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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-K**

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2013
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 001-34115

**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.)

**4 Technology Park Drive, Westford, Massachusetts 01886**  
(Address of principal executive offices, including zip code)

**(978) 614-8100**  
(Registrant's telephone number, including area code)  
Securities registered pursuant to Section 12(b) of the Act:

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**Title of each class**

Common Stock, par value \$0.001

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**Name of each exchange on which registered**

The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer   
(Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the common stock held by non-affiliates of the Registrant was approximately \$529,226,000 based on the closing price for the Common Stock on the NASDAQ Global Select Market on June 28, 2013. As of February 14, 2014, there were 266,388,259 shares of common stock, \$0.001 par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement to be delivered to stockholders in connection with the Registrant's 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

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SONUS NETWORKS, INC.  
FORM 10-K  
YEAR ENDED DECEMBER 31, 2013  
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## Cautionary Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, which are subject to a number of risks and uncertainties. All statements other than statements of historical facts contained in this Annual Report on Form 10-K, including statements regarding our future results of operations and financial position, business strategy, plans and objectives of management for future operations and plans for future product development and manufacturing are forward-looking statements. Without limiting the foregoing, the words "anticipates", "believes", "could", "estimates", "expects", "intends", "may", "plans", "seeks" and other similar language, whether in the negative or affirmative, are intended to identify forward-looking statements, although not all forward looking statements contain these identifying words. Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. We therefore caution you against relying on any of these forward-looking statements. Important factors that could cause actual results to differ materially from those in these forward-looking statements are discussed in Item 1A., "Risk Factors" of Part I and Items 7 and 7A., "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Quantitative and Qualitative Disclosures About Market Risk," respectively, of Part II of this Annual Report on Form 10-K. Also, any forward-looking statement made by us in this Annual Report on Form 10-K speaks only as of the date on which this Annual Report on Form 10-K was first filed. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

References in this Annual Report on Form 10-K to "Sonus," "Sonus Networks," "Company," "we," "us" and "our" are to Sonus Networks, Inc. and its subsidiaries, collectively, unless the context requires otherwise.

## PART I

### Item 1. Business

#### Overview

Sonus helps many of the world's leading communications service providers and enterprises embrace the next generation of Session Initiation Protocol ("SIP")-based solutions, including Voice over Internet Protocol ("VoIP"), video and Unified Communications ("UC") through secure, reliable and scalable Internet Protocol ("IP") networks. With customers around the globe and more than 15 years of experience transforming networks to IP, Sonus enables service providers and enterprises to capture and retain users and generate significant related return on investment. Sonus products include session border controllers ("SBCs"), policy/routing servers, media and signaling gateways and network analytics tools. Sonus products are supported by a global services team with experience in design, deployment and maintenance of some of the world's largest IP networks.

Our solutions enable the delivery of real time communication applications over IP infrastructure with the same performance and quality level historically delivered from legacy voice time-division multiplexing ("TDM") technologies. Our original flagship product, the GSX9000 VoIP softswitch, helped usher in the VoIP revolution by providing a carrier-class IP telephony switch that would support the transition from circuit-switched to IP-based network communications. Other products soon followed, such as the Sonus ASX Feature Server and the Sonus PSX Centralized Routing & Policy Server, that allowed communications service providers to replace high-cost circuit-based and space-consuming network equipment with smaller and more cost-efficient IP-based servers. We leveraged this expertise in managing and scaling large VoIP networks and introduced one of the industry's first SBCs to address the growing need for secure interconnection between private communications networks and the public Internet.

Today we provide communication solutions to service providers and, increasingly, to enterprises that enable them to protect, secure and unify their real time communications infrastructures. Our solutions enable our customers to seamlessly link and leverage multivendor, multiprotocol communications systems and applications across their networks, around the world and in a rapidly changing ecosystem of IP-enabled devices such as smartphones and tablets. Our solutions help our customers realize the intended value and benefits of UC platforms by enabling disparate communications environments, commonplace in most enterprises today, to work seamlessly together. Likewise, Sonus solutions facilitate the evolution to cloud-based delivery of UC solutions.

We have traditionally sold our products principally through global direct sales, with additional sales support from regional channel partners throughout the world. In 2012, we launched an expanded channel partner program, the Sonus Partner Assure Program, to expand our coverage of the service provider and enterprise markets. Our customers include AT&T, Belgacom ICS, BT Group, CenturyLink, COLT, KDDI, Level 3, Orange, Softbank Corporation, TalkTalk, Tata Communications, T-Systems Business Services (a division of Deutsche Telekom Group), Verizon, Vonage and XO Communications.

In concert with the Sonus Partner Assure Program, we enhanced our flagship SBC 5200 to be more enterprise- and channel-centric and launched a new SBC, the SBC 5100, to address the requirements for smaller office and branch office requirements for VoIP and SIP deployments. The acquisition of Network Equipment Technologies, Inc. ("NET") in August 2012 also provided Sonus with strong expertise in the Microsoft Lync market and a presence in the U.S. federal government market. Today, Sonus has more Lync-qualified SBCs than any other vendor. In October 2013 we introduced the industry's first software-based SBC architected with unlimited scalability and advanced features, the Sonus SBC SWe (Software edition). On February 24, 2014, we announced our new Sonus SBC 7000 SBC (the "SBC 7000"), which is designed to address scalability requirements for real-time, multimedia communications with the capability to license up to 150,000 sessions. The SBC 7000 is purpose-built to support emerging services such as high definition ("HD") voice and video, Voice over Long-Term Evolution ("VoLTE") and Rich Communications Services ("RCS").

Our SBC products are the fastest growing segment of our business, addressing the needs of mid- to large-sized enterprises from core infrastructures to branch offices, as well as the full spectrum of communications services providers, both large and small.

On February 19, 2014, we completed the acquisition of Performance Technologies, Incorporated ("PT"), a Delaware corporation. We believe that this acquisition will enable us to expand and diversify our portfolio with an integrated, virtualized

Diameter and SIP-based solution and deliver strategic value to service providers seeking to offer new multimedia services through mobile, cloud-based, real-time communications.

