-year and sequentially the legacy was up sequentially but down slightly year-over-year. And I don't think our view has changed on those going forward. I mean, if you look at the revenue that we did for the year, $250 million round numbers and as you know, roughly half – roughly $100 million of that is services, and then there's about $150 million a product and the growth related product is going to be roughly $100 million of that and legacy is $50 million. And we think the growth related product is going to be growing around 20% and maybe a little bit higher but probably around 20%. We think the legacy is going to shrink probably at least 10%, maybe a little bit more. So that's, again, when we talked in the third quarter, that's how we got to the mid-single digit total revenue growth year-over-year.

Jess I. Lubert
Wells Fargo Securities LLC

Q

Okay. And then I was also hoping you could give us the enterprise versus carrier split and maybe touch upon some of the bookings momentum you're seeing there, how that kind of flows through on both the enterprise and carrier side?

Mark T. Greenquist
CFO, CAO & Treasurer

A

Yeah, enterprise was 19% of revenue or product revenue in the fourth quarter and that was right on what the annual average was. Obviously in the fourth quarter, we see probably more budget flush there from the service providers so it does tend to be sometimes a little bit more weighted toward service provider, but this year it was at

19%. The enterprise was actually up a little bit from last year's 15% in the fourth quarter and it was right on the annual average.

Jess I. Lubert
Wells Fargo Securities LLC

Q

And then maybe just last one for me as the first quarter in a while you haven't had a 10% customer. Was that expected? And when we think about the full-year forecast, can you help us understand to what degree that may also be more dependent on a higher volume of smaller deals like we saw in Q4? Or some of the VoLTE, voice over Wi-Fi, WebRTC opportunities you mentioned, some of those might drive a 10% customer in 2016?

Mark T. Greenquist
CFO, CAO & Treasurer

A

Like we said in the fourth quarter, there was one customer that's historically been a 10% customer that was like very, very, very close but just didn't quite make it over the threshold. And then when you look at the mix of deals and the customer needs and everything in the fourth quarter, I mean it was very similar to what we would've expected and also experienced in the past even in the fourth quarter of 2014. So I don't think your characterization or your – maybe it's your concern that, hey, what is dependent upon a large number smaller deals is right. It's actually the various characteristics of the revenue mix were quite similar, and I do think that we'll probably have a 10% customer in the first quarter just based on what we're seeing so far. Ray, I think, wanted to add something there. No? Okay.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

That's good.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Thanks, Jess. Anything else, Jess? I'm sorry, Melody, go ahead.

Operator: That's okay. I apologize. Our next question comes from the line of Paul Silverstein with Cowan. Please proceed with your question.

Paul Silverstein
Cowen & Co. LLC

Q

Thanks. Good morning, Mark. Good morning, Ray.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Hey, Paul.

Paul Silverstein
Cowen & Co. LLC

Q

Hey, Mark. Picking up on Jess' line of questioning, the $43.5 million you cited for growth, was that a total or was that product? My apologies.

Mark T. Greenquist
CFO, CAO & Treasurer
A

It's total.

Paul Silverstein
Cowen & Co. LLC
Q

Total. Can you give us a split between products and services?

Mark T. Greenquist
CFO, CAO & Treasurer
A

The product growth revenue was $31.1 million and the legacy product with $16.7 million and then the services growth was $12.4 million and the legacy was $16.2 million I think it is, $16.1 million or $16.2 million depending on rounding.

Paul Silverstein
Cowen & Co. LLC
Q

I appreciate that. Would it be possible to get the enterprise split on a broad services basis the way you used to do it or you've been doing it?

Mark T. Greenquist
CFO, CAO & Treasurer
A

Yeah, I mean – I don't have the services, Paul, I'm sorry. I mean, on a product revenue basis, the enterprise was 19%. If you look at it, enterprise on a growth product basis was a little bit higher, 21%, which is not surprising since the legacy revenue is almost all service provider.

