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Sonus Networks, Inc. (SONS)

Q3 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Sonus Networks Third Quarter 2017 Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, we'll conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded Monday, October 30, 2017.

Now, I would like to turn the conference over to Sara Leggat, Head of Investor Relations. Please go ahead, ma'am.

Sara Leggat

Investor Relations Contact, Sonus Networks, Inc.

Good morning. I'm very pleased to introduce you to Ribbon Communications and to welcome you to our third quarter 2017 financial results conference call. On the call with me today are Ray Dolan, our CEO; Daryl Raiford, previous CFO of GENBAND and now CFO of Ribbon; and Susan Villare, former Interim CFO of Sonus.

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

As shown on slide two, please note that during this call, we'll be making forward-looking statements regarding items such as business strategy, future market opportunities and the company's financial outlook. Actual events or financial results may differ materially from these forward-looking statements and are subject to various risks and uncertainties including, without limitation, economic conditions, market acceptance of our products and

services, the timing of customer purchasing decisions and revenue recognition, our ability to successfully integrate GENBAND and Sonus now that our merger is completed, difficulties leveraging market opportunities and the impact of cost containment efforts.

A discussion of these and other factors that may affect our future results is contained in each of Sonus Networks' latest annual, quarterly and current report on Form 10-K, 10-Q and 8-K, as the case may be, in the joint proxy statement filed by Sonus Networks with the SEC on September 22, 2017 and in today's earnings release, all of which are available on our IR website.

Additionally, many risks and uncertainties could cause actual results to differ materially from these forward-looking statements. While we may elect to update or revise forward-looking statements at some point, we specifically disclaim any obligation to do so. During our call we'll be referring to certain GAAP and non-GAAP financial measures.

A reconciliation of historic non-GAAP measures to comparable GAAP financial measures is included in our presentation on our website and in our earnings press release issued today.

With that, let me turn it over to our President and Chief Executive Officer, Ray Dolan.

Raymond P. Dolan

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

Thanks, Sara, and welcome to everyone on the call today. This marks my 29th earnings call as your CEO and the first one as the CEO of our newly combined company, Ribbon Communications. Ribbon Communications is formed from the combination of Sonus and GENBAND and was announced in a press release this morning, which was issued subsequent to our earnings release.

We will continue to trade on NASDAQ using our current symbol, SONS, for a short period. In the near future, we will announce the date upon which we expect to transition to our new ticker symbol, RBBN. We anticipate this transition to take place in the fourth quarter of 2017.

The logic behind our new name is simple, Ribbon Communications will provide secure, flexible end-to-end solutions to service providers, enterprises and cloud players. Our new name reflects a more agile, nimble and software-centric company. With greater scale and a broader set of products to offer to our customers, Ribbon Communications will provide a more complete solution. Since the day we announced this merger, the feedback I've received from numerous customers has been very positive.

Now let me shift to the results for Q3 and I'll do this in two parts: the first will be for Sonus standalone; the second will be for GENBAND standalone. The details are shown in the slide deck found on our IR website, and for your convenience, we will also show the results on a combined basis to make the math easier for everyone.

As Sara stated, both Susan Villare and Daryl Raiford are on the call with me today. To avoid going back and forth, I'll cover the entire script today and then I'll defer any questions on financial details to the appropriate CFO. To be clear, going forward, Daryl will be the CFO of Ribbon Communications and Susan will assume the role of Vice President of FP&A and Treasurer.

As a reminder, gross margin, operating expense, operating income, net income and loss per share are all discussed on a non-GAAP basis and for historical periods have been reconciled for you at the end of today's press release. The slides on our IR website have the details regarding our historical financial performance and

our reporting framework is consistent with what we've presented in prior periods. We encourage you to get these materials from our IR website.

Turning to slide three, I'm very pleased to report that Q3 was another solid operating quarter for Sonus. Our total revenue was \$74.6 million, which was 34% sequential increase from Q2 last year and a 15% increase compared to Q3 of 2016.

Most importantly, we scored the conversion from Oracle to Sonus with Verizon Wireless, a project that's been underway for more than a year. We've already received expansion orders for that engagement, which we anticipate will convert to revenue in Q4 2017. This relationship couldn't be better or more strategic, and I expect that to continue going forward.