## Industry Background

The single greatest capital cost for telecommunications service providers has been and continues to be their infrastructures. In order to leverage these capital investments and deliver new services like triple-play (voice, television and Internet) bundles, service providers must consolidate their infrastructure from the costly, legacy Public Switched Telephony Network ("PSTN") infrastructures into the more efficient and flexible IP-based network models which we believe are driving their revenue growth objectives. Migrating from the PSTN to IP reduces costs by enabling the consolidation of voice, video and data on a single IP-based networking infrastructure.

The shift from PSTN- to IP-based communications began around 1996 and was driven by the desire of communications service providers to deliver new IP data services to grow their revenue. For most telecommunications service providers, the move to IP-based network communications presumed a strategic, phased migration. This strategy typically involved deploying VoIP-based network equipment to enable the inter-networking between legacy TDM infrastructures and the new IP-based infrastructures. As a result, service providers typically operate hybrid networks that feature a mix of old (TDM) and new (IP/SIP) technology. The interoperability of these technologies introduced several issues, such as security, call control and quality of service requirements, that had to be addressed over a converged IP network that now carried not just data, but voice and multimedia data streams as well. Our original solution portfolio focused almost exclusively on helping telecommunications service providers successfully transition from TDM to all-IP communications while reducing costs and increasing revenue opportunities. As IP-to-IP communications have become more common, our main product focus has naturally shifted from core network switching to SBCs.

While we anticipate that TDM-to-IP interoperability will remain a core requirement of communications networks for many years to come, communications service providers and enterprises face a new generation of potentially disruptive market trends, including cloud-based communications, UC, Bring Your Own Device/Application ("BYOD/A"), Software Defined Networking ("SDN") and Network Functions Virtualization ("NFV"). Although hosted communications have been available for years, hosting them in the cloud represents a unique opportunity for service providers. This is a key trend currently affecting both enterprises and service providers. Local and long-distance voice, video, Interactive Voice Response ("IVR") systems and call recording are just a few examples of applications that are beginning to be delivered in this manner. Another key trend affecting enterprises and service providers is the demand by users for the unification of communication modalities such as voice, instant messaging ("IM"), short message service ("SMS"), video and web-sharing. A third key trend primarily impacts enterprises and their ability to support the explosion of communications devices (e.g., tablets, smartphones, laptops) and third-party applications in the workforce. Another key trend, which is around SDN and NFV, is the decoupling of the network software from the hardware such that certain network functionality, such as the SBC is able to be run as software on commercial, off-the-shelf platforms or, alternatively, can be hosted within other network elements. The primary benefit of this trend for service providers is that it allows them to more rapidly innovate and deploy new applications, service and infrastructure to meet their customers' evolving needs. We believe our SBC and policy solutions are designed to help enterprises and service providers effectively address these trends.

## Network Requirements and the Sonus Solutions

The introduction of the Sonus GSX9000 Open Services Switch helped to change the perception that VoIP was an inferior alternative to the PSTN. That original commitment to quality, found in all of our solutions today, can be summed up in five solution attributes: Reliability, Scalability, Interoperability, Security and Simplicity.

**Reliability.** Communications service providers and enterprises operate complex, mission-critical networks. Our products are designed to offer the highest levels of quality and reliability, including:

- Full redundancy, designed for 5-nine's (99.999%) availability;
- Quality of service equal or superior to the PSTN;
- System hardware designed to comply with Network Equipment Building System ("NEBS") standards Level 3;
- Interworking between numerous signaling and media formats to support multivendor, global networks; and
- Sophisticated security, network monitoring and analytics capabilities.

**Scalability.** Communications service providers and enterprises face challenging scalability requirements, with communications networks that may support tens or even hundreds of thousands of simultaneous sessions. To be economically attractive, new infrastructure investments must compare favorably with existing networks in terms of performance, cost per port, space

occupation, power consumption and cooling requirements. Our products scale simply and cost-effectively from a handful of sessions to hundreds of thousands of simultaneous sessions. In addition, our equipment offers unparalleled density and requires significantly less space, power and cooling compared to legacy systems and is therefore more cost-efficient to operate.

**Interoperability.** New network infrastructure equipment and software must often sustain the full range of network communications standards, supporting both data networking protocols as well as telephony protocols. Infrastructure solutions must also integrate seamlessly with existing operations support systems. Our products are designed to be compatible with a wide range of voice and data networking standards and interfaces, including:

- SS7 and other telephony signaling protocols, including numerous country variants, number translations (e.g., ENUM and DNS) and intelligent services routing;
- Call signaling standards such as SIP and its variants: BICC, MGCP and H.323;
- Narrowband and Wideband media encoding/decoding formats and standards such as G.711 and G.722;
- All bearer interfaces over both packet- and circuit-based bearers such as TDM, Optical and Ethernet;
- Management and accounting interfaces such as Radius, Diameter, SNMP and AMA; and
- Interoperability with enterprise systems including Private Branch eXchanges ("PBXs"), IVR applications and Microsoft Lync Server.

**Security.** IP communications networks must be secure against both internal and external attacks. Our SBCs and other networking products provide robust network security through a variety of methods including endpoint authentication, signaling and media encryption, prevention of denial-of-service (DoS) and distributed DoS attacks, Network Address Translation firewall support and user-defined security policies such as whitelisting and blacklisting.

**Simplicity.** Our products are built on the idea of a simple, flexible architecture that allows communications service providers and enterprises to quickly deploy them individually in specific roles (e.g., as a standalone SBC) or collectively in broader solutions such as international gateways and SIP core networks. This is accomplished through our unique, centralized SIP architecture as well as our commitment to third-party interoperability testing and certification, adherence to industry standards and our industry-leading global services organization.

## Sonus Products

At December 31, 2013, our products included the following:

### **Sonus Session Border Controllers**

Our complete portfolio of SBCs addresses the network requirements for small, medium and large businesses as well as regional and global communications service providers. SBCs are the fastest-growing segment of our business, and today Sonus offers a broad range of SBCs that scale from a handful of SIP sessions to hundreds of thousands of sessions, and collectively represent the largest number of Lync-certified SBCs from any vendor on the market.

