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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549  
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FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001  
COMMISSION FILE NUMBER 000-30229  
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SONUS NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

04-3387074  
(I.R.S. Employer Identification No.)

5 CARLISLE ROAD, WESTFORD, MASSACHUSETTS  
(Address of principal executive offices)

01886  
(including Zip Code)

(978) 692-8999  
(Registrant's telephone number, including area code)  
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. (1) Yes /X/ No / / (2) Yes /X/ No / /

As of November 12, 2001, there were 203,933,972 shares of Common Stock, \$0.001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None  
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SONUS NETWORKS, INC.  
FORM 10-Q  
QUARTER ENDED SEPTEMBER 30, 2001

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PART I--FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

SONUS NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE DATA)

SEPTEMBER 30, DECEMBER 31, 2001	2000	-----	-----
---- (UNAUDITED) ASSETS CURRENT ASSETS: Cash and cash equivalents.....			
	\$ 47,563	\$	
87,108 Marketable securities.....	89,874		
54,957 Accounts receivable, net.....	7,116	14,100	
Inventories.....	24,109	20,668	Other current
assets.....	3,752	2,893	--
----- Total current			
assets.....	172,414	179,726	
PROPERTY AND EQUIPMENT,			
net.....	25,788	14,273	GOODWILL
AND PURCHASED INTANGIBLES, net.....			
	5,016	-	-
- OTHER ASSETS,			
net.....	602	836	----
----- \$ 203,820 \$194,835 =====			
LIABILITIES AND STOCKHOLDERS' EQUITY CURRENT LIABILITIES:			
Current portion of long-term obligations.....			
	\$ 1,153	\$ --	Accounts
payable.....	8,116		
13,439 Accrued expenses.....	31,613		
16,239 Accrued restructuring expenses.....	12,489	--	Deferred
revenue.....	18,949		
14,451 -----			Total current
liabilities.....	72,320		
44,129 LONG-TERM OBLIGATIONS, less current portion.....	12,741	--	CONVERTIBLE SUBORDINATED
NOTES.....			
	10,000	--	
COMMITMENTS.....			
STOCKHOLDERS' EQUITY: Preferred stock, \$0.01 par value,			
5,000,000 shares authorized; none issued and			
outstanding.....	--	--	Common stock, \$0.001 par
value, 600,000,000 shares authorized; 204,926,502 and			
184,244,474 shares issued and 203,912,752 and 183,471,974			
shares outstanding at September 30, 2001 and December 31,			
2000,			
respectively.....			
205 184 Capital in excess of par value.....	860,515	266,488	
Accumulated deficit.....			
(715,997) (83,966) Stock subscriptions receivable.....	--	(238)	Deferred
compensation.....	(35,882)		
(31,697) Treasury stock, at cost: 1,013,750 and 772,500 common shares at September 30, 2001 and December 31, 2000, respectively.....			
(82) (65) -----			Total stockholders'
equity.....	108,759	150,706	-----
--- ----- \$ 203,820 \$194,835 =====			

The accompanying notes are an integral part of these condensed consolidated financial statements.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

THREE MONTHS ENDED NINE MONTHS ENDED SEPTEMBER 30,  
 SEPTEMBER 30, -----  
 ----- 2001 2000 2001 2000 -----

REVENUES.....				
\$ 40,286 \$ 15,568 \$ 134,336 \$ 23,171	Cost of			
revenues (1).....	18,129			
8,830 58,300 14,846 -----				
	-----			
	GROSS			
PROFIT.....				
22,157 6,738 76,036 8,325	OPERATING EXPENSES:			
Research and development (1).....				
18,746 7,032 49,362 18,231	Sales and marketing			
(1).....	12,660 5,833 31,763			
13,576	General and administrative			
(1).....	3,330 1,763 9,272 3,750			
Stock-based compensation.....				
39,069 6,982 68,339 20,347	Amortization of			
	goodwill and purchased			
intangibles.....				
41,368 -- 107,279 --	Write-off of goodwill and			
	purchased			
intangibles.....				
376,719 -- 376,719 --	Restructuring			
charges.....	25,807 --			
25,807 --	In-process research and			
development.....	3,800 -- 43,800 --			
-----	Total operating			
expenses.....	521,499 21,610			
712,341 55,904 -----				
	-- LOSS FROM			
OPERATIONS.....				
(499,342) (14,872) (636,305) (47,579)	Interest			
expense.....	(147) -			
- (428) (209)	Interest			
income.....	1,328			
2,495 4,702 4,022 -----				
	-----			
	NET			
LOSS.....				
\$(498,161) \$(12,377) \$(632,031) \$(43,766)				
=====	=====			
	NET LOSS PER			
SHARE (NOTE 1(H)): Basic and				
diluted.....	\$ (2.81) \$			
(0.09) \$ (3.71) \$ (0.57)	=====			
	=====			
	Pro forma basic and			
diluted.....	\$ (0.34) =====			
	=====			
	SHARES USED IN COMPUTING NET LOSS PER SHARE (NOTE			
	1(H)): Basic and			
diluted.....	177,313			
144,836 170,220 77,448	=====			
	=====			
	Pro forma basic and			
diluted.....	130,291 =====			

(1) Excludes non-cash, stock-based compensation expense as follows:

Cost of revenues.....	\$ 535	\$ 113	\$ 1,157	\$ 302
Research and development.....	23,391	2,617	39,773	8,784
Sales and marketing.....	8,127	3,442	16,021	9,108
General and administrative.....	7,016	810	11,388	2,153
	-----	-----	-----	-----
	\$ 39,069	\$ 6,982	\$ 68,339	\$ 20,347
	=====	=====	=====	=====

The accompanying notes are an integral part of these condensed consolidated financial statements.

SONUS NETWORKS, INC.  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

COMMON STOCK CAPITAL IN STOCK -		
----- EXCESS		
OF ACCUMULATED SUBSCRIPTIONS		
DEFERRED SHARES PAR VALUE PAR		
VALUE DEFICIT RECEIVABLE		
COMPENSATION -----		
-----		
----- BALANCE,		
JANUARY 1, 2001.....		
184,244,474	\$184	\$266,488
(83,966)	\$(238)	\$(31,697)
Issuance of common stock in		
connection with the employee		
stock purchase		
program.....	1,021,333	1
7,865	-- --	-- --
Issuance of		
common stock in connection with		
acquisition of TELECOM		
TECHNOLOGIES, INC. (TTI) (Note		
3).....		
15,000,000	15	504,998
-- --	-- --	-- --
Issuance of common stock in		
connection with acquisition of		
certain assets of LINGUATEQ,		
INC. (Note 4).....		
221,753	--	--
- 4,995	-- --	-- --
Issuance of		
restricted stock awards in		
connection with acquisition of		
TTI (Note 3).....		
3,000,000	3	55,193
-- --	-- --	(55,196)
Deferred		
compensation related to		
unvested stock options assumed		
in connection with acquisition		
of TTI (Note		
3).....		
-- --	-- --	-- --
22,600	-- --	(22,600)
Exercise		
of stock options.....		
1,438,942	2	3,648
-- --	-- --	-- --
Amortization of deferred		
compensation.....		
-- --	-- --	42,910
Deferred		
compensation for terminated		
employees (Note 2)... -- --		
(5,272)	-- --	30,701
Payment on		
subscriptions		
receivable.....		
-- --	-- --	238
Repurchase		
of common stock.....		
-- --	-- --	-- --
Net		
loss.....		
-- --	-- --	(632,031)
-----		
----- BALANCE,		
SEPTEMBER 30, 2001.....		
204,926,502	\$205	\$860,515
\$(715,997)	\$ --	\$(35,882)
=====	=====	=====
=====	=====	=====
TREASURY STOCK TOTAL -----		
----- STOCKHOLDERS' SHARES		
COST EQUITY -----		
----- BALANCE, JANUARY		
1, 2001.....		
772,500		
\$(65)	\$ 150,706	
Issuance of		
common stock in connection with		
the employee stock purchase		
program.....		
-- --	-- --	7,866
Issuance of common stock in		
connection with acquisition of		
TELECOM TECHNOLOGIES, INC.		
(TTI) (Note		
3).....		
-- --	-- --	-- --
- 505,013	Issuance of common	
stock in connection with		
acquisition of certain assets		
of LINGUATEQ, INC. (Note		

4)..... -- -- 4,995 Issuance  
of restricted stock awards in  
connection with acquisition of  
TTI (Note 3)..... -- -- --  
Deferred compensation related  
to unvested stock options  
assumed in connection with  
acquisition of TTI (Note  
3)..... -- -- --  
Exercise of stock  
options..... -- -- 3,650  
Amortization of deferred  
compensation.....  
-- -- 42,910 Deferred  
compensation for terminated  
employees (Note 2)... -- --  
25,429 Payment on subscriptions  
receivable.....  
-- -- 238 Repurchase of common  
stock..... 241,250 (17) (17)  
Net  
loss.....  
-- -- (632,031) -----  
----- BALANCE, SEPTEMBER  
30, 2001..... 1,013,750  
\$(82) \$ 108,759 =====  
=====

The accompanying notes are an integral part of these condensed consolidated  
financial statements.

SONUS NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, -----  
2001 2000 ----- CASH FLOWS FROM OPERATING  
ACTIVITIES: Net  
loss.....  
\$(632,031) \$(43,766) Adjustments to reconcile net loss  
to net cash used in operating activities: Depreciation  
and amortization..... 11,036  
3,150 Stock-based  
compensation..... 68,339  
20,347 Amortization of goodwill and purchased  
intangibles..... 107,279 -- Write-off of goodwill and  
purchased intangibles..... 376,719 -- In-process  
research and development..... 43,800 --  
Changes in current assets and liabilities: Accounts  
receivable..... 9,006  
(7,617)  
Inventories.....  
(2,960) (12,178) Other current  
assets..... 281 (1,581)  
Accounts payable.....  
(6,179) 10,388 Accrued  
expenses..... 10,545  
11,072 Accrued restructuring  
expenses..... 12,489 -- Deferred  
revenue..... (1,181)  
11,233 ----- Net cash used in operating  
activities..... (2,857) (8,952) -----  
----- CASH FLOWS FROM INVESTING ACTIVITIES: Purchases  
of property and equipment.....  
(21,427) (9,384) Maturities of marketable  
securities..... 26,287 32,262  
Purchases of marketable  
securities..... (61,204) (17,581)  
Other  
assets.....  
(30) (672) Acquisitions, net of cash  
acquired..... (6,125) -- -----  
----- Net cash provided by (used in) investing  
activities.....