Our non-GAAP total gross margin was a record high of 75.6% in Q3 with software revenue continuing to drive margin improvements. In Q4, Sonus standalone margins are projected to be approximately 72%, which equates to our full year being slightly greater than 71%.

We've made tremendous progress on Sonus' gross margins, driven principally through our investment in R&D and the streamlining of internal processes. We will focus intensely to continue this trend on a consolidated basis as we move forward as Ribbon Communications.

With tightly controlled operating expenses, which were \$43 million this past quarter, we were able to deliver non-GAAP EPS of \$0.26 for Q3, positioning us well against our future – our full year standalone non-GAAP EPS guidance of \$0.26. We ended Q3 with over \$130 million of cash and no debt.

Slide four shows Sonus' historical operating results on a quarterly basis. Slide five shows Sonus' balance sheet. DSOs at the end of Q3 were 62 days after another solid quarter of bookings linearity.

Slide six shows Sonus' statement of cash flows, reflecting positive cash from operations of more than \$6 million. Slide 7 shows Sonus' key stats. We had two 10% customers in Q3, Verizon and AT&T, who were also 10% customers in Q2. Our combined 5K/7K and software-related revenue accounted for about two-thirds of our product revenue this past quarter, which was up nicely both quarter-over-quarter and year-over-year. I couldn't be more proud of the Sonus team for delivering these solid results, while also planning for the merger with GENBAND.

Turning to slide 8. I'll now cover GENBAND's Q3 results. We've included some quarterly history, so you can see their linearity as we combine to form Ribbon Communications. Since, we've closed our merger subsequent to the end of Q3, none of the financial highlights shown on this slide are included in our consolidated financial results.

GENBAND's software Q3 revenues as compared to prior year were partially offset by higher gross margins, resulting in a solid quarter of EBITDA. Revenue was \$84.3 million. Gross margin was 55.8%. Operating expenses were \$43.4 million and that led to an adjusted EBITDA of \$6.2 million. Some important strategic projects were completed, including a major upgrade of the phone system for the Pentagon with Verizon as our integration partner.

Let me pause and add some color on the Q3 GENBAND revenue. It's likely that some of the competitive activity, especially regarding SBC products, created a pause in the planned activity related to the anticipated merger. I don't know enough today to go much further than that given that we couldn't discuss the issues until we were

formally closed. I'll provide more color on that as well as the reduction in Q4 revenue forecast for GENBAND on our next call in February 2018.

Turning to slide 9, let's begin our discussion of Q4 and full year guidance. To keep things simple, I'll start with Sonus standalone as if the merger didn't happen, and then I'll show the same thing for GENBAND. Then we'll provide those numbers combined. This way, you can see how we expect each business to perform during Q4 and without the mathematical complications that are required by properly accounting for changes and share count that occurred mid-quarter or the application purchase accounting and other adjustments that will be made when we formally report our combined financial results in February 2018. These estimates are just that, estimates. And once Q4 is completed, we'll report our actual results and explain any variances.

Also in 2018, we will scramble the egg and we'll provide actual and forecast data on a consolidated basis as Ribbon. We plan to integrate the two companies rapidly to realize savings and efficiencies and thus reporting it separately in 2018 would not be practical.

The Sonus standalone Q4 guidance, excluding GENBAND, calls for revenue for the full year to be flat, implying approximately \$69 million in Q4, with gross margins of approximately 72%, non-GAAP net income of \$5.8 million and adjusted EBITDA of roughly \$8 million.

Fiscal 2017 guidance remains unchanged for non-GAAP net income at \$13 million, which equates to our prior guidance of \$0.26 per share of EPS or approximately \$21 million of adjusted EBITDA. While we are impacted by the consolidation of two large customers, Level 3 and CenturyLink, we've now seen sufficient pick-up in other areas to offset that setback and maintain our guidance of flat for the full year. The expansion order on the Verizon Wireless project is a good example of how other projects are filling in the fourth quarter outlook.