Paul Silverstein
Cowen & Co. LLC
Q

And that enterprise growth, the 21%, that's enterprise growth products or that's enterprise growth total?

Mark T. Greenquist
CFO, CAO & Treasurer
A

No, enterprise growth product revenue.

Paul Silverstein
Cowen & Co. LLC
Q

Product. You don't have the total enterprise? Enterprise as a percentage of total? Obviously you don't have that. Otherwise, you'd be able to give us those. Okay.

Mark T. Greenquist
CFO, CAO & Treasurer
A

I'll try to get back to you with that.

Paul Silverstein
Cowen & Co. LLC
Q

No, I appreciate it. What are you all seeing in the enterprise market especially with respect to Microsoft, they have their new Azure platform, any additional insight you could share with us?

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

Sure, Paul. How are you doing? It's Ray. We've seen some really good trends in the enterprise. Some adoption in Microsoft. There's also some confusion because they've done a global rollout in various theaters and specifically in APAC I think there's been some pause there but I expect that to just resolve itself. More broadly though in the enterprise beyond just Skype for Business has a launched with Microsoft. There's a lot of work to move to the cloud architecture that we've been preparing the enterprise for, for a number of years. So we're seeing some pretty good [ph] take-up (27:51) in some RFPs, in some large multinationals and in some contact center work that these companies are doing as well. And that's where I think with the WebRTC opportunity, we have what's probably a number of service providers globally as a channel into that marketplace and we're pretty excited about that as an opportunity. It may be a small part of our revenue this year, but it's a strategic piece of our architecture going forward.

Paul Silverstein
Cowen & Co. LLC Q

Ray, at the service provider level what's the single biggest driver this year?

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

For our service providers, you mean as far as the sell-to?

Paul Silverstein
Cowen & Co. LLC Q

For you. The service provider piece of the business was still the dominant portion of revenue. I expect that WebRTC is an exciting opportunity longer term, but what will be the biggest driver this year?

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

Well, the biggest driver this year will be probably their continued drive to the cloud and their pursuit of the enterprise cloud opportunity. A lot of them are moving hard on that so we're partnering with them to resolve that. And then there's additional growth in their voice markets and as well as additional growth in their video markets.

Paul Silverstein
Cowen & Co. LLC Q

And one last point...

Mark T. Greenquist
CFO, CAO & Treasurer A

And also the IP – I will. I'm just point out, there's also the IP peering process that's been happening for some time in North America. We do expect that to globalize and in particular in Japanese market. We do think that at the end of this calendar year, which is still within their fiscal year, you'll see a nice interconnect opportunity for IP peering both within carriers in Japan as well as Japan becoming part of the global IP peering market.

Paul Silverstein
Cowen & Co. LLC

Q

One last quick question before I pass it along. Mark, in terms of rate of price erosion, any change for better or worse?

Mark T. Greenquist
CFO, CAO & Treasurer

A

No, no. There hasn't been – the thing that's impacting gross margins, Paul, really is mix and there really hasn't been much or any big changes in pricing. So it's again margins are not going up bec ause we're necessarily charging more. They're going up because we're selling more of the higher end product in the mix and it comes with a very good [ph] track margin (30:07).

Paul Silverstein
Cowen & Co. LLC

Q

Got it. Thanks, guys. I'll pass it on.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Thanks.

Operator: Thank you for your question. Our next question comes from the line of Dmitry Netis with William Blair. Please proceed with your question.

Dmitry G. Netis
William Blair & Co. LLC

Q

Dmitry Netis. Hi. Good morning, gentlemen.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Hey. How are you?

Dmitry G. Netis
William Blair & Co. LLC

Q

Good. Nice to see a steady progress.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Thanks, Dmitry.