(62,499)	4,625	-----	-----	CASH FLOWS FROM
FINANCING ACTIVITIES: Net proceeds from sale of common				
				stock..... 7,866 128,074
				Proceeds from
				exercise of stock options..... 3,650 146
				Net proceeds from issuance of redeemable convertible
				preferred
				stock..... --
				24,710 Payment of stock subscriptions
				receivable..... 238 -- Additions to long-
				term obligations..... 12,460 405
				Payments of long-term
				obligations..... (386) (5,143)
				Payment of note payable to
				bank..... (8,000) -- Proceeds
				from issuance of convertible subordinated
				notes.....
				10,000 -- Repurchase of common
				stock..... (17) (65) -----
				-- ----- Net cash provided by financing
				activities..... 25,811 148,127 -----
				NET INCREASE (DECREASE) IN CASH AND CASH
				EQUIVALENTS..... (39,545) 143,800 CASH AND CASH
				EQUIVALENTS, BEGINNING OF PERIOD..... 87,108
				8,885 ----- CASH AND CASH EQUIVALENTS, END
				OF PERIOD..... \$ 47,563 \$152,685
				=====

The accompanying notes are an integral part of these condensed consolidated financial statements.

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying unaudited condensed consolidated financial statements have been prepared by Sonus Networks, Inc. (the Company or Sonus) and reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair statement of the results for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), and omit or condense certain information and footnote disclosure pursuant to existing SEC rules and regulations. Results for the interim periods are not necessarily indicative of results to be expected for the entire fiscal year. These statements should be read in conjunction with the financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed with the SEC on March 28, 2001.

The unaudited condensed consolidated financial statements include the accounts of Sonus and its wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated.

(b) CASH EQUIVALENTS AND MARKETABLE SECURITIES

Cash equivalents are stated at cost plus accrued interest, which approximates market value, and have maturities of three months or less at the date of purchase.

Marketable securities are classified as held-to-maturity, as Sonus has the intent and ability to hold to maturity. Marketable securities are reported at amortized cost. Cash equivalents and marketable securities are invested in high-quality credit instruments, primarily U.S. Government obligations and corporate obligations with contractual maturities of less than one year. There have been no gains or losses to date.

(c) GOODWILL AND PURCHASED INTANGIBLES

Goodwill and purchased intangibles are being amortized over two and three year periods (Notes 3 and 4). Statement of Financial Accounting Standards (SFAS) No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF, requires that long-lived assets, goodwill and other intangibles be reviewed for impairment whenever circumstances indicate that the

carrying value of an asset may not be recoverable. The carrying value of long-lived assets, goodwill and other intangibles are considered impaired when the anticipated undiscounted future cash flows from such assets is less than the carrying value (Note 2).

(d) CONCENTRATION OF CREDIT RISK, SIGNIFICANT CUSTOMERS AND LIMITED SUPPLIERS

Financial instruments that potentially subject Sonus to concentrations of credit risk are cash, cash equivalents, marketable securities and receivables. Sonus has no foreign exchange contracts, option contracts or other foreign hedging arrangements. Sonus' cash, cash equivalents and marketable security holdings are diversified between three financial institutions.

For the nine months ended September 30, 2001 and 2000, four and three customers each contributed more than 10% of our revenues which represented an aggregate of 69% and 71% of total revenues. Two customers represented 82% of the Company's accounts receivable balance as of

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SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

September 30, 2001. International revenues, primarily to Asia and Europe, were 21% and 12% of revenues for the nine months ended September 30, 2001 and 2000. Certain components and software licenses from third-parties used in Sonus' products are procured from a single source. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby adversely affect Sonus' revenues and operating results.

(e) REVENUE RECOGNITION

Sonus recognizes revenue from product sales to end users, resellers and distributors upon shipment, provided there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collection of the related receivable is probable. If uncertainties exist, Sonus recognizes revenue when those uncertainties are resolved. In multiple element arrangements, in accordance with Statement of Position 97-2 and 98-9, Sonus uses the residual method when vendor specific evidence does not exist for one of the delivered elements in the arrangement. Service revenues are recognized as the services are provided. Revenues from maintenance and support arrangements are recognized ratably over the term of the contract. Amounts collected prior to satisfying the revenue recognition criteria are reflected as deferred revenue. Warranty costs are estimated and recorded by Sonus at the time of product revenue recognition.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, REVENUE RECOGNITION IN FINANCIAL STATEMENTS. This bulletin established guidelines for revenue recognition. Sonus' revenue recognition policy complies with this pronouncement.

(f) STOCK-BASED COMPENSATION

Sonus uses the intrinsic value-based method of Accounting Principles Board (APB) Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, to account for all of its employee stock-based compensation plans and uses the fair value method to account for all non-employee stock-based compensation.

(g) COMPREHENSIVE LOSS

Sonus applies Financial Accounting Standards Board (FASB) SFAS No. 130, REPORTING COMPREHENSIVE INCOME. The comprehensive loss for the period for the three and nine months ended September 30, 2001 and 2000 does not differ from the reported loss.

(h) NET LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of unrestricted common stock outstanding during the period. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of unrestricted common stock and potential common stock outstanding during the period, if dilutive. Potential common stock consists of restricted shares of common stock, shares of common stock issuable upon the exercise of stock options and conversion of convertible subordinated notes and shares of common stock issued in connection with our acquisition of telecom technologies, inc. (TTI) which are subject to the achievement of milestones and employee retention (Note 3). For both basic and diluted net loss per share, shares of common stock

issuable upon the conversion of Sonus' redeemable convertible preferred stock have been excluded from the date of issuance until conversion into common

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

stock. There were no dilutive shares of potential common stock for these periods as the Company incurred a net loss in each period.

Pro forma basic and diluted net loss per share for the nine months ended September 30, 2000 is computed using the weighted average number of unrestricted common shares outstanding, including the pro forma effects of the automatic conversion of Sonus' Series A, B, C and D redeemable convertible preferred stock into shares of Sonus' common stock which occurred upon the closing of Sonus' initial public offering, as if such conversion occurred at the date of original issuance.

The following table sets forth the computation of basic and diluted net loss per share and pro forma basic and diluted net loss per share:

	THREE MONTHS ENDED 30, SEPTEMBER 30, 2001	NINE MONTHS ENDED 2001	THREE MONTHS ENDED 30, SEPTEMBER 30, 2000	NINE MONTHS ENDED 2000
	----- (IN THOUSANDS, EXCEPT PER SHARE DATA) NET			
LOSS.....	\$ (498,161)	\$ (12,377)	\$ (632,031)	\$ (43,766)
	=====			
HISTORICAL-- Weighted average common shares outstanding.....	200,537	183,144	197,034	
118,761 Less weighted average restricted common shares				
outstanding.....	(23,224)	(38,308)	(26,814)	(41,313)
	----- Shares used in computing basic and diluted net loss per share.....			
	144,836	170,220	77,448	177,313
	=====			
per share.....	\$ (2.81)	\$ (0.09)	\$ (3.71)	\$ (0.57)
	=====			
PRO FORMA-- Shares used in computing historical basic and diluted net loss per share.....	77,448			
average number of shares assumed upon conversion of redeemable convertible preferred stock.....				
52,843 ----- Shares used in computing pro forma basic and diluted net loss per share.....	130,291			
	=====			
Pro forma basic and diluted net loss per share... \$ (0.34)				

Excluded from the computation of diluted net loss per share in the above table are options to purchase shares of common stock and shares of common stock issuable upon conversion of convertible subordinated notes representing an aggregate of 21,393,658 and 12,471,249 shares for the three and nine months ended September 30, 2001 and 2000, as their effects would have been anti-dilutive. Had Sonus recorded net income for the three and nine months ended September 30, 2001 and used the treasury stock method in accordance with SFAS No. 128, EARNINGS PER SHARE, approximately 210,000,000 weighted average shares of common stock would have been used in the computation of diluted earnings per share.

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

(i) RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 141, BUSINESS COMBINATIONS, and SFAS



No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method of accounting and prohibits the use of the pooling of interest method. SFAS No. 142 eliminates the amortization of goodwill and certain other intangibles and instead subjects these assets to periodic impairment assessments. SFAS No. 142 is effective immediately for all goodwill and certain other intangible assets acquired after June 30, 2001 and shall commence on January 1, 2002 for all goodwill and certain other intangibles existing on June 30, 2001. Sonus is currently assessing the potential impact SFAS No. 141 and SFAS No. 142 will have on its financial statements.

In August 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS, which supersedes SFAS No. 121 and the accounting and reporting provisions of APB No. 30, REPORTING THE RESULTS OF OPERATIONS--REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS, AND EXTRAORDINARY, UNUSUAL AND INFREQUENTLY OCCURRING EVENTS AND TRANSACTIONS. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is currently reviewing this statement to determine the effect on its financial statements.

NOTE 2. RESTRUCTURING CHARGES AND WRITE-OFF OF GOODWILL AND PURCHASED INTANGIBLES

On September 26, 2001, in response to unfavorable business conditions primarily caused by declines in capital spending by telecommunications service providers, Sonus announced a restructuring plan designed to reduce expenses and align its cost structure with its revised business outlook. The restructuring plan includes a worldwide workforce reduction, consolidation of excess facilities and other charges. Additionally, Sonus recorded a write-off of goodwill and purchased intangibles related to the acquisition of TTI (Note 3).