Now turning to slide 10, we have the outlook for GENBAND standalone. For Q4, revenue is expected to be within the range of \$106 million to \$120 million. Gross margins are expected to continue to improve to 55% to 56%. This results in a Q4 adjusted EBITDA range of \$12 million to \$21 million.

Now the combined company pro forma is shown on slide 11. To be clear, this reflects the sum of the parts as if the merger didn't happen, meaning slide nine plus slide 10. With a projected adjusted EBITDA of roughly \$42 million for the two combined businesses, and synergies, which are now tracking above \$50 million in 2018, I remain comfortable with our outlook for roughly \$100 million of adjusted EBITDA exiting 2018 on a run-rate basis.

Finally, before shifting to a more strategic discussion, please turn to slide 12, which shows the full year 2017 outlook for Ribbon Communications. Now in this case, we've accounted for our current estimates for the GENBAND's stub period of approximately two months and our new adjusted share count. There are numerous footnotes shown at the bottom of slide 12 that you should review so you understand the components of the math.

This slide is intended to help you move from the sum of the parts approach, which I gave you in slide 11 to what actually we believe we'll report in fourth quarter 2017. I realize this is a lot of information, which we hope is helpful to you as you rebuild your model.

Now I'd like to shift to a more strategic discussion and share with you why I'm so excited about the prospects for Ribbon Communications. Ribbon is off to a solid start, having closed only this past Friday. We've already organized the company around our new leadership structure, and on Friday, we notified most who might be impacted by organizational changes.

Additionally, we have taken cost reduction actions that are expected to achieve company-wide savings of approximately \$3 million in just the last two months of Q4 alone, which would equate to annualized savings of approximately \$18 million.

We expect that our 2018 end-year savings will exceed \$50 million, underpinning our initial estimate to achieve approximately \$100 million of EBITDA in 2018, at least exiting the year on a run-rate basis. So from a financial point of view, we believe this combination is extremely positive.

Beyond the numbers, the customer feedback has been very supportive. I've spoken with many of Sonus' largest customers and they acknowledged the many benefits of our combination. We will achieve far greater scale than either company could achieve alone, and that increased scale will allow sustained investments in critical areas that are strategic to their success.

Most important is that they see a combination of solid network technology and products with the emerging Kandy cPaaS platform and the opportunity to more tightly couple these assets into a unified offering that is unique in the marketplace. This has appealed to large service providers as well as enterprises. I've received that feedback firsthand and we should soon begin a number of proofs of concepts.

I expect that the first half of next year will bring some concrete evidence of interest with at least one Tier 1 service provider and at least one Fortune 100 enterprise endorsing Kandy and our SBC as a packaged solution targeted to radically simplify and transform their workflow.

Ribbon has the scale and financial strength to continue the investment required and to partner with global customers to make this happen. I also expect that we'll continue our progress to date with cloud players. As you know, we've had a strategic relationship with Microsoft for many years, providing SBCs into their enterprise offerings for Skype for Business. We continue to work with them to explore ways to bring real-time communications to Azure.

Beyond Microsoft, you've likely seen Google announce a massive commitment to their cloud, and recently, you likely saw Amazon add Alexa calling to their in-home service offerings. All these trends represent large opportunities for Ribbon to provide solutions that converts the traditional resilient telco architecture and the rapidly evolving agile and elastic cloud architecture.

With our current technology assets, the combined talent that we have together as one team and the financial strength to invest for leadership, I'm very excited to lead this team forward. I know we've provided a great deal of information during this call, and now we're happy to take your questions.

Operator, please open the lines.

QUESTION AND ANSWER SECTION

Operator: Certainly. Thank you. [Operator Instructions] And we'll get to our first question on the line from Dmitry Netis with William Blair. Please go ahead.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. Thank you. Congratulations, guys, for closing this merger.

Raymond P. Dolan

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

A

Thanks, Dmitry.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. I have a couple of questions. First, on the \$7 million order, this is not a one-time thing. It sounds like you did get expansion orders. Can you just quantify how lumpy this particular customer may be going forward? Is that a continuum with sort of expansion opportunity for you as far as the project that's going on there and consistent upgrades or is that a one-time [ph] offer with (17:47) maybe a one-time expansion order next quarter?