Dmitry G. Netis
William Blair & Co. LLC

Q

A couple of questions. On the 7 K, I'm just curious, is that about – how do we think about the mix of 7 K versus the rest of the Session Border Control of products out there? Is it about 50%? Is it over? Has it hit over 50% threshold yet? Can you give us a sense of where that product line is tracking right now?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, Dmitry, this is Ray. I'll approach it without putting specific numbers on it, but it definitely is our flagship. And from a service provider point of view since it scales so well, it is the – I think it is the product of choice at least in the core network architecture. As you get to the edge of enterprise deployments, the 5K suite competes with that because it's so efficient in lower session density areas as well as the 1K/2K but the 7K is probably more than half of our SBC revenue.

Dmitry G. Netis
William Blair & Co. LLC

Q

Total? Not just service provider?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, in total.

Dmitry G. Netis
William Blair & Co. LLC

Q

Okay. All right. That's helpful. Thank you. And then as I look at a big project we had last quarter which was with the Inteliquent, that was over 10% of your revenue at the time. Can you tell us whether that project is completed or is there still ongoing kind of deployment in there and you expect more revenue to come out in 2016?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, the project had an initial network deployment. My guess is it will have a number of growth tranches to it. We've completed the initial deployment of that project. It's too early to tell when in 2016 we'll see those growth tranches, so we're not calling that at this point in time, Dmitry.

Dmitry G. Netis
William Blair & Co. LLC

Q

Understood. Okay. That's helpful. And then on the international side, I think that was a pretty strong quarter. I think on a year-over-year basis, it's about 30% international revenue and it was I think 30% Q4 of last year as well, but quarter-over-quarter, it improved quite significantly from 23% to 30%. So we had a nice growth in the international theatre. I was just curious what if you could just give a little bit more color, what are some of the project internationally you're seeing? Was it mostly APAC, Europe? Give us some color there.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

So in the third quarter, that was heavily influenced, Dmitry, by the Inteliquent deal, as well as Centurylink was a 10% customer. So it was a heavy quarter from a North American perspective and then we – fourth quarter, frankly, we're at 30%. We're pretty much like right on the annual average. So I think in the fourth quarter just ended up again from both the customer mix of product in a geographic mix perspective, you ended up just going back to what we consider to be more normal. With specific regions it was probably more APAC than it was EMEA, but there's nothing terribly special to read into that.

Dmitry G. Netis
William Blair & Co. LLC

Q

Okay. Understood. So it's just [indiscernible] (33:47) from last SKU. Okay. And then on the Verizon opportunity, that was an interesting win you guys announced. Any color as to what's involved in this WebRTC opportunities. Is there just generally hardware or is it generally software sales? When I ask for hardware I mean Session Border Control is this just the software and WebRTC controller that you are selling in there? Obviously if you could talk about the potential opportunity or the nature of the size of this opportunity, that would be really good. And if there's any operators within North America that are sort of taking on this template and sort of going with that as well, like Verizon just did?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Sure. Thanks, Dmitry. So we're limited as to what we can say specifically about the Verizon win. So I'll talk more broadly about WebRTC as opposed to that specific opportunity. I'm really proud that we were authorized to announce that which is rare amongst the Tier 1 service providers. So what we've got in WebRTC in general, Dmitry, is we think we've got the best product that can scale and secure the HTTP to SIP architecture that WebRTC really drives. And we do expect that there'll be additional wins at some point in time. I'm not going to call the timing of that, but we are going to work with all service providers.

We are going to work with all contact centers. And we think WebRTC over a period of years will become a major access mechanism as the cloud architecture emerges. And so whether or not they deploy in hardware or software is too soon to tell. I am not going to speak to the specific Verizon win, but we are encouraged by that victory, and we do think it's a natural derivative of our experience in voice over IP, and now video over IP architecture that we've had since the company was formed in the late 1990s?