Sonus' restructuring related reserves as of September 30, 2001 are summarized as follows, in thousands:

TOTAL RESTRUCTURING ACCRUAL	CURRENT	LONG-TERM	PAYMENTS	BALANCE	PORTION
PORTION	-----	-----	-----	-----	-----
reduction.....				\$ 4,506	
\$ -- \$ 4,506	\$ 4,506	\$ --			Consolidation of facilities and other charges.....
21,301	858	20,443	7,983	12,460	-----
					-----
Total.....					
	\$25,807	\$858	\$24,949	\$12,489	\$12,460
	=====	=====	=====	=====	=====

Cash expenditures relating to the workforce reductions will be substantially paid in the fourth quarter of fiscal 2001. Amounts related to the net lease expense due to the consolidation of excess facilities and other miscellaneous charges will begin to be paid in the fourth quarter of fiscal 2001 and are expected to continue through January 2009.

A) WORKFORCE REDUCTION

Restructuring actions resulted in the reduction of Sonus' workforce by approximately 150 employees, or 21%. The affected employees are entitled to severance and other benefits for which

Sonus recorded a charge of \$4,506,000 in the third quarter of fiscal 2001. In addition, the Company recorded non-cash stock-based compensation expense of \$25,429,000 related to the write-off of deferred compensation associated with shares and options held by terminated employees.

B) CONSOLIDATION OF EXCESS FACILITIES AND OTHER CHARGES

The Company recorded a restructuring charge in the third quarter of fiscal 2001 of \$21,301,000 for the consolidation of excess facilities and other miscellaneous charges, which are included on the balance sheet in accrued

restructuring expenses and long-term obligations.

C) WRITE-OFF OF GOODWILL AND PURCHASED INTANGIBLES.

In light of negative industry and economic conditions, a general decline in technology valuations and our decision to discontinue the development and use of non-strategic and overlapping products and services, we performed an assessment of the carrying value of the goodwill and purchased intangibles recorded in connection with our acquisition of TTI. In accordance with SFAS 121, Sonus recorded a non-cash impairment charge of \$376,719,000 in the third quarter of fiscal 2001 for the write-off of goodwill and certain purchased intangibles because the estimated undiscounted future cash flows of these assets was less than the carrying value.

NOTE 3. ACQUISITION OF TELECOM TECHNOLOGIES, INC.

On January 18, 2001, Sonus acquired privately-held TTI. Upon the closing of this acquisition, an aggregate of 10,800,000 shares of Sonus common stock (Merger Shares) were exchanged for all outstanding shares of TTI common stock. Of the 10,800,000 shares issued to the TTI stockholders, 1,200,000 shares were placed into escrow as security for TTI's indemnity obligations under the merger agreement and will be released to TTI stockholders upon expiration of those indemnity obligations, expected to be on the first anniversary of the closing date. In addition to the Merger Shares, the TTI stockholders will have the right to receive up to an aggregate of 4,200,000 additional shares of Sonus common stock which have been issued and placed in escrow in the event that TTI achieves certain specified business expansion and product development milestones from time to time prior to December 31, 2002. As of September 30, 2001, 2,400,000 milestone related shares had been released from escrow.

Sonus has also issued contingent awards of 3,000,000 shares of common stock under the 2000 Retention Plan (the Plan) to certain employees of TTI who became employees of Sonus as a result of the acquisition. Pursuant to the Plan, these awards will vest in equal installments on each of October 31, 2002, November 30, 2002, January 31, 2003 and February 28, 2003, if (i) the recipients do not voluntarily terminate employment with TTI or Sonus prior to such vesting dates and (ii) the business expansion and product development escrow release conditions are satisfied in whole or in part. The portion of the total number of shares of Sonus common stock awarded to each employee that will be deemed vested on each vesting date will not exceed the proportion of all of the shares escrowed in the acquisition subject to the satisfaction of the business expansion and product development escrow release conditions that have been released prior to such vesting date. Generally, any awards forfeited by employees who terminate employment with TTI, other than a termination by Sonus or TTI without cause, prior to the date on which they would otherwise vest, may be reallocated to remaining TTI employees, awarded to replacement hires or returned to Sonus as provided by the terms of the Plan. The value of the 3,000,000 shares awarded under the Plan is \$55,196,000. This amount is being

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

expensed during the approximate two-year vesting period and has been adjusted for changes in the fair value of Sonus common stock on the date the related milestone release conditions were earned for accounting purposes. Upon termination of an employee, the remaining value of shares held to which such employee is entitled, if any, will be expensed. Due to the termination of certain TTI employees in connection with the restructuring plan announced in September 2001, approximately 1,000,000 shares of common stock are scheduled to be released.

The acquisition of TTI was accounted for using the purchase method of accounting in accordance with APB Opinion No. 16, BUSINESS COMBINATIONS. Accordingly, the total purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values. The purchase price has been determined by using the average market value of Sonus common stock for the period from two days before to two days after the announcement of the TTI acquisition (\$41.61 per share) to value the 10,800,000 Sonus common shares issued to the TTI stockholders at the closing date and adding the fair value of liabilities assumed and expenses of the acquisition. Additionally, since the closing date, the purchase price has increased as the 4,200,000 escrowed shares subject to milestone conditions have been earned for accounting purposes. As of September 30, 2001, the purchase price has been computed as follows, in thousands:



addition, they are not intended to be a projection of future results and do not reflect any synergies from combining operations.

NOTE 4. ACQUISITION OF CERTAIN ASSETS OF LINGUATEQ, INC.

On July 31, 2001, Sonus completed the acquisition of certain intellectual property and other assets of privately-held Linguateq Incorporated. Linguateq was a provider of data distribution and billing application software for both next generation and legacy networks.

The acquisition of certain intellectual property and other assets was accounted for using the purchase method of accounting in accordance with SFAS 141, BUSINESS COMBINATIONS. The purchase price has been determined by using the average market value of Sonus common stock for the period from two days before to two days after the terms were agreed upon for the acquisition (\$22.53 per share) to value the 221,753 Sonus common shares issued to the Linguateq stockholders at the closing date and adding payments to employees and vendors and expenses of the acquisition. As of September 30, 2001, the purchase price has been computed as follows, in thousands:

Fair market value of shares issued.....	\$4,995
Payments to employees and vendors.....	241
Acquisition expenses.....	141
	-----
	\$5,377
	=====

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

In accordance with SFAS No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS and with the assistance of valuation experts, the purchase price was allocated to the intangible assets acquired based upon their fair values. Based upon these appraisals, the purchase price allocation is as follows, in thousands:

Intangible assets:	
Developed technology and customer list.....	\$ 700
In-process research and development.....	3,800
Goodwill.....	877
	-----
	\$5,377
	=====

Sonus engaged third-party appraisers to conduct a valuation of the intangible assets and to assist in the determination of useful lives for such assets. Based on the results of the appraisal, \$3,800,000 was allocated to in-process research and development, which was expensed in the third quarter of fiscal 2001. The amounts allocated to developed technology and customer list are being amortized over their estimated useful lives of up to two years. During the three and nine months ended September 30, 2001, amortization of purchased intangibles for Linguateq was \$67,000.

The valuation of in-process research and development was determined using the income method. Revenue and expense projections for the in-process development project were prepared by the management of Sonus through 2007 and the present value was computed using a discount rate of 25.0%. In the event that the project is not completed and technological feasibility is not achieved, there is no alternative future use for the in-process technology. The assumptions used for the valuation of in-process research and development are the responsibility of management.

NOTE 5. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out basis) or market and consist of the following, in thousands:

SEPTEMBER 30, DECEMBER 31, 2001	2000	-----
	Raw	
materials.....		
	\$ 7,798	\$ 3,082
	Work in	

process.....	3,500	3,021	Finished		
goods.....				\$24,109	\$20,668
12,811	14,565	-----	-----		
		=====	=====		

NOTE 6. LONG-TERM OBLIGATIONS

Long-term obligations consist of capital leases and operating lease obligations related to the restructuring. Sonus assumed certain capital leases as part of the acquisition of TTI. The capital leases are due in monthly installments expiring at various dates through March 2005 and accrue interest at

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SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

annual rates ranging from 4.62% to 14.39%. The future payments under these capital leases and amounts due for long-term obligations, as of September 30, 2001, are as follows, in thousands:

CAPITAL LEASES:

Total minimum lease payments.....	\$ 1,566
Less amount representing interest.....	(132)
	-----
Present value of minimum payments.....	1,434
Less current portion of capital leases.....	(1,153)
	-----
Long-term portion of capital leases.....	281

RESTRUCTURING EXPENSES:

Long-term portion of restructuring expenses.....	12,460
	-----
Total long-term obligations.....	\$12,741
	=====

NOTE 7. CONVERTIBLE SUBORDINATED NOTES

In May 2001, Sonus completed a private placement of an aggregate principal amount of \$10,000,000 of 4.75% convertible subordinated notes, due May 1, 2006, with a customer. Interest payments are due semi-annually on May 1 and November 1 of each year through 2006. The notes may be converted by the holder into shares of Sonus' common stock at any time before their maturity or prior to their redemption or repurchase by Sonus. The conversion rate is 33.314 shares per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances. After May 1, 2004, Sonus has the option to redeem all or a portion of the notes at 100% of the principal amount. Also, at any time if the market price of Sonus' common stock exceeds \$60.04 per share for twenty trading days in any thirty trading-day period, Sonus may redeem these notes through the issuance of shares of common stock or for cash.

NOTE 8. LEASE COMMITMENTS

Sonus leases its facilities under operating leases, which expire through January 2009. Sonus is responsible for certain real estate taxes, utilities and maintenance costs under these leases. The future minimum annual payments under operating lease arrangements, including those leases assumed as part of the TTI acquisition, as of December 31, 2000 are as follows: \$4,015,000 in 2001; \$5,376,000 in 2002; \$4,236,000 in 2003; \$2,786,000 in 2004; \$2,339,000 in 2005; and \$6,898,000 thereafter.