Raymond P. Dolan

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

A

Yes, Dmitry. Thanks. So that order, that expansion order is about half of the initial order and I expect expansion orders to continue every few quarters, maybe more often than that. There's plenty of opportunity to continue to evolve that network beyond where there's Oracle presence and continue to convert that to a Ribbon network.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. Great. And then on the gross margin side, I noticed GENBAND's gross margins came in nicely at 55%. Is that a result of cost rationalization? Or is there something else going on? And should we expect that level of gross margin to continue out of GENBAND, or maybe on a combined basis, which would be an upside obviously?

Raymond P. Dolan

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

A

Yeah. So, we – you saw in my prepared remarks that we guided the GENBAND gross margin 55% to 56%, as the progress continues. Daryl is here and can get into details if [ph] you'd (18:55) like, but they've done a really good job and they're on the same journey we're on, which is migrate through R&D from a hardware-based solution to more software. The initial sales that go in sometimes have [ph] light (19:12) capacity and then capacity extensions [indiscernible] (19:15) margins, and then of course, there's been some cost control and there's been some process improvements that we've actually been able to model in our integration discussions and I think they'll continue going forward. One of the biggest focuses we're going to have is Ribbon. It's going to be to drive the consolidated gross margin from the low 60s, through the 60s into the 70s.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. Very good. And then maybe if I could kind of go back to the preannouncement initially and kind of the reduction in the GENBAND's guide, which came down about \$20 million from the initial thought when you filed your S-4. Would you sort of explain what happened there and maybe [ph] you're still early (20:00) that you didn't see all the kind of puts and takes of that business, or what exactly happened? And I do think I caught you say that you weren't ready or prepared to say something at this moment and you will next quarter, was that related to this exact reduction in the outlook or any detail on that would be very helpful [indiscernible] (20:20).

Raymond P. Dolan

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

A

Sure, Dmitry. So most of what we've seen so far, I'd say at least half, if not more, has been some deceleration on the SBC side in orders where companies have looked for – they're just paused because they anticipate that the Sonus SBC will displace at least a number of opportunities going forward, where GENBAND anticipated winning some SBC business. I did say in my prepared remarks, and I would like us to wait another quarter for us to come back to you with a more comprehensive review of the full year takedown, which is in the range of about \$20 million.

Here's what I would suggest though. This – revenue is critical because you can't get to bottom line until you start at the top, right? But this to me has never been just about revenue trajectory. GENBAND has been flat to declining. We've been flat to declining. Both companies are stabilizing, but there's a huge – this has always been about synergies, margin improvement and EBITDA. And I'm glad to confirm that I feel just as comfortable, if not more so, today, looking forward to \$100 million of EBITDA exit run rate in 2018. But we'll come back to you on the February call with a more comprehensive review as soon as we can get the teams fully integrated.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

And should we expect your next quarter also to give us kind of a sense of what products are going forward, which ones are getting maybe put on the shelves and which ones are going to be go-to products for you, is that – as far as the product rationalization of your portfolio, is that something you will be prepared to discuss next quarter?

Raymond P. Dolan

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

A

Yes. There'll be some high-level discussion on the earnings call, Dmitry, [ph] we'll (22:05) be in much more detailed discussions with our customers. I don't think there will be too much disruption but I feel comfortable as the Sonus SBC platform, as it's virtualized, will be the fundamental platform. There's a tremendous opportunity and the teams have been working real hard to integrate a lot of very powerful GENBAND technology and talent into that road map, and then you'll see the application server and the Kandy CPaaS platform play out in a unified offer. We'll talk more about that in February.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. My last question if I may. On the network transformation deals, Ray, when can we start to see some evidence of those large transformation projects? You may already have those, but I know you kind of indicated there were some 14,000 [indiscernible] (22:57) TDM switches out there. When will we see the initial evidence of

your ability to transform these switches into an IP type deployment, will you give us some examples of that or how should we think about that?

Raymond P. Dolan

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

A

Yeah. We'll give you some examples. Coming out of our fourth quarter results, Dmitry, we should have some evidence in there that we'll be able to pick out and use as examples, and then we'll look forward and give you some sense as to how that looks in 2018.