We currently offer eight different SBC products:

- **Sonus SBC 1000** for small businesses and branch offices that require performance of up to 160 concurrent SIP sessions in a standalone SBC;
- **Sonus SBC 2000** for mid-size enterprises, branch offices and regional Points of Presence ("PoPs") that require performance of up to 600 concurrent SIP sessions in a standalone SBC;
- **Sonus SBC 5100/5110** for enterprises and service providers that require performance of up to 10,000 concurrent SIP sessions in a standalone SBC;
- **Sonus SBC 5200/5210** for enterprises and large national/global service providers that require performance of up to 64,000 concurrent SIP sessions in a standalone SBC;
- **Sonus SBC 9000** for large enterprises and service providers that require a hybrid gateway/SBC solution for a mix of TDM and IP voice traffic;
- **SBC VX**, a hybrid solution sold to the U.S. government and its agencies;
- **Sonus SBC SWe (Software edition)**, a software-based SBC for virtual environments, remote deployments and instances where virtualized software-based implementations are required; and
- **Sonus SBC 7000** for real-time, multimedia communications with the capability to license up to 150,000 sessions.

### **Sonus GSX9000 Open Services Switch and Sonus GSX4000 Open Services Switch**

The Sonus GSX9000 Open Services Switch, or the GSX9000, bridges IP and TDM networks by converting any type of voice signal into IP packets and transmitting those IP packets over a data network. It then converts whatever type of signal is

necessary to be deposited back onto non-IP networks and delivers such signal to its intended destination. The GSX9000 is designed to deliver voice quality that is equal or superior to that of the legacy circuit-switched public network. Further, it supports multiple voice encoding schemes used in circuit switches and delivers a number of other voice compression algorithms. The GSX9000 scales to very large configurations, such as those required by large national service providers. A single GSX9000 shelf can support up to 22,000 simultaneous calls, while a single GSX9000 in a multiple-shelf configuration can support 100,000 or more simultaneous calls. The GSX9000 also operates with our PSX Policy & Routing Server and with softswitches and network products offered by other vendors. The Sonus GSX4000 Open Services Switch allows service providers and enterprises to realize the benefits of the GSX9000 in a smaller form factor.

### **Sonus PSX Policy & Routing Server**

The Sonus PSX Policy & Routing Server, or the PSX, is the central routing and policy engine for our softswitch and distributed SBC solutions. The PSX plays an integral role in many of our network deployments, and provides both the call routing intelligence and policy intelligence for SIP sessions across the network. The PSX is unique in that it can act as a central control and provisioning point for hundreds of switches or SBCs, resulting in significant operational savings for our customers. The PSX is based upon a modular architecture that is designed for high performance and scalability, as well as interoperability with third-party gateways, devices and services. The PSX is an all-IP component and can perform most IP-based database lookups natively. The core PSX platform is also extensible through applications to address solutions such as Least Cost Routing, Number Portability and Breakout Gateway Control Functions (for hybrid IP Multimedia Subsystem networks).

### **Sonus Network Management Solutions**

We offer our customers a variety of products to help manage and integrate our networked solutions with internal provisioning and billing systems, including:

- **Sonus NetScore** network performance analysis tool, which provides a real-time assessment of the state of a service provider's or enterprise's network, including quality of service, call delay, network effectiveness, congestion and efficiency;
- **Sonus Element Management System** for centralized management and provisioning of Sonus network elements; and
- **Sonus DataStream Integrator** for integration of call detail records with back-office billing and accounting systems.

### **Sonus Global Services**

Sonus Global Services offers professional consulting and services that support our industry-leading IP communications solutions. Through a wide range of service offerings, our consultants provide the skill and expertise to help communications service providers and enterprises transform their communications networks, from network engineering and design through network integration and commissioning to network operations. These service offerings accelerate our customers' return on investment, optimize their operational capability, enhance their network's performance and health, and help them generate new revenue. In addition to end-to-end design, integration and deployment services, our Global Services team offers customized engagements, training workshops, interoperability/verification testing and around-the-clock technical support worldwide.

The Sonus Global Services team is an important part of our success, providing our customers with:

- A full-service portfolio including consulting, integration, deployment, migration and operation support services;
- Global reach through our worldwide service organization and partner presence in all major global markets;
- Program managers who use a disciplined methodology for all deployment and integration projects; and
- Consistent execution in the design, deployment and support of the world's largest and most advanced networks.

In addition to global solution support teams, at December 31, 2013, Sonus Global Services maintained regional technical assistance centers located in Westford (Massachusetts), Tokyo and Prague and had customer test and support centers located in Richardson, Texas and Bangalore, India.

### **Sonus Market Strategy**

Sonus sees opportunity in the cloud as enterprise-based UC infrastructures move to being delivered from cloud-based delivery infrastructures. The trend toward cloud-based communications is driven by many market factors and requires infrastructure investment by the enterprises who buy cloud services as well as the communications service providers who deliver cloud services. Our SBCs, installed in service provider networks, enable service providers to deliver high quality real time communication services when delivered across and between multiple service provider infrastructures. Additionally, our SBCs, installed at the edge of service providers' networks, allow service providers to securely and seamlessly deliver consolidated voice and data services to enterprises through SIP trunking services.



We expect that communications service providers will look to a variety of ways to monetize their SIP trunking services by offering new cloud services, including hosted and managed UC infrastructure and applications. We also anticipate that service providers will expand their cloud-based real time communication services, further driving a need for SIP-based infrastructure equipment. We are partnering with companies such as BroadSoft whose products allow service providers to increase their cloud application offerings while using our SBCs and our policy solutions to facilitate the integration of their networks and offerings.