NOTE 9. STOCKHOLDERS' EQUITY

(a) AUTHORIZED CAPITAL STOCK

In May 2001, Sonus' stockholders approved an increase in the authorized common stock from 300,000,000 to 600,000,000 shares.

(b) STOCK SPLIT

On October 6, 2000, the Company effected a three-for-one stock split in the form of a stock dividend. All shares of common stock, common stock options and per share amounts in the accompanying financial statements and footnotes have

been retroactively adjusted to reflect the stock split.

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

(c) INITIAL PUBLIC OFFERING

On May 31, 2000, the Company completed its initial public offering of 17,250,000 shares of common stock, which included the exercise of the underwriters' over-allotment option of 2,250,000 shares, at \$7.67 per share. The proceeds from the initial public offering were \$121,600,000, after deducting the underwriters' discounts and commissions and offering expenses paid by us of approximately \$10,600,000.

(d) STOCK-BASED COMPENSATION

Stock-based compensation expenses include the amortization of deferred employee compensation and other equity related expenses for non-employees.

In connection with certain employee stock option grants and the issuance of employee restricted common stock during the years ended December 31, 1999 and 2000, Sonus recorded deferred compensation representing the aggregate difference between the exercise price or purchase price and the fair value of the common stock on the date of grant or sale for accounting purposes. The deferred compensation is recognized as an expense over the vesting period of the underlying stock options and restricted common stock.

Upon the closing of our acquisition of TTI, Sonus recorded deferred stock-based compensation of \$22,600,000 related to the intrinsic value of unvested TTI stock options assumed by Sonus. This deferred compensation will be recognized as an expense over the remaining vesting period of the underlying stock options of up to four years. Additionally, Sonus recorded \$55,196,000 of deferred stock-based compensation on 3,000,000 restricted shares of common stock awarded to TTI employees under the 2000 Retention Plan. This deferred compensation will be expensed over the approximate two-year vesting period of the retention shares and has been adjusted for changes in the fair value of Sonus common stock on the date the related milestone release conditions were earned for accounting purposes. Upon termination of an employee, the remaining value of shares held under the 2000 Retention Plan, to which such employee is entitled, if any, will be expensed.

Sonus has valued the stock options and the issuances of restricted common stock to non-employees based upon the fair market value of the services rendered where Sonus believes the value of these services is more readily determinable than the value of the options or restricted stock. All other grants of options and issuances of restricted stock to non-employees are valued based upon the Black-Scholes option-pricing model. As of September 30, 2001, Sonus has 135,000 stock options and 120,000 shares of restricted common stock outstanding to non-employees. In accordance with Emerging Issues Task Force 96-18, Sonus will record the value at the time the services are provided.

Total stock-based compensation expense was \$39,069,000 and \$6,982,000 for the three months ended September 30, 2001 and 2000, and \$68,339,000 and \$20,347,000 for the nine months ended September 30, 2001 and 2000. Total stock-based compensation expense for the three and nine months ended September 30, 2001 includes \$25,429,000 related to the write-off of deferred compensation with respect to shares held by terminated employees impacted by the restructuring plan (Note 2). Based on the grant of stock options, sale of restricted common stock and grant of awards of restricted common stock through September 30, 2001, Sonus expects stock-based compensation expense to impact its results through fiscal 2005.

SONUS NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

NOTE 10. SUPPLEMENTAL CASH FLOW INFORMATION

NINE MONTHS ENDED SEPTEMBER 30, -----  
2001 2000 ----- SUPPLEMENTAL DISCLOSURE OF  
CASH FLOW INFORMATION: Cash paid during the period for  
interest..... \$ 230 \$ 209 =====

ACQUISITION OF TELECOM TECHNOLOGIES, INC: Tangible  
assets..... \$ 6,312  
\$ -- Liabilities  
assumed..... (21,184) -  
- Goodwill and purchased  
intangibles..... 525,718 -- Issuance  
of common stock in connection with  
acquisition.....  
(505,013) -- Cash  
acquired.....  
(90) -- ----- Acquisition, net of cash  
acquired..... 5,743 -- -----  
-- ACQUISITION OF CERTAIN ASSETS OF LINGUATEQ, INC.:  
Goodwill and purchased  
intangibles..... 5,377 -- Issuance of  
common stock in connection with  
acquisition.....  
(4,995) -- -----  
Acquisition.....  
382 -- ----- TOTAL ACQUISITIONS, NET OF  
CASH ACQUIRED..... \$ 6,125 \$ -- =====  
===== SUPPLEMENTARY DISCLOSURE OF NON-CASH  
TRANSACTION: Conversion of redeemable convertible  
preferred stock into common  
stock..... \$ -- \$70,859  
=====

NOTE 11. SUBSEQUENT EVENT

On November 8, 2001, a securities class action complaint was filed against the Company, two of its officers and the lead underwriters in connection with our initial public offering. The complaint alleges violations of federal securities laws by making material false and misleading statements in the Company's prospectus incorporated in its registration statement on Form S-1 filed with the SEC in May 2000. The complaint is generally related to the alleged receipt of undisclosed compensation by the underwriters and the existence of undisclosed arrangements between the underwriters and certain purchasers to make additional purchases in the after market. Sonus is in the process of reviewing the complaint and anticipates it will defend this action vigorously.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which are subject to a number of risks and uncertainties. These forward-looking statements are based on our current expectations, assumptions, estimates and projections about ourselves and our industry. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including the factors set forth in "Cautionary Statements" beginning on page 22 of this Quarterly Report on Form 10-Q. This discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes for the periods specified. Further reference should be made to Sonus' Annual Report on Form 10-K for the year ended December 31, 2000.

OVERVIEW

We are a leading provider of voice infrastructure products for the new public network. We offer a new generation of carrier-class switching equipment and software that enable voice services to be delivered over packet-based networks.

Since our inception, we have incurred significant losses and, as of September 30, 2001 had an accumulated deficit of \$716.0 million. We have not achieved profitability on a quarterly or an annual basis, and anticipate that we will continue to incur net losses. We have a lengthy sales cycle for our products and, accordingly, we expect to incur sales and other expenses before we realize the related revenues. We expect to incur significant sales and marketing, research and development and general and administrative expenses and, as a result, we will need to generate significant revenues to achieve and maintain profitability.

We sell our products primarily through a direct sales force and in some markets, through resellers and distributors. In the future, we anticipate expanding our sales efforts to include additional overseas distribution partners. Customers' decisions to purchase our products to deploy in commercial networks involve a significant commitment of resources and a lengthy evaluation,

testing and product qualification process. We believe these long sales cycles, as well as our expectation that customers will tend to sporadically place large orders with short lead times, will cause our revenues and results of operations to vary significantly and unexpectedly from quarter to quarter. We expect to recognize revenues from a limited number of customers for the foreseeable future.

Sonus began shipping product to customers during the fourth quarter of fiscal 1999 and recorded its first revenues of \$51.8 million in fiscal 2000. For the first nine months of fiscal 2001, Sonus recognized \$134.3 million in revenue. For the six consecutive quarters ending June 30, 2001, our revenue increased each quarter sequentially compared to the previous quarter. However, our revenue declined sequentially in the third quarter of fiscal 2001 to \$40.3 million due to unfavorable business conditions primarily caused by declines in capital spending by telecommunications service providers. In response to these unfavorable economic conditions, in September 2001 Sonus announced a restructuring plan designed to reduce expenses and align its cost structure with its revised business outlook. Accordingly, Sonus recorded a restructuring charge in the third quarter of fiscal 2001 of \$25.8 million for a worldwide workforce reduction, consolidation of excess facilities and other charges, a non-cash impairment charge of \$376.7 million for the write-off of goodwill and certain purchased intangibles of TTI and a \$25.4 million write-off of deferred compensation for shares and options held by terminated employees. See Note 2 to our unaudited condensed consolidated financial statements.

#### ACQUISITION OF TELECOM TECHNOLOGIES, INC.

On January 18, 2001, we acquired TTI. Upon the closing of this acquisition, we issued an aggregate of 10,800,000 shares of common stock in exchange for all outstanding capital stock of TTI. Of the 10,800,000 shares issued to the TTI shareholders, 1,200,000 shares were placed into escrow as security for indemnity obligations under the merger agreement, and will be released to TTI

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shareholders upon expiration of those indemnity obligations, expected to be on the first anniversary of the closing date. In addition, TTI shareholders have the right to receive an aggregate of 4,200,000 additional shares of common stock, which have been placed in escrow in the event that TTI achieves certain specified business expansion and product development milestones from time to time prior to December 31, 2002. As of September 30, 2001, 2,400,000 milestone related shares had been released from escrow. In connection with our acquisition of TTI, we adopted our 2000 Retention Plan and issued 3,000,000 shares of common stock under this plan to certain employees of TTI who became employees of Sonus, the vesting of which shares are subject to continued employment and the attainment of business expansion and product development milestones. Due to the termination of certain TTI employees in connection with the restructuring plan, approximately 1,000,000 shares of common stock under the 2000 Retention Plan are scheduled to be released.

We have accounted for the acquisition as a purchase for financial reporting purposes. Accordingly, Sonus' financial statements for the three and nine months ended September 30, 2001 reflect the results of operations of TTI since the date of acquisition. The purchase price was allocated to TTI's assets and liabilities based on the fair value of the assets acquired and the liabilities assumed. The excess of the purchase price over the fair value of the net tangible assets and identifiable intangible assets acquired has been classified as goodwill. In addition, a portion of the purchase price has been allocated to in-process research and development. Additionally, since the closing date, the purchase price has been increased as escrowed shares subject to milestone conditions were earned for accounting purposes. Goodwill and other intangibles have been amortized by charges to operations over their estimated useful lives of three years and purchased in-process research and development was charged to operations at the time of closing. Sonus has recorded deferred stock-based compensation relating to the issuance of awards under our 2000 Retention Plan. The amount of charges for stock-based compensation will be significant and will therefore have a material negative impact on the combined company's future operating results. In the third quarter of fiscal 2001, Sonus recorded a non-cash impairment charge of \$376.7 million for the write-off of goodwill and purchased intangibles related to the acquisition of TTI.