Dmitry G. Netis

Analyst, William Blair & Co. LLC

Q

Okay. I'll jump [ph] off the line (23:31). Thank you so much.

Raymond P. Dolan

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

A

Thank you.

Operator: And we'll get to our next question on the lines from the line of Paul Silverstein with Cowen. Please go ahead with your question.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Ray, I've two basic questions, one, and I apologize if you've reviewed this before, but I don't recall hearing it, which is a simple question of what is the revenue complexion for GENBAND by products in terms of media gateways, SBC and Kandy and whatever else actually may be selling? If you can review that for us? I don't think I've heard you go through it before. And then my other question is the \$50 million of synergies that you're expecting, how much of that is OpEx? How much is on the COGS side? Thanks. Or I assume it's all OpEx. Go ahead.

Raymond P. Dolan

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

A

Well, It won't all be OpEx, Paul, because some of the services components will be rolled into COGS. So there's a pretty good piece of synergies that will drive COGS, which will drive margins. I would say that that's probably about 20% and the rest will be in OpEx spread between sales and marketing, G&A and R&D. So – and on the first piece, we haven't really broken out the pieces of SBC versus application server, but Daryl, if you want to just – you're here, can you speak to Paul's question as to the general makeup of the GENBAND revenue?
[indiscernible] (24:55).

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

Sure, Paul. Paul, it's nice to speak with you on the phone. It's important to emphasize again our previous disclosures, which is GENBAND's bulk of its revenue is in its NTr product portfolio [ph] sold as a (25:14) solution, and that includes softswitch, media gateway and telephony application servers bundled in different ways depending on the architecture or needs of the solution itself with any particular telecom carrier. So the mix will change quite a bit.

That includes also SBC. We principally would measure our customer wins and our NTr product solution portfolio but because of software revenue recognition, we don't really attempt to break out definitive small numbers between media gateways and softswitch and things like that.

We do track our TDM revenue and we've disclosed that. Our TDM revenue over time has dramatically fallen. We've disclosed in 2016 that our TDM revenue was \$16 million and we would expect it to be a lower figure this year. And then we disclosed our services revenue as well.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Daryl, so given what you said, is it possible to come up with an approximation of what your SBC and application server revenue is in dollars [ph] as a percent (26:16)?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

In terms of our VoIP product revenue that we've disclosed, I would say roughly 70% – 60% to 70% of our VoIP product revenue is softswitch and media gateways. Telephony application server, unified communications as a software only and SBCs would be the remaining.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Sorry, I just want to make sure I have it right, softswitch and media gateways 60% to 70%, SBC, being the balance?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

Along with telephony application server, unified communications, which is a software-only sales, those would be the makeup, and then there will be some minor products [ph] after that (27:06).

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

I appreciate that. Thank you.

Operator: Thank you very much. We'll get to our next question on the line from Mark Kelleher with D. A. Davidson. Please go ahead with your question.

Mark Kelleher

Analyst, D. A. Davidson & Co.

Q

Great. Thanks for taking the questions. First, just on the share count. Can you tell us what the fully diluted share count is right now, the number that we should be using into next year?

Raymond P. Dolan

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

A

Next year would be 102 million.

Mark Kelleher

Analyst, D. A. Davidson & Co.

Q

Okay. And then maybe you could talk a little bit about the competitive environment with Cisco announcing their BroadSoft acquisition? What do you think of that? And what do you think of the competitive situation right now?

Raymond P. Dolan

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

A

Well, on the competitive situation right now, I couldn't be more thrilled that we've brought the two companies together under the Ribbon brand. I think we've got one of, if not, the best product suite and the most focused product suite with regard to virtualization and CPaaS.

With regard to BroadSoft's decision to sell to Cisco, I actually think it's a huge opportunity for us because I think Cisco will probably do what Oracle did to Acme, which is very, very hard to take a focused successful company like BroadSoft and integrate it into a very broad suite of UC when, in fact, the company's orientation is really around layer three and below. That's still the critical mass [ph] of where (28:38) Cisco is.