We currently sell our SBCs to enterprise customers for use at both the core and the edge of their networks, which allows them to set up a secure IP network with their service providers consolidate dial plans and routing services and enable evolution of their legacy PBX infrastructures. In adopting cloud-based services, we expect that enterprises will continue to leverage their premise-based assets (e.g., PBXs) and, as such, will continue to need strong interworking and policy management to enable the cloud- and premise-based components to work together seamlessly. We believe that enterprises are also seeking to enable UC solutions in their networks and Microsoft Lync to continue to increase their communications productivity. Sonus currently offers the broadest portfolio of Lync-qualified SBCs to enable enterprises to integrate Lync with existing PBXs or even facilitate the migration from a PBX to Lync. Additionally, we have strong certified channel partners that continue to support customers' migrations to Lync.

We plan to continue developing new solutions internally and through partnerships that allow our customers to stay ahead of the rapid technology shifts in the communications industry. Following are some key principles driving our product evolution:

***Expand our solutions to address emerging IP-based markets, such as session border control.*** The transformation of legacy TDM networks to all-IP networks has created requirements for security, peering and media manipulation as well as an opportunity for creating IP-to-IP services at the network edges. The requirements for security and peering go far beyond the legacy functionality of SBCs and include not only the operator's requirements for a border gateway to other IP networks, but also a wide variety of requirements associated with the need for enterprises to control their own IP networks. The multimedia nature of these emerging services also provides an opportunity for us to create innovative services at the edge of the network, both individually and with the help of partners such as BroadSoft, F5 and Juniper Networks. The evolution of our SBC product family empowers operators to address all of the above requirements and enables them to create unique IP-IP services.

***Expand and broaden our customer base by targeting specific market segments, such as enterprises and wireless operators.*** We plan to penetrate additional customer segments and believe that new and incumbent service providers will build out their VoIP infrastructures at different rates. The next-generation communications service providers, who are relatively unencumbered by legacy equipment, have been initial purchasers of our equipment and software. Other newer entrants, including wireless operators, cable operators and Internet service providers, or ISPs, have also been early adopters of certain of our products. Moreover, incumbents, including interexchange carriers, regional Bell operating companies and international operators, are adopting packet voice technologies. Large enterprises are often operating voice networks as complex as a small to mid-sized service provider, and believe that our products are a good match for their needs for secure, reliable and scalable communication. We also expanded our SBC portfolio with several products in 2012, which are designed with the needs of the small and medium business customer in mind.

***Expand our global sales, marketing, support and distribution capabilities.*** As a primary supplier of network infrastructure solutions to Tier 1 service providers (a service provider that can reach every other network on the Internet without purchasing IP transit), we require a strong worldwide presence. We have an established sales presence throughout North America, Europe, Asia/Pacific, the Middle East, Africa, and Central/South America. We augment our global direct sales force by working with international partners in key markets around the world. In 2013, we expanded our partner program, the Sonus Partner Assure Program, into a two-tiered structure to better support our growing and diverse community of SBC channel resellers. As of December 31, 2013, we had 286 partners enrolled in the Sonus Partner Assure Program worldwide.

***Leverage our technology leadership to attract and retain key communications service providers.*** As one of the first companies to offer carrier-class IP network solutions, we have worked with many of the world's leading communications service providers to help them develop their next-generation, IP-based multimedia networks. We expect service providers to select vendors that deliver leading technology and can maintain that technology leadership. We believe that our solutions are an integral part of our customers' network architecture and we will continue to help these customers move forward as their networks grow and evolve. By working closely with leading service providers, we gain valuable knowledge about their requirements, and we will continue to use this knowledge to enhance our existing products and create new products that address the most important requirements of network operators globally.



## Sonus Customers

In 2012, we saw a significant increase in the number of enterprise customers and the number of SBCs sold as a percentage of our total solutions revenue, and this increase continued throughout 2013. Our SBC product revenue was \$97.4 million in 2013, \$67.6 million in 2012 and \$37.9 million in 2011, representing increases of 44.1% in 2013 compared to 2012 and 78.6% in 2012 compared to 2011.

To date, our solutions are deployed in many of the world's leading service provider and enterprise networks, including AT&T, Belgacom, BT Group, Cable & Wireless, CenturyLink, CITIC 1616, Global Crossing, KDDI, KVH, Level 3, NTT Communications, Orange Business Services, Softbank Corporation, TalkTalk, T-Systems Business Services (a division of Deutsche Telekom Group), Verizon and XO Communications.

The table below provides information regarding our customers who accounted for 10% or more of our revenue for the years ended December 31, 2013, 2012 and 2011:

	Year ended December 31,		
	2013	2012	2011
Bahamas Telecommunications Company Ltd.	*	*	14%
AT&T	15%	20%	12%

\* Represents less than 10% of revenue.

## Sales and Marketing

We sell our products principally through a direct sales force and, in some markets, through or with the assistance of distributors and resellers such as AT&T, Arrow S3, Dimension Data, Nissho Electronics Corporation (Japan), Orange Business Systems, ScanSource, TSG, Sumitomo Corporation (Japan), Verizon and Westcon. In 2012, we established our channel partner program, Sonus Partner Assure, to serve particular markets and provide our customers with opportunities to purchase our products in combination with related services and products. In 2013, we continued to add partners to our Sonus Partner Assure Program.

## Product Research and Development

We believe that strong product development capabilities are essential to our strategy of enhancing our core technology, developing additional applications, incorporating that technology into new products and maintaining comprehensive product and service offerings. Our research and development process leverages innovative technology in response to market data and customer feedback. In 2012, we introduced differentiated products to address market and customer needs, including the Sonus SBC 5100 Session Border Controller. In addition, we completed the acquisition of Network Equipment Technologies, Inc. (NET) and have incorporated their SBC products into our product SBC portfolio as the Sonus SBC 1000 and the Sonus SBC 2000. In 2013, we introduced the first software-based SBC to feature advanced capabilities and unlimited scalability, the Sonus SBC SWe (Software edition).

We have assembled a team of highly skilled engineers with significant telecommunications and networking industry experience. Our engineers have experience in and with leading wireline and wireless telecommunications equipment suppliers, computer data networking and multimedia companies. Our engineering effort is focused on SBC product development, new applications and network access features for enterprises, solutions to support Unified and cloud-based communications services and next-generation wireless technologies. At December 31, 2013, we maintained research and development offices in Massachusetts, California and New Jersey in the United States; Bangalore, India and Swindon, United Kingdom. We have made, and intend to continue to make, a substantial investment in research and development.