#### RESULTS OF OPERATIONS

##### THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

REVENUES. Revenues were \$40.3 million for the three months ended September 30, 2001, an increase of \$24.7 million, or 159% from \$15.6 million for the same period in fiscal 2000. Revenues were \$134.3 million for the nine months ended September 30, 2001, an increase of \$111.1 million, or 480% from \$23.2 million for the same period in fiscal 2000. The increase in revenues for these periods was the result of a significant increase in the sale of voice



infrastructure products. For the nine months ended September 30, 2001 and 2000, four and three customers each contributed more than 10% of our revenues which represented an aggregate of 68.8% and 71.1% of total revenues. International revenues, primarily to Asia and Europe, were 21.0% and 12.1% of revenues for the nine months ended September 30, 2001 and 2000.

GROSS PROFIT. Cost of revenues consist primarily of amounts paid to third-party manufacturers for purchased materials and services, and manufacturing and professional services personnel and related costs. Gross profit was \$22.2 million, or 55.0% of revenues, for the three months ended September 30, 2001, compared with \$6.7 million, or 43.3% of revenues, for the same period in fiscal 2000. Gross profit was \$76.0 million, or 56.6% of revenues, for the nine months ended September 30, 2001, compared with \$8.3 million, or 35.9% of revenues, for the same period in fiscal 2000. These increases in gross profit as a percentage of revenues are primarily the result of improved manufacturing efficiencies due to increased volume, product mix and a reduction in material costs. We expect gross profit as a percentage of revenues to increase modestly in the future due to continuing product mix changes and increases in support and maintenance revenues.

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RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses consist primarily of salaries and related personnel costs, recruiting expenses and prototype costs related to the design, development, testing and enhancement of our products. We expense our research and development costs as incurred. Research and development expenses were \$18.7 million for the three months ended September 30, 2001, an increase of \$11.7 million, or 167%, from \$7.0 million for the same period in fiscal 2000. Research and development expenses were \$49.4 million for the nine months ended September 30, 2001, an increase of \$31.2 million, or 171%, from \$18.2 million for the same period in fiscal 2000. These increases reflect costs primarily associated with a significant increase in personnel and personnel-related expenses including our acquisition of TTI, and, to a lesser extent, prototype and software expenses for the development of our products. We believe that our restructuring actions will reduce research and development expenses from the current level beginning in the fourth quarter of fiscal 2001, with the full effect being realized during the first quarter of fiscal 2002. However, we believe that rapid technological innovation is critical to our long-term success and we intend to continue to make substantial investments to enhance our products and technologies.

SALES AND MARKETING EXPENSES. Sales and marketing expenses consist primarily of salaries and related personnel expenses, commissions, travel and entertainment expenses, promotions, customer evaluations and other marketing expenses. Sales and marketing expenses were \$12.7 million for the three months ended September 30, 2001, an increase of \$6.8 million, or 117%, from \$5.9 million for the same period in fiscal 2000. Sales and marketing expenses were \$31.8 million for the nine months ended September 30, 2001, an increase of \$18.2 million, or 134%, from \$13.6 million for the same period in fiscal 2000. These increases reflect costs primarily associated with the hiring of additional U.S. and international sales and marketing personnel including our acquisition of TTI, commissions, the opening of international sales offices and, to a lesser extent, travel-related expenses, marketing program costs and trade shows. We believe that our restructuring actions will reduce sales and marketing expenses from the current level beginning in the fourth quarter of fiscal 2001, with the full effect being realized during the first quarter of fiscal 2002.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of salaries and related expenses for executive and administrative personnel, recruiting expenses and professional fees. General and administrative expenses were \$3.3 million for the three months ended September 30, 2001, an increase of \$1.5 million, or 89%, from \$1.8 million for the same period in fiscal 2000. General and administrative expenses were \$9.3 million for the nine months ended September 30, 2001, an increase of \$5.5 million, or 147%, from \$3.8 million for the same period in fiscal 2000. These increases reflect the hiring of additional general and administrative personnel including our acquisition of TTI, and, to a lesser extent, costs associated with being a public company. We believe that our restructuring actions will reduce general and administrative expenses from the current level beginning in the fourth quarter of fiscal 2001, with the full effect being realized during the first quarter of fiscal 2002.

STOCK-BASED COMPENSATION EXPENSES. Stock-based compensation expenses include the amortization of stock compensation charges resulting from the granting of stock options, including those TTI stock options assumed by Sonus, stock awards to TTI employees under the 2000 Retention Plan, and the sales of restricted common stock to employees and compensation expense associated with the grant of stock options and issuance of restricted stock to non-employees. See Note 9(d) to our unaudited condensed consolidated financial statements. Deferred compensation related to the granting of stock options and sales of restricted common stock to employees, including those TTI stock options assumed by Sonus,

are being amortized over the vesting periods of four to five years. The deferred compensation associated with the 2000 Retention Plan awarded to TTI employees will be expensed over the approximate two-year vesting period of the retention shares. These amounts have been adjusted for changes in the fair value of Sonus common stock on the date the related milestone release conditions were earned for accounting purposes. Upon the termination of an employee, the remaining

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value of shares held under the 2000 Retention Plan, to which such employee is entitled, if any, will be expensed. The compensation expense associated with non-employees is recorded at the time services are provided.

Stock-based compensation expenses were \$39.1 million for the three months ended September 30, 2001, an increase of \$32.1 million, from \$7.0 million for the same period in fiscal 2000. Stock-based compensation expenses were \$68.3 million for the nine months ended September 30, 2001, an increase of \$48.0 million, from \$20.3 million for the same period in fiscal 2000. These increases are primarily due to the amortization of deferred stock-based compensation resulting from the unvested TTI stock options assumed by Sonus, retention stock awards issued to TTI employees and the write-off of \$25.4 million of deferred compensation of shares held by terminated employees impacted by the restructuring plan. Based on the grant of stock options, sale of restricted common stock and grant of awards of restricted common stock through September 30, 2001, we expect stock-based compensation expense to impact our results through fiscal 2005.

GOODWILL, PURCHASED INTANGIBLES AND IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSES. In January 2001, Sonus acquired certain intellectual property, in-process research and development and intangible assets in connection with our acquisition of TTI, which resulted in the recording of \$525.7 million of goodwill and other intangibles. Results of operations for the three months ended September 30, 2001 include \$41.3 million in amortization of TTI goodwill and purchased intangibles. Results of operations for the nine months ended September 30, 2001, include \$107.2 million in amortization of TTI goodwill and purchased intangibles and a \$40.0 million write-off of purchased in-process research and development. Due to the write-off of \$376.7 million in TTI goodwill and certain purchased intangibles in the third quarter of fiscal 2001, amortization expense for the fourth quarter of fiscal 2001 will be substantially reduced from its current level. See Notes 2 and 3 to our unaudited condensed consolidated financial statements.

In July 2001, Sonus completed the acquisition of certain intellectual property and other assets of privately-held LinguatEQ Incorporated, a provider of data distribution and billing application software. Results of operations for the three and nine months ended include the amortization of purchased intangibles and a non-cash charge of \$3.8 million for purchased in-process research and development.

RESTRUCTURING CHARGES. On September 26, 2001, in response to unfavorable business conditions largely caused by a rapid further decrease in capital spending by telecommunications service providers, Sonus announced a restructuring plan designed to reduce expenses and align its cost structure with its revised business outlook. Accordingly, during the third quarter of fiscal 2001, Sonus recorded a restructuring charge of \$25.8 million for a worldwide workforce reduction, consolidation of excess facilities and other charges.

#### WORKFORCE REDUCTION

Restructuring actions resulted in the reduction of Sonus' workforce by approximately 150 employees, or 21%. The affected employees are entitled to severance and other benefits for which Sonus recorded a charge of \$4.5 million in the third quarter of fiscal 2001. Cash expenditures relating to workforce reductions will be substantially paid in the fourth quarter of fiscal 2001.

#### CONSOLIDATION OF EXCESS FACILITIES AND OTHER CHARGES

The Company recorded a restructuring charge in the third quarter of fiscal 2001 of \$21.3 million for the consolidation of excess facilities and other miscellaneous charges, which are included on the balance sheet as accrued restructuring expenses and long-term obligations. Cash expenditures relating to the consolidation of excess facilities and other miscellaneous charges will begin to be paid in the fourth quarter of fiscal 2001 and are expected to continue through January 2009.

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WRITE-OFF OF GOODWILL AND PURCHASED INTANGIBLES. In light of negative industry and economic conditions, a general decline in technology valuations and our decision to discontinue the development and use of non-strategic and overlapping products and services, we performed an assessment of the carrying

value of the goodwill and purchased intangibles recorded in connection with our acquisition of TTI. In accordance with SFAS 121, Sonus recorded a non-cash impairment charge of \$376.7 million in the third quarter of fiscal 2001 for the write-off of goodwill and certain purchased intangibles because the estimated undiscounted future cash flows of these assets was less than the carrying value.

**INTEREST INCOME (EXPENSE), NET.** Interest income, net of interest expense was \$1.2 million for the three months ended September 30, 2001, a decrease of \$1.3 million from \$2.5 million for the same period in fiscal 2000. Interest income, net of interest expense was \$4.3 million for the first nine months ended September 30, 2001, an increase of \$461,000 from \$3.8 million for the same period in fiscal 2000. The decrease for the third quarter of fiscal 2001 compared to the same period of the prior year reflects decreasing interest rates and invested balances and increasing interest expenses incurred on convertible subordinated notes and capital lease arrangements. The increase for the first nine months of fiscal 2001 compared to the same period of the prior year reflects higher invested balances partially offset by decreasing interest rates and increasing interest expense.