It probably will open an opportunity for us, which we, frankly, already had but it'll create an opportunity for us to compete better and maybe even replace those solutions in some of their service provider networks as we bring an entire suite of products from SBCs and gateways all the way up to Kandy. So I think it's a great opportunity for us to stay focused, continue to invest and drive better financial performance ourselves.

Mark Kelleher

Analyst, D. A. Davidson & Co.

Q

Okay, great. Thanks.

Operator: Thank you very much. We'll get to our next question on the line from Greg Mesniaeff from Drexel Hamilton. Please go ahead.

Greg Mesniaeff

Analyst, Drexel Hamilton LLC

Q

Yes. Thank you. Ray, I was wondering if you can give us some additional color on GENBAND's revenue profile, particularly as it relates to revenue recognition now that you've gotten the chance to see it in detail. Is their revenue profile more turns-oriented or more backlog-oriented vis-à-vis Sonus' revenues? Thanks.

Raymond P. Dolan

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

A

Thanks, Greg. Yes. There is a greater backlog component to GENBAND than there is to Sonus. There is a greater professional services component because they live on the edge of their network. So actually that will give us a little bit more visibility [ph] in quarter (30:14). Their lower margin profile is improving. It has improved over the last six quarters. I expect it will continue to improve as we come together, which is really nice. It's a great opportunity to drive even higher calories out of the same revenue.

There, I believe, will be even greater software content as the companies combine to become Ribbon as we sell greater licenses into our SBC and the same thing happens on the application server and as we evolve towards Kandy. But initially, you'll see more backlog and more deferred revenue coming off of the GENBAND side of our combined company [ph] than it will on (30:57) the Sonus side.

Greg Mesniaeff

Analyst, Drexel Hamilton LLC

Got you. Okay, that's very helpful. Thanks.

Q

Raymond P. Dolan

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

Sure. Thank you, Greg.

A

Operator: Thank you very much. [Operator Instructions] And we'll get to our next question on the line from Mike Latimore with Northland Capital Markets. Please go right ahead.

Michael Latimore

Analyst, Northland Securities Inc.

Yeah, great. Thanks [indiscernible] (31:26). On the revenue side of things, I guess, Ray, you talked about an exit rate of kind of \$100 million of EBITDA. Any general thoughts on kind of what that means from a revenue standpoint? Are you assuming kind of flattish revenues next year, [ph] something like (31:40) that, or any color on that?

Q

Raymond P. Dolan

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

Hey, Mike. We're not providing any color on that. I'd like to just use the balance of the fourth quarter to get our arms around both companies, but it would probably be in that ballpark. We'll probably be there ourselves as Sonus. I haven't characterized the GENBAND for 2018 yet.

A

Michael Latimore

Analyst, Northland Securities Inc.

Right. And then, obviously, a lot more service revenue in the mix with the combined companies. Any thought on service area, is that a flattish kind of business too or stable or...?

Q

Raymond P. Dolan

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

Again, I'm going to go ahead and take a pass on that, Mike, for now. I just want to get my arms around the projects that are underneath all of this revenue. We haven't been able to do that for competitive reasons at this point in time. I don't expect there to be drastic changes. But I also don't want to put a marker out there that we have to move away from if we decided to shift it all.

A

I do feel good, though, that the strategic direction that GENBAND had leading up to our announcement and throughout our integration process remains completely aligned with what we expected as we brought the two companies together. And I think we've got some opportunities to do some great global expansion as a combined company under Ribbon.

Michael Latimore

Analyst, Northland Securities Inc.

Great. And then, just a housekeeping question. What is the cash and debt level right now post close?

Q

Raymond P. Dolan

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

A

I don't have a number post close? But are you looking at a trough level, [ph] you're saying (33:10)?

Michael Latimore

Analyst, Northland Securities Inc.

Q

No. I'm just kind of curious what the current cash and debt level [ph] is, I guess (33:18).

Raymond P. Dolan

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

A

Okay. Yeah, we'll be about \$55 million net cash.

Michael Latimore

Analyst, Northland Securities Inc.

Q

Net cash. Okay. Right. And then just on – yeah...

Raymond P. Dolan

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

A

Sorry. That's gross cash.