Our research and development expenses were \$69.6 million for the year ended December 31, 2013, \$67.3 million for the year ended December 31, 2012 and \$64.4 million for the year ended December 31, 2011.

## Competition

The market for voice and multimedia network equipment remains competitive worldwide, but there are historical regional differences in services, regulations and business practices among sub-markets that can benefit individual vendors. Regardless of the region, the overall market is subject to rapid technological change, affected by new product introductions, changing customer demands, industry consolidation and other market activities of industry participants. To compete effectively, we must

deliver innovative products that are easy to use and deploy, provide extremely high reliability and quality, scale easily and efficiently, interoperate with existing network infrastructures and multivendor solutions, provide effective network management, are accompanied by comprehensive customer support and professional services, provide a cost-effective and space-efficient solution for enterprises and service providers and meet price competition from low-cost equipment providers. We expect competition to persist and intensify in the future. Our primary sources of competition include vendors of networking and telecommunications equipment, such as AudioCodes Ltd., Cisco Systems, Inc., Ericsson LM Telephone Company, GENBAND Inc., Huawei Technologies Co. Ltd., Metaswitch and Oracle Corp. (who acquired Acme Packet, Inc. in 2013).

Although we believe we compete favorably because our solutions are widely deployed, highly scalable and cost-effective for our customers, some of our competitors have broader product portfolios than we have and are able to devote greater resources to the development, promotion, sale and support of their products. In addition, some of these competitors have more extensive customer bases and broader customer relationships than we have, including relationships with our potential customers and established relationships with distribution partners. Other smaller private and public companies are also focusing on similar market opportunities.

## **Intellectual Property**

Intellectual property is fundamental to our business and our success, and we depend upon our ability to develop, maintain and protect our technology. Therefore, we seek to safeguard our investments in technology and rely on a combination of United States and foreign patent, trademark, trade secret and copyright law and contractual restrictions to protect the proprietary aspects of our technology and to defend us against claims from others. Our general policy has been to seek to patent those patentable inventions that we expect to incorporate in our products or that we expect will be valuable otherwise. We have a program to file applications for and obtain patents, copyrights and trademarks in the United States and in specific foreign countries where we believe filing for such protection is appropriate.

At December 31, 2013, we held 110 U.S. patents with expiration dates ranging from May 2014 through October 2031, and had 29 patent applications pending in the United States. While we have one patent that is set to expire within the next two years, the expiration of this individual patent is not expected to have a material effect on our financial position or future operations since this patent does not relate to our current business strategy and therefore is not of material value to us. In addition, at December 31, 2013, we held 33 foreign patents with expiration dates ranging from June 2019 through October 2027, and had 17 patent applications pending abroad. We also have a number of registered trademarks in the United States, including Sonus, the Sonus logo, GSX9000, NetAssure, NetEng, NetScore, Promina and Tenor and have one pending trademark application in the United States. In addition to the protections described above, we seek to safeguard our intellectual property by:

- Protecting the source and object code for our software, documentation and other written materials under copyright laws and trade secret;
- Licensing our software pursuant to signed license agreements, which impose restrictions on others' ability to use our software; and
- Seeking to limit disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements.

We have incorporated third-party licensed technology into certain of our current products. From time to time, we may be required to license additional technology from third parties to develop new products or to enhance existing products. Based on experience and standard industry practice, we believe that licenses to use third-party technology generally can be obtained on commercially reasonable terms. Nonetheless, there can be no assurance that necessary third-party licenses will be available or continue to be available to us on commercially reasonable terms. As a result, the inability to maintain, license 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 enhance existing products could require us to obtain substitute technology of lower quality or performance standards or at greater cost. This could delay or prevent us from making these products or enhancements, any of which could seriously harm our business, financial condition and operating results.

Please see generally the risks that are more fully discussed in "Item 1A. Risk Factors" for risks related to our intellectual property.

## **Manufacturing**

As of December 31, 2013, we outsourced the manufacturing of our products to three manufacturers. Our contract manufacturers provide comprehensive manufacturing services, including assembly and testing of our products and procurement

of component materials on our behalf. We believe that outsourcing our manufacturing enables us to preserve working capital, allows for greater flexibility in meeting changes in demand and enables us to be more responsive in delivering products to our customers. At present, we purchase products from our contract manufacturers on a purchase order basis.

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.

Please see generally the risks that are more fully discussed in “Item 1A. Risk Factors” for risks related to our manufacturing operations.

### Backlog

We sell products and services pursuant to purchase orders issued under master agreements that provide standard terms and conditions that govern the general commercial terms and conditions of the sale. These agreements typically do not obligate customers to purchase any minimum or guaranteed quantities, nor do they generally require upfront cash deposits. At any given time, we have orders for products that have not yet been shipped and for services (including our customer support obligations) that have not yet been performed. We also have orders relating to products that have been delivered and services that have been performed but have not yet been accepted by the customer under the applicable purchase terms. We include both of these situations in our calculation of backlog. A backlogged order may not result in revenue in the quarter in which it was booked, and the actual revenue recognized in a quarter may not equal the total amount of related backlog. Therefore, we do not believe that our backlog, as of any particular date, is necessarily indicative of actual revenue for any future period. In addition, we expect to derive a greater percentage of our revenue in the future from the enterprise market and through sales channels where speed of fulfillment is essential to winning business. Consequently, we expect to derive a lower percentage of our business from large service provider orders that are delivered over multiple quarters and years and we expect our backlog to decrease as a result. Our backlog was approximately \$115 million at December 31, 2013 and approximately \$152 million at December 31, 2012.

### Employees

At December 31, 2013, we had a total of 1,059 employees. Our employees are not represented by any collective bargaining agreement. We believe our relations with our employees are good.

### Geographic and Segment Information

We operate in a single segment. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, our chief operating decision maker has made such decisions and assessed performance at the company level, as one segment. Our chief operating decision maker is our President and Chief Executive Officer.