**INCOME TAXES.** No provision for income taxes has been recorded for the three and nine months ended September 30, 2001 and 2000, due to accumulated net losses. We did not record any tax benefits relating to these losses or other tax benefits due to the uncertainty surrounding the realization of these future tax benefits.

#### LIQUIDITY AND CAPITAL RESOURCES

Prior to our initial public offering, we financed our operations primarily through private sales of redeemable convertible preferred stock totaling \$70.7 million in net proceeds. Upon the closing of our initial public offering on May 31, 2000, the Company received cash proceeds, net of underwriters' discount and offering expenses, totaling \$121.6 million, and all of our redeemable convertible preferred stock converted into 96,957,222 shares of common stock. At September 30, 2001, cash, cash equivalents and marketable securities totaled \$137.4 million.

Net cash used in operating activities was \$2.9 million for the nine months ended September 30, 2001, as compared to \$9.0 million for the nine months ended September 30, 2000. The cash used in operating activities in the nine months ended September 30, 2001 compared to the same period of the prior year reflects a significantly higher net loss and a reduction in accounts payable offset by higher non-cash charges, decreases in accounts receivable and an increase in accrued restructuring expenses.

Net cash used in investing activities was \$62.5 million for the nine months ended September 30, 2001, as compared to cash provided by investing activities of \$4.6 million for the nine months ended September 30, 2000. Net cash used in investing activities for the nine months ended September 30, 2001 primarily reflects net purchases of marketable securities of \$34.9 million, purchases of property and equipment of \$21.4 million and cash expenditures associated with our acquisitions of \$6.1 million. The amount of capital expenditures in the near term are anticipated to be consistent with the current quarterly level.

Net cash provided by financing activities was \$25.8 million for the nine months ended September 30, 2001, as compared to \$148.1 million for the nine months ended September 30, 2000. The net cash provided for the nine months ended September 30, 2001 resulted from the sale of common stock, long-term restructuring obligations, the exercise of stock options and the issuance of \$10.0 million in convertible subordinated notes offset by the repayment of \$8.0 million in a bank note payable assumed as part of the acquisition of TTI. The net cash provided for the nine months ended September 30, 2000, is primarily a result of net proceeds received from the Sonus' initial public offering and to a lesser extent, from the sale of Series D redeemable convertible preferred stock, partially offset by repayment of long-term obligations.

We believe our current cash, cash equivalents and marketable securities will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least 12 months. If our existing resources and cash generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders, and we cannot be certain that additional financing will be available in amounts or on terms acceptable to us, if at all. If we are unable to obtain this additional financing, we may be required to reduce the scope of our planned product development and sales and marketing efforts, which could harm our business, financial condition and operating results.

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, BUSINESS COMBINATIONS, and SFAS No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method of accounting and prohibits the use of the pooling of interest method. SFAS No. 142 eliminates the amortization of goodwill and certain other intangibles and instead subjects these assets to periodic impairment assessments. SFAS No. 142 is effective immediately for all goodwill and certain other intangible assets acquired after June 30, 2001 and shall commence on January 1, 2002 for all goodwill and certain other intangibles existing on June 30, 2001. Sonus is currently assessing the potential impact SFAS No. 141 and SFAS No. 142 will have on its financial statements.

In August 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS, which supersedes SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, and the accounting and reporting provisions of APB No. 30, REPORTING THE RESULTS OF OPERATIONS--REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS, AND EXTRAORDINARY, UNUSUAL AND INFREQUENTLY OCCURRING EVENTS AND TRANSACTIONS. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. Sonus is currently reviewing this statement to determine the effect on its financial statements.

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#### CAUTIONARY STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995 that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the following cautionary statements and elsewhere in this Quarterly Report on Form 10-Q. If any of the following risks were to occur, our business, financial condition or results of operations would likely suffer and the trading price of our common stock would likely decline.

WE EXPECT THAT A MAJORITY OF OUR REVENUES WILL BE GENERATED FROM A LIMITED NUMBER OF CUSTOMERS AND OUR REVENUES WILL NOT GROW IF WE DO NOT SUCCESSFULLY SELL PRODUCTS TO THESE CUSTOMERS.

To date, we have shipped our products to a limited number of customers and only during the first quarter of fiscal 2000 did we begin to recognize revenues. We expect that in the foreseeable future, substantially all of our revenues will depend on sales of our products to a limited number of customers. For example, four and three customers each contributed more than 10% of our revenues for the nine months ended September 30, 2001 and 2000, which represented an aggregate of 69% and 71% of total revenues. Some of the customers to whom we have shipped products have deployed our products in their commercial networks, while others are using our products in laboratory testing or internal trials. Our customers may not, or may not continue to, deploy our products in their commercial networks on a timely basis, or at all, and any delay or failure by our customers to introduce commercial services based on our products, or a downturn in their business, would seriously harm our ability to sell products and generate revenues.

WE WILL NOT BE SUCCESSFUL IF WE DO NOT GROW OUR CUSTOMER BASE.

Our future success will depend on our ability to attract additional customers beyond our current limited number. The growth of our customer base could be adversely affected by:

- customer unwillingness to implement our new voice infrastructure products;
- any delays or difficulties that we may incur in completing the development and introduction of our planned products or product enhancements;
- our customers' inability to raise capital to finance their business plans;
- new product introductions by our competitors;
- any failure of our products to perform as expected; or
- any difficulty we may incur in meeting customers' delivery requirements.

If we do not expand our customer base to include additional customers that deploy our products in operational commercial networks, our revenues will not grow significantly, or at all.

THE MARKET FOR VOICE INFRASTRUCTURE PRODUCTS FOR THE NEW PUBLIC NETWORK IS NEW

AND EVOLVING AND OUR BUSINESS WILL SUFFER IF IT DOES NOT DEVELOP AS WE EXPECT.

The market for our products is rapidly evolving. Packet-based technology may not be widely accepted as a platform for voice and a viable market for our products may not develop or be sustainable. If this market does not develop, or develops more slowly than we expect, we may not be able to sell our products in significant volumes, or at all.

WE HAVE BEEN IN BUSINESS FOR A SHORT PERIOD OF TIME WHICH MAKES FORECASTING DIFFICULT.

We were founded in August 1997, and only during the first quarter of fiscal 2000 did we begin to recognize any revenues. As a result of our limited operating history, it is difficult to accurately forecast revenues and there is limited meaningful historical financial data upon which to base planned operating expenses. In addition, our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are, and will continue to be, fixed in the short-term. Changes in capital spending levels by telecommunications service providers further complicate the forecasting process.

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WE ARE EXPOSED TO GENERAL ECONOMIC CONDITIONS.

Our business is subject to the effects of general economic conditions in the United States and globally, and, in particular, market conditions in the telecommunications industry. In the third quarter of fiscal 2001, our operating results have been adversely affected as a result of unfavorable business conditions primarily caused by declines in capital spending from telecommunications service providers. If the economic conditions in the United States and globally do not improve, or if we experience a worsening in the global economic and/or telecommunications industry slowdown, we may continue to experience adverse impacts on our business, operating results and financial condition.

REVENUES TO EMERGING SERVICE PROVIDERS MAY INCREASE THE UNPREDICTABILITY OF OUR RESULTS.

A substantial portion of our revenues have come from emerging service providers who are the primary early adopters of our voice infrastructure products. As a result of current economic and market conditions, many emerging service providers have seen a decrease in funding available to finance large capital expenditures. This has contributed to the uncertainty of the amounts and timing of capital expenditures by emerging service provider customers for products such as those we offer. Additionally, ability to recognize revenue from emerging service provider customers will depend on the relative financial strength of the particular customer. Our operating results could be materially and adversely affected if any present or future emerging service providers were to choose to reduce its level of orders or were to experience financial, operational or other difficulties that resulted in a reduction of orders to us or a delay or failure to pay our receivables.

WE ARE ENTIRELY DEPENDENT UPON OUR VOICE INFRASTRUCTURE PRODUCTS AND OUR FUTURE REVENUES DEPEND UPON THEIR COMMERCIAL SUCCESS.

Our future growth depends upon the commercial success of our voice infrastructure products. We intend to develop and introduce new products and enhancements to existing products in the future. We may not successfully complete the development or introduction of these products. If our target customers do not adopt, purchase and successfully deploy our current or planned products, our revenues will not grow.

BECAUSE OUR PRODUCTS ARE SOPHISTICATED AND DESIGNED TO BE DEPLOYED IN COMPLEX ENVIRONMENTS, THEY MAY HAVE ERRORS OR DEFECTS THAT WE FIND ONLY AFTER FULL DEPLOYMENT, WHICH COULD SERIOUSLY HARM OUR BUSINESS.

Our products are sophisticated and are designed to be deployed in large and complex networks. Because of the nature of our products, they can only be fully tested when substantially deployed in very large networks with high volumes of traffic. Some of our customers have only recently begun to commercially deploy our products and they may discover errors or defects in the software or hardware, or the products may not operate as expected.

If we are unable to fix errors or other performance problems that may be identified after full deployment of our products, we could experience:

- loss of, or delay in, revenues;
- loss of customers and market share;
- a failure to attract new customers or achieve market acceptance for our

products;

- increased service, support and warranty costs and a diversion of development resources; and
- costly and time-consuming legal actions by our customers.

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IF WE DO NOT RESPOND RAPIDLY TO TECHNOLOGICAL CHANGES OR TO CHANGES IN INDUSTRY STANDARDS, OUR PRODUCTS COULD BECOME OBSOLETE.

The market for voice infrastructure products for the new public network is likely to be characterized by rapid technological change and frequent new product introductions. We may be unable to respond quickly or effectively to these developments. We may experience difficulties with software development, hardware design, manufacturing or marketing that could delay or prevent our development, introduction or marketing of new products and enhancements. The introduction of new products by our competitors, the market acceptance of products based on new or alternative technologies or the emergence of new industry standards could render our existing or future products obsolete. If the standards adopted are different from those that we have chosen to support, market acceptance of our products may be significantly reduced or delayed. If our products become technologically obsolete, we may be unable to sell our products in the marketplace and generate revenues.