Dmitry G. Netis
William Blair & Co. LLC

Q

Okay. Was it virtualized at all? Or was it just sort of a standard product? I apologize going back to it, but are you starting to see elements of this next generation virtualized software being applied to these new opportunities, including Verizon?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Okay. Again, I'm not going to speak to the Verizon specific opportunity, Dmitry, I appreciate your patience on that. But now on broader WebRTC, yes, we have both a hardware configuration as well as the virtualized configuration. We believe we've led the market in virtualization because we started with our policy engine four years ago, and our SBC code load we announced years ago as the single code load it scales from one to infinite number of sessions based on the number of virtual environments that you spin up.

So we've been out in front of this trend, and in fact its implications do reach into WebRTC, and importantly they reach into the entire notion of securing the sessions as well. And we do believe that there is a very big play at security as viewed as – frankly you're not even going to start a session, data or real-time, without knowing that you can secure it on an end-to-end basis. So the security layer is likely to become either the entire orchestration layer or major part of the orchestration layer of the NextGen cloud. And that's where we're going with our architecture both the WebRTC as well as for all cost flows.

Dmitry G. Netis
William Blair & Co. LLC

Q

I appreciate that perspective. If I could just throw one last one for Mark or you. On the buybacks, you didn't buy a lot of stock this quarter, so just wondering, what's you're thinking there? Are you going to continue to buy back the stock? The reason you didn't buy much as you were hitting the max of your average daily volume? Or any perspective you could give there this quarter? And then what you're thinking going forward would be very helpful.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, so the thinking hasn't changed. We continue to target cash at $100 million to $150 million on the balance sheet and as we've said consistently, if we get up close to $150 million you'd expect us to start repurchasing shares again. So it wasn't clear to us in the fourth quarter that was going to happen. It became clear, we started to purchase some shares but we really weren't in the market that many days. Given where cash ended and what we see going on in the first quarter you'd expect us to start buying some shares again in the first quarter.

Dmitry G. Netis
William Blair & Co. LLC

Q

Great. Thank you very much.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yes. Thanks,

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

Mike J. Latimore
Northland Capital Markets

Q

Thanks. Very nice quarter there.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Hey, Mike.

Mike J. Latimore
Northland Capital Markets

Q

I guess, Ray, you mentioned there was a couple opportunity's in VoLTE interconnect has there been any decisions there yet of Tier 1 carriers? If not, do you expect a decision this year?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

We do expect some decisions this year, Mike, but I have nothing to announce with you today.

Mike J. Latimore
Northland Capital Markets

Q

Got it. And that'll be generally with Tier 1 carriers or a mix?

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

I think, yeah, Tier 1s as well as Tier 2s, definitely.

Mike J. Latimore
Northland Capital Markets
Q

And then on the SBC 7K how important is video in terms of the carriers decisions there? Is a kind of a checkbox sort of thing or is it key to their decision around the 7K?

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

I think it's evolved it went from a checkbox say a year ago to – my senses is that it's changing right now to more than that but people are exploring video growth strategies, you saw Cisco pick off Acano, for example, as the architecture is clearly moving heavy tele presence architecture to more of a web-based architecture for video, we expect those trends to accelerate so I think the 7K selection went from 2014 early 2015 checkbox to now one more that is strategic to their video growth strategies.

Mike J. Latimore
Northland Capital Markets
Q

Got it. And just curious I know you have some cable operator customers can you give us some perspective on how big the cable sector is overall the percent of bookings to revenue or how important there?

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

Great question, Mike. The cable industry is very important to our growth strategy. When I joined Sonus five years ago, we had zero cable revenue, we simply missed the access opportunity for the triple-play piece that cable was looking at. But the good news is we started investing about four years ago. We have been working with and selected and driving revenue from a number of North American cable operators, we're starting to see that go global.

The bottom line is the cable industry is evolving very quickly from media companies to network access companies with some of their own media running over the top of their own pipe. And I would expect over the next 24 months, they're going to migrate from a DOCSIS model to an IP model they're just trying to figure out how.