Our classification of revenue by geographic area is determined by the location of our customers. The following table summarizes revenue by geographic area as a percentage of total revenue:

	Year ended December 31,		
	2013	2012	2011
United States	69%	68%	60%
Europe, Middle East and Africa	12	13	12
Japan	12	14	11
Other Asia Pacific	5	4	2
Other	2	1	15
	<u>100%</u>	<u>100%</u>	<u>100%</u>

Information regarding the geographic components of our property and equipment is provided in Note 8 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

### Additional Information

We were incorporated in August 1997 as a Delaware corporation. Our principal executive offices are located at 4 Technology Park Drive, Westford, MA 01886. Our telephone number at our principal executive offices is 978-614-8100.

This Annual Report on Form 10-K, as well as all other reports filed with or furnished to the United States Securities and Exchange Commission (the "SEC"), are available free of charge through our Internet site (<http://www.sonus.net>) once we electronically file such material with, or furnish it to, the SEC. Information found on our website is not part of this report or any other report we file with or furnish to the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

## Item 1A. Risk Factors

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below before buying our common stock. If any of the following risks actually occurs, our business, financial condition, results of operations and cash flows could be materially adversely affected, the trading price of our common stock could decline materially and you could lose all or part of your investment.*

***Our quarterly revenue and operating results are unpredictable and may fluctuate significantly from quarter to quarter, which could adversely affect our business, consolidated financial statements and the trading price of our common stock.***

Our revenues and operating results may 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. The primary factors that may affect our revenues and operating results include but are not limited to the following:

- consolidation within the telecommunications industry, including acquisitions of or by our customers;
- general economic conditions in our markets, both domestic and international, as well as the level of discretionary IT spending;
- competitive conditions in our markets, including the effects of new entrants, consolidation, technological innovation and substantial price discounting;
- fluctuation in demand for our voice infrastructure products and services, and the timing and size of customer orders;
- fluctuations in foreign exchange rates;
- cancellation or deferral of existing customer orders or the renegotiation of existing contractual commitments;
- mix of product configurations sold;
- length and variability of the sales cycle for our products;
- application of complex revenue recognition accounting rules to our customer arrangements;
- timing of revenue recognition;
- changes in our pricing policies, the pricing policies of our competitors and the prices of the components of our products;
- market acceptance of new products, product enhancements and services that we offer;
- the quality and level of our execution of our business strategy and operating plan, and the effectiveness of our sales and marketing programs;
- new product announcements, introductions and enhancements by us or our competitors, which could result in deferrals of customer orders;
- our ability to develop, introduce, ship and successfully deliver new products and product enhancements that meet customer requirements in a timely manner;
- our reliance on contract manufacturers for the production and shipment of our hardware products;
- our or our contract manufacturers' ability to obtain sufficient supplies of sole or limited source components or materials;
- our ability to attain and maintain production volumes and quality levels for our products;
- variability and unpredictability in the rate of growth in the markets in which we compete;
- costs related to acquisitions; and
- corporate restructurings.

Equipment purchases by communications service providers and enterprises have become increasingly unpredictable given the current economic conditions. Additionally, as with other telecommunications product suppliers, we typically recognize a portion of our revenue in a given quarter from sales booked and shipped in the last weeks of that quarter. As a result, delays in customer orders may result in delays in shipments and recognition of revenue beyond the end of a given quarter. Additionally,

it can be difficult for us to predict the timing of receipt of major customer orders, and we are unable to control timing decisions made by our customers. As a result, our quarterly operating results are difficult to predict even in the near term and a delay in an anticipated sale past the end of a particular quarter may negatively impact our results of operations for that quarter, or in some cases, that year. Therefore, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. If our revenue or operating results fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, the price of our common stock could decline substantially. Such a stock price decline could also occur when we have met our publicly stated revenue and/or earnings guidance.

A significant portion of our operating expenses is fixed in the short term. If revenues for a particular quarter are below expectations, we may not be able to reduce costs and expenses proportionally for that quarter. Any such revenue shortfall would, therefore, have a significant effect on our operating results for that quarter.

***We have incurred net losses and may incur additional net losses.***

We incurred net losses in 2013 as well as in 2012 and 2011. We may incur additional net losses in future quarters and years. Our revenues may not grow and we may never generate sufficient revenues to sustain profitability.

***We will not be successful if we do not grow our customer base, especially since our revenue has historically been generated from a limited number of customers and the per-order revenue from orders placed by the majority of our new customers is generally lower than the per-order revenue generated from our historical sales. Additionally, if we are unable to generate recurring business from our existing customers, our consolidated financial statements could be materially and adversely affected.***

Prior to our acquisition of NET on August 24, 2012, we had shipped our products to a limited number of customers. In connection with our acquisition of NET, we began selling the SBC 1000 (formerly the NET UX 1000), the SBC 2000 (formerly the NET UX 2000) and the SBC VX, a hybrid solution (formerly the NET VX). The SBC 1000 provides SBC SIP communication capability to the enterprise branch and small and medium businesses, while the SBC 2000 provides SBC SIP communications capability to the enterprise branch and medium to large businesses. The SBC VX is sold to small, medium and large enterprises that require a hybrid solution. Since the acquisition of NET, the number of customers to whom we have shipped our products has increased significantly. However, due to the nature of the former NET products, in general, the per-order revenue from orders placed by the majority of our new customers is lower than the per-order revenue generated from our historical sales.

Our future success will depend on our ability to attract additional customers beyond our current customer base. In 2013 and 2012, one customer, AT&T, contributed more than 10% of our revenue, representing approximately 15% of our revenue in 2013 and 20% of our revenue in 2012. In 2011, two customers, Bahamas Telecommunications Company Ltd. and AT&T, each contributed more than 10% of our revenue, representing approximately 26% of our revenue in the aggregate. Factors that may affect our ability to grow our customer base include the following:

- economic conditions that discourage potential new customers from making the capital investments required to adopt new technologies;
- deterioration in the general financial condition of service providers and enterprises, or their ability to raise capital or access lending sources; and
- new product introductions by our competitors.