WE DEPEND UPON CONTRACT MANUFACTURERS AND ANY DISRUPTION IN THESE RELATIONSHIPS MAY CAUSE US TO FAIL TO MEET THE DEMANDS OF OUR CUSTOMERS AND DAMAGE OUR CUSTOMER RELATIONSHIPS.

We rely on a small number of contract manufacturers to manufacture our products according to our specifications and to fill orders on a timely basis. Our contract manufacturers provide comprehensive manufacturing services, including assembly of our products and procurement of materials. Each of our contract manufacturers also builds products for other companies and may not always have sufficient quantities of inventory available to fill our orders or may not allocate their internal resources to fill these orders on a timely basis. We do not have long-term supply contracts with our manufacturers and they are not required to manufacture products for any specified period.

We do not have internal manufacturing capabilities to meet our customers' demands. Qualifying a new contract manufacturer and commencing commercial-scale production is expensive and time consuming and could result in a significant interruption in the supply of our products. If a change in contract manufacturers results in delays in our fulfillment of customer orders or if a contract manufacturer fails to make timely delivery of orders, we may lose revenues and suffer damage to our customer relationships.

THE UNPREDICTABILITY OF OUR QUARTERLY RESULTS MAY ADVERSELY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our revenues and operating results will vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate. Generally, purchases by service providers of telecommunications equipment from manufacturers have been unpredictable and clustered, rather than steady, as the providers build out their networks. The primary factors that may affect our revenues and results include the following:

- fluctuation in demand for our voice infrastructure products and the timing and size of customer orders;
- the cancellation or deferral of existing customer orders;
- the length and variability of the sales cycle for our products and the corresponding timing of recognizing or deferring revenues;
- new product introductions and enhancements by our competitors and us;
- changes in our pricing policies, the pricing policies of our competitors and the prices of the components of our products;
- our ability to develop, introduce and ship new products and product enhancements that meet customer requirements in a timely manner;
- the mix of product configurations sold;

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- our ability to obtain sufficient supplies of sole or limited source components;

- our ability to attain and maintain production volumes and quality levels for our products;
- costs related to acquisitions of complementary products, technologies or businesses; and
- general economic conditions, as well as those specific to the telecommunications, networking and related industries and other factors.

As with other telecommunications product suppliers, we may recognize a substantial portion of our revenue in a given quarter from sales booked and shipped in the last weeks of that quarter. As a result, a delay in customer orders is likely to result in a delay in shipments and recognition of revenue beyond the end of a given quarter, which would have a significant impact on our operating results for that quarter.

Our operating expenses are largely based on anticipated organizational growth and revenue trends. As a result, a delay in generating or recognizing revenues for the reasons set forth above, or for any other reason, could cause significant variations in our operating results. We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is likely that in some future quarters, our operating results may be below the expectations of public market analysts and investors. In this event, the price of our common stock will probably substantially decrease.

WE MAY NOT BECOME PROFITABLE.

We have incurred significant losses since inception and expect to continue to incur losses in the future. As of September 30, 2001, we had an accumulated deficit of \$716.0 million and had only recognized cumulative revenues since inception of \$186.2 million through September 30, 2001. We have not achieved profitability on a quarterly or annual basis. As a result of our acquisition of telecom technologies, inc., or TTI, we expect to incur significant additional expenses for stock-based compensation which will make achieving profitability more difficult in the near to mid-term. Our revenues may not grow and we may never generate sufficient revenues to achieve or sustain profitability.

WE WILL NOT RETAIN CUSTOMERS OR ATTRACT NEW CUSTOMERS IF WE DO NOT ANTICIPATE AND MEET SPECIFIC CUSTOMER REQUIREMENTS OR IF OUR PRODUCTS DO NOT INTEROPERATE WITH OUR CUSTOMERS' EXISTING NETWORKS.

To achieve market acceptance for our products, we must effectively anticipate, and adapt in a timely manner to, customer requirements and offer products and services that meet changing customer demands. Prospective customers may require product features and capabilities that our current products do not have. The introduction of new or enhanced products also requires that we carefully manage the transition from older products in order to minimize disruption in customer ordering patterns and ensure that adequate supplies of new products can be delivered to meet anticipated customer demand. If we fail to develop products and offer services that satisfy customer requirements, or to effectively manage the transition from older products, our ability to create or increase demand for our products would be seriously harmed and we may lose current and prospective customers.

Many of our customers will require that our products be designed to interface with their existing networks, each of which may have different specifications. Issues caused by an unanticipated lack of interoperability may result in significant warranty, support and repair costs, divert the attention of our engineering personnel from our hardware and software development efforts and cause significant customer relations problems. If our products do not interoperate with those of our customers' networks, installations could be delayed or orders for our products could be cancelled, which would seriously harm our gross margins and result in loss of revenues or customers.

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IF WE FAIL TO COMPETE SUCCESSFULLY, OUR ABILITY TO INCREASE OUR REVENUES OR ACHIEVE PROFITABILITY WILL BE IMPAIRED.

Competition in the telecommunications market is intense. This market has historically been dominated by large companies, such as Lucent Technologies and Nortel Networks, both of whom are our direct competitors. We also face competition from other large telecommunications and networking companies, including Cisco Systems, which have entered our market by acquiring companies that design competing products. In addition, a number of smaller and mostly private companies have announced plans for new products that target market opportunities similar to those we address. Because this market is rapidly evolving, additional competitors with significant financial resources may enter these markets and further intensify competition.

Many of our current and potential competitors have significantly greater selling and marketing, technical, manufacturing, financial and other resources, including the ability to offer vendor-sponsored financing programs. If we are unable or unwilling to offer vendor-sponsored financing, prospective customers may decide to purchase products from one of our competitors that offers this type of financing. Furthermore, some of our competitors are currently selling significant amounts of other products to our current and prospective customers. Our competitors' broad product portfolios coupled with already existing relationships may cause our customers to buy our competitors' products or harm our ability to attract new customers.

To compete effectively, we must deliver innovative products that:

- provide extremely high reliability and voice quality;
- scale easily and efficiently;
- interoperate with existing network designs and other vendors' equipment;
- provide effective network management;
- are accompanied by comprehensive customer support and professional services; and
- provide a cost-effective and space-efficient solution for service providers.

If we are unable to compete successfully against our current and future competitors, we could experience price reductions, order cancellations, loss of revenues and reduced gross margins.

WE AND OUR CONTRACT MANUFACTURERS RELY ON SINGLE OR LIMITED SOURCES FOR SUPPLY OF SOME COMPONENTS OF OUR PRODUCTS AND IF WE FAIL TO ADEQUATELY PREDICT OUR MANUFACTURING REQUIREMENTS OR IF OUR SUPPLY OF ANY OF THESE COMPONENTS IS DISRUPTED, WE WILL BE UNABLE TO SHIP OUR PRODUCTS.

We and our contract manufacturers currently purchase several key components of our products, including commercial digital signal processors, from single or limited sources. We purchase these components on a purchase order basis. If we overestimate our component requirements, we could have excess inventory, which would increase our costs. If we underestimate our requirements, we may not have an adequate supply, which could interrupt manufacturing of our products and result in delays in shipments and revenues.

We currently do not have long-term supply contracts with our component suppliers and they are not required to supply us with products for any specified periods, in any specified quantities or at any set price, except as may be specified in a particular purchase order. In the event of a disruption or delay in supply, or inability to obtain products, we may not be able to develop an alternate source in a timely manner or at favorable prices, or at all. A failure to find acceptable alternative sources could hurt our ability to deliver high-quality products to our customers and negatively affect our operating margins. In addition, our reliance on our suppliers exposes us to potential supplier production difficulties or quality variations. Our customers rely upon our ability to meet committed delivery dates, and any disruption in the supply of key components would seriously impact our ability to meet these

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dates and could result in legal action by our customers, loss of customers or harm to our ability to attract new customers.

IF WE ARE NOT ABLE TO OBTAIN NECESSARY LICENSES OF THIRD-PARTY TECHNOLOGY AT ACCEPTABLE PRICES, OR AT ALL, OUR PRODUCTS COULD BECOME OBSOLETE.

We have incorporated third-party licensed technology into our current products. From time to time, we may be required to license additional technology from third parties to develop new products or product enhancements. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. The inability to maintain or re-license any third-party licenses required in our current products or to obtain any new third-party licenses to develop new products and product enhancements could require us to obtain substitute technology of lower quality or performance standards or at greater cost, and delay or prevent us from making these products or enhancements, any of which could seriously harm the competitiveness of our products.

OUR FAILURE TO MANAGE OUR EXPANSION EFFECTIVELY IN A RAPIDLY CHANGING MARKET COULD INCREASE OUR COSTS, HARM OUR ABILITY TO SELL FUTURE PRODUCTS AND IMPAIR OUR FUTURE GROWTH.



We have expanded our operations rapidly and have hired a significant number of employees during fiscal 2001. Our growth has placed, and our anticipated growth will continue to place, a significant strain on our management systems and resources. Our ability to successfully offer our products and implement our business plan in a rapidly evolving market requires effective planning and management processes. We expect that we will need to continue to improve our financial, managerial and manufacturing controls and reporting systems, and will need to continue to train and manage our worldwide workforce. If we fail to implement adequate control systems in an efficient and timely manner, our costs may be increased and our growth could be impaired and we may not be able to accurately anticipate and fulfill market demand, the result of which will be a loss of revenues and customers.

IF WE FAIL TO HIRE AND RETAIN NEEDED PERSONNEL, THE IMPLEMENTATION OF OUR BUSINESS PLAN COULD SLOW OR OUR FUTURE GROWTH COULD HALT.