It's not an easy turnaround to do but the economics of doing it are very, very compelling and when they do that, they'll not only interconnect on an IP basis with the Telcos, which has been a great opportunity for us in North America but they'll move to access technologies over IP and they'll probably drive the majority of energy behind voice over Wi-Fi, which is another place that we're collaborating with them as well because they don't really, at this point in time, own traditional mobility networks. So all of those areas are very, very important for us from the standpoint of our growth opportunity, very exciting.

Mike J. Latimore
Northland Capital Markets
Q

I'm curious on the enterprise business, how important is Microsoft Skype for Business, does it drive half of the enterprise business? Less than half?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

It's probably a little less than half, some of our enterprise business is large architecture multinational Fortune 40 banks, Fortune 50 banks, that kind of thing but we are seeing a nice migration amongst those large players to moving to UC seats a couple of our large banks of hundreds and thousands of seats that are moving into that Skype for Business environment it's a great opportunity for us to migrate them. We've been with those banks running contact centers for number of years and it's a great opportunity for us to help them move their edge works as well.

Mike J. Latimore
Northland Capital Markets

Q

Last question, I guess, WebRTC, are you seeing interests initially here coming out of the context in our market or just kind of more broadly?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

I'd say it's both. We are seeing initial uptake in the contact center that is the traditional ATTP to SIP architecture but is broadening as well.

Mike J. Latimore
Northland Capital Markets

Q

Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Thanks, Mike.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Thanks, Mike.

Operator: Thank you. Your next question comes from the line of Greg Mesniaeff with Drexel Hamilton. Please proceed with your question.

Greg Mesniaeff
Drexel Hamilton LLC

Q

Thank you.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Hey, Greg.

Greg Mesniaeff
Drexel Hamilton LLC

Q

How are you?

Mark T. Greenquist
CFO, CAO & Treasurer

A

Good. How are you doing?

Greg Mesniaeff
Drexel Hamilton LLC

Q

Good. Good. I noticed the DSO levels came down again in the fourth quarter into the low 60s days range. Is that a good range to be modeling going forward, or is it conceivable that perhaps that we could see even a better situation unfold down the road?

Mark T. Greenquist
CFO, CAO & Treasurer

A

I wouldn't say that it's going to get a lot better. In fact, for your modeling purposes, I'd suggest you float back up to like 70 or 75 days. I just think we had very, very good collections in the fourth quarter. And just to put that into context, I mean, remember we had very good bookings in the third quarter, so the revenue was pretty linear or more linear than it normally would be in the fourth quarter, and that's the main determinant of what our DSOs are going to be at the end of a particular quarter. So the revenue came in earlier, we collected it earlier, therefore we had less receivables at the end of the year than we otherwise would.

I think you're going to – we're going to continue to have decent collections in the first quarter, but you're just not going to see the usual very large collections in the first quarter coming off of a higher fourth quarter revenue and as a result, higher end-of-year receivables. So I do – I actually think the DSOs in all likelihood will float back up a little bit higher. I don't think they're going to improve more, but in the end, again, it all depends on the linearity of the revenue in any particular quarter, and the fourth quarter was just really well set up to allow us to do that.

Greg Mesniaeff
Drexel Hamilton LLC

Q

Got you. Thank you. That's very helpful.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Any other questions, Greg?

Operator: Oh, I'm sorry. We do have our next question coming from the line of Ryan Hutchinson with Guggenheim. Please proceed with your question.

Q

Hey. Good morning, guys. This is [ph] Nate (46:02) on for Ryan.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Oh, hey, [ph] Nate (46:04).

Q

Hey. Can you give us any updates on progress in terms of deploying software-based SBCs, specifically at the edge?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, [ph] Nate (46:18), your question is – well, we've been virtualized at the edge for a number of years, but most of the time in the edge of networks it's still carrying some TDM legacy which requires hardware instances, and that's as a result carrying the day right now at the edge of access networks. The 1K, 2K is a great workhorse in both of those environments, and is – they've been very effective products for us in those environments. We do expect that to change over time as TDM goes away, but it may take another year or two or three, and if it does, we'll continue to sell hardware based products. But we're seeing folks exploring software-based SBCs at the edge of networks, just not deploying them yet. I hope that answers your question.