Michael Latimore

Analyst, Northland Securities Inc.

Q

Okay, gross. And then the debt. Okay, got it. And then just last, you mentioned some interesting prospects for Kandy, I think in the first half of 2018. Can you talk a little bit about just the applications there? Is the service provider going to sort of operate [ph] its own APIs (33:45) Fortune 100 company are going to maybe use it more internally? Just a little more color on how Kandy would be used and then the voice messaging and video, just a little more color on that would be interesting.

Raymond P. Dolan

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

A

Sure, Mike. I'll go ahead and just give you a high level answer now. As we come together as a team, I'll ask David to join us and talk a lot more about that strategically, because I'd like to save some of that for 2018 as we articulate our revenue outlook and get underneath the used case – the specific used cases.

But I think there's a tremendous opportunity to start in the enterprise for them to just look at their workflows, look at their architecture and technology in a multi-vendor environment and create a much more simplified telecom IT architecture and a much more simplified cross functional workflow, all right? There's just a tremendous amount of power in that.

And from the service provider's point of view, I think what they can do is provide into the enterprise everything from ease of setup of SIP trunks to a complete redesign of their workflows as well, where they end up becoming a much more value-added service provider and system integrator than just providing circuits.

So as we get closer to our proofs of concept, what we'd like to do is describe what those objectives are and give you a sense as to how we can really step in and not only compete with, say, for example, a BroadCloud, BroadWorks environment under Cisco, but actually eclipse that [indiscernible] (35:24) if you will.

And I'll probably ask David to articulate that because he's been the principal sponsor and pioneer and innovator and leader of that Kandy platform. Okay?

Michael Latimore

Analyst, Northland Securities Inc.

Great. Thank you.

Q

Raymond P. Dolan

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

Thank you.

A

Operator: Thank you very much. We'll get to our next question on the line from [ph] Steve Cohen with Provo Partners (35:44). Please go ahead.

Q

Hi, Ray, congratulations on closing the deal. Two questions that are sort of interrelated. First would be slower than, [ph] I think (35:55), forecast revenue coming out of the GENBAND side of the business, does that mean achievement of \$100 million EBITDA objective is going to be more dependent on cost and expense reductions?

And then related to that, given what the product mix of the GENBAND products are, and you said that you are going to be aiming for a 70% plus gross margin in the combined business, how long do you anticipate that would take to get there?

Raymond P. Dolan

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

Sure, [ph] Steve (36:25). Thanks for the question. So yes, we'll have a higher contribution from synergies in that \$100 million number than we might have anticipated when we guided to [ph] 40%, 50% (36:48). Even then, I expected that we'll have some opportunity [ph] and didn't (36:44) know enough yet, and now we're seeing it tracking above [ph] 50% (36:46) on an end-period business.

Now having said that, some of the revenue softness is being offset right now by higher gross margin. So we probably backed off some of the lower-margin projects, which will create some revenue softness, and some of it has just been pushed out. And I don't know how much of that will come back to us or not, which is why I'm reluctant to guide beyond the fourth quarter. So if you just look at the sum of the parts, some softness has been offset by margin improvement and then the rest will be supplemented with a slightly greater cost savings.

Now with a goal of 70% gross margin, my guess is the companies will come together next year somewhere in the range of low 60s gross margin, and then what we've been able to do as a company at Sonus prior to becoming Ribbon is do about 200 basis points a year. That would be about the cadence that I'd hope to get the entire revenue stream margin towards 70%. We haven't bottomed up that yet and I'll try to talk about that on the February call, we'll make a note of that, but I would hope that if we could start in the low 60s, we'd make at least 200 basis points of margin in at least the first couple of years together. Okay?

A

Q

Thanks.

Raymond P. Dolan

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

A

Just as a reminder, we started that journey from about a stable 56% gross margin number. We had Acme out there as a comp in a pure-play model where they were really selling – terminating [indiscernible] (38:21) the edge enterprise networks and into the service provider, with 80% gross margins. And there were a lot of questions, saying, can you get to 60%? If it can, can you get to 70%? If you can, can you get to 75%? And I'm really pleased that that march has continued for standalone Sonus. I have tremendous confidence that we can do that together as Ribbon, and there's a unified commitment to doing that across the leadership team.