Competition for highly skilled engineering, sales, marketing and support personnel is intense because there are a limited number of people available with the necessary technical skills and understanding of our market. Any failure to attract, assimilate or retain qualified personnel to fulfill our current or future needs could impair our growth. The support of our products requires highly trained customer support and professional services personnel. Once we hire them, they may require extensive training in our voice infrastructure products. If we are unable to hire, train and retain our customer support and professional services personnel, we may not be able to increase sales of our products. Our future success depends upon the continued services of our executive officers who have critical industry experience and relationships that we rely on to implement our business plan. Most of our officers or key employees are not bound by an employment agreement for any specific term. The loss of the services of any of our officers or key employees could delay the development and introduction of, and negatively impact our ability to sell, our products.

OUR ABILITY TO COMPETE AND OUR BUSINESS COULD BE JEOPARDIZED IF WE ARE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY OR BECOME SUBJECT TO INTELLECTUAL PROPERTY RIGHTS LITIGATION, WHICH COULD REQUIRE US TO INCUR SIGNIFICANT COSTS.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries

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where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be harmed.

In addition, we may become involved in litigation as a result of allegations that we infringe the intellectual property rights of others. Any parties asserting that our products infringe upon their proprietary rights would force us to defend ourselves and possibly our customers or contract manufacturers against the alleged infringement. These claims and any resulting lawsuit, if successful, could subject us to significant liability for damages and invalidation of our proprietary rights. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling, incorporating or using our products that use the challenged intellectual property;
- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or
- redesign those products that use any allegedly infringing technology.

Any lawsuits regarding intellectual property rights, regardless of their success, would be time-consuming, expensive to resolve and would divert our management's time and attention.

ANY INVESTMENTS OR ACQUISITIONS WE MAKE COULD DISRUPT OUR BUSINESS AND SERIOUSLY HARM OUR FINANCIAL CONDITION.

Although we have no current agreements to do so, we intend to consider investing in, or acquiring, complementary products, technologies or businesses. In the event of future investments or acquisitions, we could:

- issue stock that would dilute our current stockholders' percentage

ownership;

- incur debt or assume liabilities;
- incur significant impairment charges related to the write-off of goodwill and purchased intangible assets;
- incur significant amortization expenses related to purchased intangible assets; or
- incur large and immediate write-offs for in-process research and development and stock-based compensation.

Our integration of any acquired products, technologies or businesses will also involve numerous risks, including:

- problems and unanticipated costs associated with combining the purchased products, technologies or businesses;
- diversion of management's attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have limited or no prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

We may be unable to successfully integrate any products, technologies, businesses or personnel that we might acquire in the future without significant costs or disruption to our business.

WE MAY FACE RISKS ASSOCIATED WITH OUR INTERNATIONAL EXPANSION THAT COULD IMPAIR OUR ABILITY TO GROW OUR REVENUES ABROAD.

Our expansion into international markets will require significant management attention and financial resources to successfully develop direct and indirect international sales and support channels.

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In addition, we may not be able to develop international market demand for our products, which could impair our ability to grow our revenues.

We have limited experience marketing and distributing our products internationally and, to do so, we expect that we will need to develop versions of our products that comply with local standards. Furthermore, international operations are subject to other inherent risks, including:

- greater difficulty collecting accounts receivable and longer collection periods;
- difficulties and costs of staffing and managing international operations;
- the impact of differing technical standards outside the United States;
- the impact of recessions in economies outside the United States;
- unexpected changes in regulatory requirements and currency exchange rates;
- certification requirements;
- reduced protection for intellectual property rights in some countries; and
- potentially adverse tax consequences.

IF WE ARE SUBJECT TO UNFAIR HIRING CLAIMS, WE COULD INCUR SUBSTANTIAL COSTS IN DEFENDING OURSELVES.

Companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We may be subject to claims of this kind in the future as we seek to hire qualified personnel. Those claims may result in material litigation. We could incur substantial costs defending ourselves or our employees against those claims, regardless of their merits. In addition, defending ourselves from those types of claims could divert our management's attention from our operations. If we are found to have engaged in unfair hiring practices, or our employees are found to have violated agreements with previous employers, we may suffer a significant disruption in our operations.

WE MAY NEED ADDITIONAL CAPITAL IN THE FUTURE, WHICH MAY NOT BE AVAILABLE TO US, AND IF IT IS AVAILABLE, MAY DILUTE THE OWNERSHIP OF OUR COMMON STOCK.

We may need to raise additional funds through public or private debt or equity financings in order to:

- fund ongoing operations and capital requirements;
- take advantage of opportunities, including more rapid expansion or acquisition of complementary products, technologies or businesses;
- develop new products; or
- respond to competitive pressures.

Any additional capital raised through the sale of equity may dilute an investor's percentage ownership of our common stock. Furthermore, additional financings may not be available on terms favorable to us, or at all. A failure to obtain additional funding could prevent us from making expenditures that may be required to grow or maintain our operations.

OUR STOCK PRICE HAS BEEN AND MAY CONTINUE TO BE VOLATILE.

The market for technology stocks has been and will likely continue to be extremely volatile. The following factors could cause the market price of our common stock to fluctuate significantly:

- loss of any of our major customers;

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- changes in the financial condition or anticipated capital expenditure purchases of any of our major customers;
- the addition or departure of key personnel;
- variations in our quarterly operating results;
- announcements by us or our competitors of significant contracts, new products or product enhancements, acquisitions, distribution partnerships, joint ventures or capital commitments;
- changes in financial estimates by securities analysts;
- sales of common stock or other securities by us or by our stockholders in the future;
- release and sale of shares of common stock currently held in escrow;
- worldwide economic instability; and
- any acquisitions, distribution partnerships, joint ventures or capital commitments.

On November 8, 2001, a securities class action complaint was filed against Sonus, two of its officers and the lead underwriters in connection with our initial public offering. Sonus is in the process of reviewing the complaint and anticipates it will defend this action vigorously. In the past securities class action litigation has often been brought against companies following periods of volatility in the market price of their securities. Securities litigation could result in substantial costs and divert management's attention and resources, which could seriously harm our business.

SALES OF A SUBSTANTIAL AMOUNT OF OUR COMMON STOCK IN THE FUTURE COULD CAUSE OUR STOCK PRICE TO FALL.

Some stockholders who acquired shares prior to our initial public offering or in connection with our acquisition of TTI hold a substantial number of shares of our common stock that have not yet been sold in the public market. Further, additional shares may become available for sale upon the conversion or redemption of convertible subordinated notes.

Sales of a substantial number of shares of our common stock within a short period of time in the future could impair our ability to raise capital through the sale of additional debt or stock and/or cause our stock price to fall.

INSIDERS HAVE SUBSTANTIAL CONTROL OVER US AND COULD LIMIT YOUR ABILITY TO INFLUENCE THE OUTCOME OF KEY TRANSACTIONS, INCLUDING A CHANGE OF CONTROL.

Our executive officers, directors and entities affiliated with them in the

aggregate, beneficially own a significant portion of our outstanding common stock. These stockholders, if acting together, would be able to influence significantly all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

PROVISIONS OF OUR CHARTER DOCUMENTS AND DELAWARE LAW MAY HAVE ANTI-TAKEOVER EFFECTS THAT COULD PREVENT A CHANGE OF CONTROL.

Provisions of our amended and restated certificate of incorporation, our amended and restated by-laws and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not currently use derivative financial instruments. We generally place our marketable security investments in high-quality credit instruments, primarily U.S. Government obligations and corporate obligations with contractual maturities of less than one year. We do not expect any material loss from our marketable security investments and therefore believe that our potential interest rate exposure is not material.

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## PART II--OTHER INFORMATION

### ITEM 1: LEGAL PROCEEDINGS

On November 8, 2001, a purchaser of the Company's common stock filed a complaint in the federal district court for the Southern District of New York against the Company, two of its officers and the lead underwriters alleging violations of the federal securities laws in connection with our initial public offering and seeking unspecified monetary damages. The purchaser seeks to represent a class of persons who purchased the Company's common stock between the offering on May 24, 2000 and December 6, 2000. The complaint alleges that the Company's registration statement contained false or misleading information or omitted to state material facts concerning the alleged receipt of undisclosed compensation by the underwriters and the existence of undisclosed arrangements between underwriters and certain purchasers to make additional purchases in the after market. The claims against the Company are asserted under Section 11 of the Securities Act of 1933 and against the individual defendants under Sections 11 and 15 of that Act. Sonus is in the process of reviewing the complaint and anticipates it will defend this action vigorously.

### ITEM 2: CHANGES IN SECURITIES AND USE OF PROCEEDS

On July 31, 2001, Sonus completed the acquisition of certain intellectual property and other assets of privately-held LinguatEQ Incorporated. Sonus purchased these assets from LinguatEQ and its secured creditors in exchange for 221,753 shares of Sonus common stock and approximately \$382,000 in cash, including acquisition expenses. This transaction was made in reliance on Rule 506 of Regulation D, promulgated under the Securities Act, and Section 4(2) of the Securities Act as a transaction with an accredited investor not involving a public offering.

### ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: None

(b) Reports on Form 8-K:

Sonus filed on August 7, 2001 a Current Report on Form 8-K dated July 31, 2001 with the SEC in connection with the purchase of certain intellectual property and other assets of privately-held LinguatEQ Incorporated.

Sonus filed on October 11, 2001 a Current Report on Form 8-K dated September 26, 2001 with the SEC in connection with its revised business and financial outlook for the third and fourth quarters of fiscal 2001.

### SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 14, 2001

SONUS NETWORKS, INC.

By: /s/ STEPHEN J. NILL

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Stephen J. Nill  
CHIEF FINANCIAL OFFICER, VICE PRESIDENT OF  
FINANCE AND ADMINISTRATION AND TREASURER  
(AUTHORIZED OFFICER AND PRINCIPAL  
FINANCIAL AND ACCOUNTING OFFICER)