If we are unable to expand our customer base, we will be forced to rely on generating recurring revenue from existing customers, which may not be successful. We expect to derive an increasing percentage of our revenue from engagements with our distribution, value-added resellers ("VAR") and systems integration partners; however, in the foreseeable future, the majority of our revenue will continue to depend on sales of our products to a limited number of existing customers or sales to customers with lower per-order revenue than those generated from our historical sales. Factors that may affect our ability to generate recurring revenues from our existing customers include the following:

- customer willingness to implement our new voice infrastructure products;
- acquisitions of or by our customers;
- delays or difficulties that we may incur in completing the development and introduction of our planned products or product enhancements;
- failure of our products to perform as expected; and
- difficulties we may incur in meeting customers' delivery requirements.

The loss of any significant customer or any substantial reduction in purchase orders from these customers could materially and adversely affect our consolidated financial statements.

***We continue to enhance our sales strategy, which we expect will include more significant engagements with distribution, value-added resellers and systems integration partners to resell our products. Disruptions to, or our failure to effectively develop and manage, these partners and the processes and procedures that support them could adversely affect our ability to generate revenues from the sale of our products. If we do not have adequate personnel, experience and resources to manage the relationships with these partners and to fulfill our responsibilities under such arrangements, such shortcomings could lead to the decrease of the sales of our products and our operating results could suffer.***

We continue to enhance our sales strategy, which we expect will include more significant engagements with distribution and VAR channel partners to resell our products. In addition, some of our target customers, including the U.S. federal government, rely on systems integrators to incorporate new equipment or services into their networks. Our future success is dependent upon establishing and maintaining successful relationships with a variety of value-added distribution, VAR and systems integration partners. While we have begun the process of identifying and entering into agreements with software application, system integrator and OEM or resale partners, we will need to increase our engagement with such partners for us to be successful. We may also need to pursue strategic partnerships with vendors who have broader technology or product offerings in order to compete with end-to-end solution providers. In addition, many of the enterprise markets we are pursuing require a broad network of resale partners in order to achieve effective distribution.

Many of our distribution and channel partners sell competitive products and the loss of, or reduction in sales by, these partners could materially reduce our revenues. Our sales through channel partners typically involve the use of our products as components of a larger solution being implemented by the systems integrator. In these instances, the purchase and sale of our products are dependent on the channel partner, who typically controls the timing, prioritization and implementation of the project. Project delays, changes in priority or solution re-design decisions by the systems integrator can adversely affect our product sales. If we fail to maintain relationships with our distribution, VAR and systems integration partners; fail to develop new relationships with other partners in new markets; fail to manage, train or provide incentives to our existing partners effectively or if these partners are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer. Moreover, if we do not have adequate personnel, experience and resource to manage the relationships with our partners and to fulfill our responsibilities under such arrangements, any shortcomings could have a material adverse impact on our business and consolidated financial statements.

In addition, we recognize some of our revenue based on a sell-through model using information provided by our partners. If those partners provide us with inaccurate or untimely information, the amount or timing of our revenues could be adversely affected. We may also experience financial failure of our partners, which could result in our inability to collect accounts receivable in full.

***In 2012, the macro-environment for our media gateway trunking business faced significant declining revenues that happened faster than we were anticipating. In 2013, we continued to experience significant declines in customer spending in our media gateway trunking business. Even though we continue to transform our company from a media gateway trunking business to an SBC business, we remain dependent upon our voice infrastructure products, and our revenues will continue to depend upon their commercial success for the foreseeable future. If the market for these products continues to significantly decline and if our SBC sales do not accelerate as quickly as we forecast, our operating results could suffer.***

While we continue to transform our company from a media gateway trunking business to an SBC business, our current revenues still depend upon the commercial success of our TDM-to-IP and our all-IP voice infrastructure products and solutions, and we believe this will remain true for the foreseeable future. Product revenue from sales of our trunking and communications applications products was \$69.8 million for the year ended December 31, 2013, \$85.7 million for the year ended December 31, 2012 and \$116.5 million for the year ended December 31, 2011, which represented decreases of 18.5% in year 2013 compared to 2012 and 26.4% in 2012 compared to 2011. If the market for these products continues to significantly decline and if our SBC sales do not accelerate as quickly as we forecast, our operating results could suffer.

***As the telecommunications industry and the requirements of our current and potential customers evolve, we are redirecting certain of our resources to more readily respond to the changing environment through the research and development of innovative new products and the improvement of existing products. If our strategic plan is not aligned with the direction our customers take as they invest in the evolution of their networks, customers may not buy our products or use our services.***

Success in our industry requires large investments in technology and creates exposure to rapid technological and market changes. We spend a significant amount of time, money and resources developing new technology, products and solutions.

Our strategic plan includes a significant shift in our investments from mature technologies that previously generated significant revenue for us toward certain next-generation technologies as well as working with more channel partners to sell our products. In order for us to be successful, our technologies, products and solutions must be accepted by relevant standardization bodies and by the industry as a whole. Our choices of specific technologies to pursue, and those to de-emphasize, may prove to be inconsistent with our customers' investment spending. Moreover, if we invest in the development of technologies, products and solutions that do not function as expected, are not adopted by the industry, are not ready in time, are not accepted by our customers as quickly as anticipated or are not successful in the marketplace, our sales and earnings may suffer and, as a result, our stock price could decline. As technology advances, we may not be able to respond quickly or effectively to developments in the market for our products, or new industry standards may emerge and could render our existing or future products obsolete. If our products become technologically obsolete or if we are unable to develop successor products that are accepted by our customers, we may be unable to sell our products in the marketplace and face declines in sales. We may also 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.