Q

Okay. Yes. So generally speaking, you've seen more explorations on the edge than in the core, correct?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

I would say we've seen people exploring them in both places because with all of these functions now being virtualized, it's a great opportunity for people to look at what's the right stack for the cloud going forward. It doesn't need to be precisely the way it was before. They can reorganize in the core of these networks, and we're working with all of the over-the-top cloud players to build a new Agile stack for resilient cloud and a secure cloud. So we're seeing the exact same opportunity to explore software-based in the core as we were on the edge.

Q

Okay. And now that the core business is definitely stable, can you give us your thoughts on any areas where you're looking to augment the portfolio with M&A?

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Well, [ph] Nate (48:02), we're not going to get out ahead of our skis on that area, but if you just look at what our strategic areas of focus are, those are the areas that we're going to focus both organically in and inorganically in.

Q

Yeah, thank you.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Okay. Thanks.

Operator: Thank you for your question. Our next question comes from the line of [ph] Steve Cohen with Provo Partners (48:24). Please proceed with your question.

<Q >

Hi. Good morning.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Hey, [ph] Steve (48:31).

Q

Recognizing that you can't talk a lot about the Verizon, can you indicate whether you would be sharing that opportunity with others or if there's some exclusivity there? And then going beyond just the Verizon, I note that you're counting on second half of the year revenue being about 54% of total based on midpoints of your guidance which is up a couple percentage points from what you had been done – had been doing for most years. Is that WebRTC driven or there are other factors that you hope are going to drive that? Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Yeah, thanks, [ph] Steve (49:10). First, no we can't get any deeper into the Verizon opportunity so I'll just leave that question hanging. I apologize for that. Second, with regard to your second half ratios, I have to go back and calculate. I don't see that as some pattern in our revenue. What it really is, is us giving you our best [ph] feasibility (49:29) into the first half and then calling the ball on the second half about flat year-over-year based on what we see as the market evolves. We'll give you more color on the second half as the year plays out and the math will just be what the math is.

Mark T. Greenquist
CFO, CAO & Treasurer

A

Yeah, I don't think the second half at 54% of total is unusual. I think what was more unusual was the percentage of second half revenue as a percentage of total in 2015. I mean that was extremely high. I think it's actually coming back to something that I would consider to be more normal. I mean obviously 2014 was a little bit more front-end loaded, but I actually think that the quarterly pattern that were sort of calling for in 2016 is pretty much right straight down the middle.

Q

Yeah, I wasn't looking at the 2015. I was looking at the 2012 to 2014 when it was [indiscernible] (50:30) 51%, 52% versus the 54% that you're now expecting and just wondering if that is just the way the arithmetic plays out or are there some specific opportunities that you're anticipating in the second half of the year.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

It's arithmetic, [ph] Steven (50:47).

Q

Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Thank you. Melody?

Operator: We have no further questions at this time. [Operator Instructions]

Raymond P. Dolan
President, Chief Executive Officer & Director

A

Okay.

Operator: We have no one queued up at this time. I'll turn it back to you for closing remarks.

Raymond P. Dolan
President, Chief Executive Officer & Director

Okay. Thank you.

Mark T. Greenquist
CFO, CAO & Treasurer

Thank you very much, Melody, and thank you for everyone that's attending this morning. If you're in the Northeast, let's get continue to warm weather. Thanks for your support to Sonus. We look forward to reporting our progress throughout 2016. Have a good day, everyone.

Operator: Ladies and gentlemen, that does conclude today's conference call. We thank you for yo ur participation, and ask that you please disconnect your lines.