Q

Remember that well.

Raymond P. Dolan

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

A

Thank you.

Operator: Thank you very much. We'll get to our next question in the line and it's our follow-up question in the line of Paul Silverstein from Cowen. Please go ahead.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Ray, I heard your response on the Verizon that you think you could – the extension orders are 50% and you expect – of the original and you expect [ph] once you read (39:09) couple of quarters. Can you just – relative to the almost \$12 million you do with Verizon this quarter, can you remind us that project that you delivered, how much was that in total? When you talk about 50% and I appreciate there's only so much you want to go into with any one customer, but given the outsized impact going forward, how should we view that revenue run rate?

Raymond P. Dolan

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

A

Yeah. Thanks, Paul. So the initial project was in the \$10 million range. We've disclosed that on a prior call. The extension order is just below half that, close enough to call it half. So that's how it's played out so far. I don't know that it's created a stable pattern yet but the way I would look at it is my hope would be we continue to engage strategically with them as we do with all of our other customers, and we'll continue to see expansion both in the current project as well as additional projects coming our way if we can continue to innovate.

They are, by the way, very strategic with what was GENBAND. GENBAND's done extensive NTr with them. GENBAND's done a tremendous job getting integrated into FiOs. The former GENBAND has done a tremendous job beginning to work with them on Kandy. And so there's a tremendous amount of energy for Ribbon to bring to not only Verizon but AT&T, CenturyLink and a number of other Tier 1s around the world globally as we bring what

I believe is the best product suite together with the best talented workforce together to help them migrate these networks to the cloud.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

The \$5 million of extension, you expect to recognize all of that in the fourth quarter?

Raymond P. Dolan

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

A

Yes.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

And is Verizon a 10% customer to GENBAND stand-alone?

Raymond P. Dolan

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

A

Yes.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Does GENBAND have any other 10% customers?

Raymond P. Dolan

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

A

Daryl?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

AT&T.

Raymond P. Dolan

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

A

AT&T.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

And what was AT&T and Verizon individually or collectively?

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

Paul, that's in the merger – that's in the S-4, specifically in our MD&A, and so I'll point you there.

Raymond P. Dolan

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

A

Yeah.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

All right.

Raymond P. Dolan

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

A

[ph] And the call backs (41:26), Paul, if we can dig that out [indiscernible] (41:28).

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

That's fine.

Daryl E. Raiford

Executive Vice President & Chief Financial Officer, Ribbon Communications

A

I don't want to give you a [ph] wrong definition on (41:31) that, but it's specific right there in the MD&A.

Paul J. Silverstein

Analyst, Cowen & Co. LLC

Q

Thank you.

Raymond P. Dolan

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

A

Thank you. If there's no further questions, operator, are there any others?

Operator: We do have a follow-up question from the line of [ph] Steve Cohen from Provo Partners (41:45). Please go ahead.

Q

Yeah. Ray, one further thing. On last quarter's call, you had talked about a, I believe, was a non-U.S. Tier 1 maybe in the fourth quarter, can you give us an update on that?

Raymond P. Dolan

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

A

A non-U.S. Tier 1. Well, we did say that it was a Latin America Tier 1 for an Oracle replacement to Sonus in the [ph] core (42:16), which actually became referenceable off of our Verizon Wireless win, and that looks really good this quarter in Q4 as well.

Q

Okay. That was the one. Thanks.

Raymond P. Dolan

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

A

We also referred to the cable industry and the MSOs, and I'll just highlight that we continue to score a substantial amount with the Comcast, Charter types of names throughout this year and I expect those wins to continue into next year. So pretty good opportunity for us to come together with a common Ribbon product suite portfolio there and continue to penetrate the cable industry on a global basis.

Raymond P. Dolan

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

Thanks to everyone for your attendance this morning. Hope you have a great week. Happy Halloween. Thanks for covering both Sonus and GENBAND, and we look forward to sharing our results as Ribbon Communications. Have a good day.

Operator: Thank you very much. And thank you, everyone. Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation and ask you to disconnect your lines. Have a good day, everyone.

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