***Restructuring activities could adversely affect our ability to execute our business strategy.***

In August 2012, we announced that we were implementing a restructuring initiative to streamline operations and reduce our operating costs. In connection with this action, we recorded restructuring expense of \$13.1 million in the aggregate in 2013 and 2012, comprised of \$4.4 million for the consolidation of certain facilities, \$8.4 million for severance and related costs and \$0.3 million for the write-off of assets associated with the headcount reduction and facilities consolidations. This restructuring and any future restructurings, should it become necessary for us to continue to restructure our business due to worldwide market conditions or other factors that reduce the demand for our products and services, could adversely affect our ability to execute our business strategy in a number of ways, including through:

- loss of key employees;
- diversion of management's attention from normal daily operations of the business;
- diminished ability to respond to customer requirements related to both products and services;
- decrease in cash and profits related to severance payments and facility termination costs;
- disruption of our engineering and manufacturing processes, which could adversely affect our ability to introduce new products and to deliver products both on a timely basis and in accordance with the highest quality standards; and/or
- reduced ability to execute effectively internal administrative processes, including the implementation of key information technology programs.

***If we fail to realize the anticipated benefits from our acquisition of Performance Technologies, Incorporated on a timely basis, or at all, our business and financial condition may be adversely affected.***

We may fail to realize the anticipated benefits from our acquisition of Performance Technologies, Incorporated ("PT") on a timely basis, or at all, for a variety of reasons, including the following:

- problems or delays in assimilating or transitioning to Sonus the acquired operations, systems, processes, controls, technologies, products or personnel;
- loss of acquired customer accounts;
- unanticipated costs associated with the acquisition;
- failure to identify in the due diligence process or assess the magnitude of certain liabilities we are assuming in the acquisition, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits, significant issues with product quality or development or other adverse effects on our business or consolidated financial statements;
- multiple or overlapping product lines as a result of the acquisition that are offered, priced and supported differently, which could cause customer confusion and delays;
- higher than anticipated costs in continuing support and development of acquired products;
- diversion of management's attention from our core business and the challenges of managing larger and more widespread operations from the acquisition;
- adverse effects on existing business relationships of Sonus or PT with respective suppliers, licensors, contract manufacturers, customers, distributors, resellers and industry experts;
- significant impairment, exit and/or restructuring charges if the products or technologies acquired in the acquisition do not meet our sales expectations or are unsuccessful;
- insufficient revenue to offset increased expenses associated with the acquisition;
- risks associated with entering markets in which we have no or limited prior experience;
- potential loss of PT's or our own employees; and/or



- failure to properly integrate internal controls and financial systems of the combined companies.

If we are not able to successfully manage these issues, the anticipated benefits and efficiencies of the PT acquisition may not be realized fully or at all, or may take longer to realize than expected, and our ability to compete, our revenue and gross margins and our results of operations may be adversely affected.

***The acquisition of PT may result in restructuring charges that could adversely affect the financial results of the combined company.***

The financial results of Sonus and PT as a combined company may be adversely affected by cash expenses and non-cash accounting charges incurred in connection with the combination. The amount and timing of these possible charges are not yet known. The price of our common stock could decline to the extent the combined company's financial results are materially affected by these charges.

***Any future investments or acquisitions we make could be difficult to integrate, disrupt our business, dilute shareholder value and seriously harm our financial condition.***

We are not currently a party to any material pending acquisition agreements. However, we may acquire additional businesses, products or technologies in the future. Acquisitions are inherently risky and no assurance can be given that our future acquisitions will be successful or will not materially and adversely affect our business, operating results or financial condition. We expect to continue to review opportunities to acquire other businesses or technologies that would add to our existing product line, complement and enhance our current products, expand the breadth of our markets, enhance our technical capabilities or otherwise offer growth opportunities. If we make further acquisitions, we could, among other things:

- issue stock that would dilute existing stockholders' percentage ownership;
- incur debt or assume liabilities;
- reduce significantly our cash and investments;
- incur significant impairment charges related to the write-off of goodwill and intangible assets;
- incur significant amortization expenses related to intangible assets; and/or
- incur large and immediate write-offs for in-process research and development and stock-based compensation.

Mergers and acquisitions are inherently risky and subject to many factors outside of our control, and we cannot be certain that we would be successful in overcoming problems in connection with our past or future acquisitions. Our inability to do so could significantly harm our business, revenues, and results of operations.

***Worldwide efforts to contain capital spending, general uncertainty as to continued economic growth during the current post-recessionary global economy, the possibility of another recession and a continued weakened global economy could have a material adverse effect on us.***

One factor that significantly affects our operating results is the impact of economic conditions on the willingness of our current and potential customers to make capital investments. Given the general uncertainty as to continued economic growth during the current post-recessionary global economy, we believe that customers continue to be cautious about sustained economic growth and have tried to maintain or improve profitability through cost control and constrained capital spending, which places additional pressure on IT departments to demonstrate acceptable return on investment. Some of our current or prospective customers may cancel or delay spending on the development or roll-out of capital and technology projects with us due to the continuing economic uncertainty and, consequently, our results of operations may be adversely affected. In addition, the current uncertain worldwide economic environment and fragile financial markets make it increasingly difficult for us, our customers and our suppliers to accurately forecast future product demand, which could result in an inability to satisfy demand for our products and a loss of market share. Our revenues are likely to decline in such circumstances and our profit margins could erode, or we could incur significant losses.

Moreover, economic conditions worldwide may continue to contribute to slowdowns in the communications and networking industries, as well as to specific segments and markets in which we operate, resulting in:

- reduced demand for our products as a result of our customers choosing to refrain from building capital intensive networks;
- increased price competition for our products, not only from our competitors, but also as a consequence of customers disposing of unutilized products;
- risk of excess and obsolete inventories;

- excess facilities and manufacturing capacity; and/or
- higher overhead costs as a percentage of revenue and higher interest expense.

Continuing turmoil in the geopolitical environment in many parts of the world, including terrorist activities and military actions, particularly the continuing tension in Southeast Asia, the Middle East and Africa, as well as political and economic issues in Europe continue to put pressure on global economic conditions. Our operating results and our ability to expand into other international markets may also be affected by changing economic conditions particularly germane to that sector or to particular customer markets within that sector.

***If we fail to compete successfully against telecommunications equipment and networking companies, our ability to increase our revenues and achieve profitability will be impaired.***

Competition in the telecommunications market is intense. This market has historically been dominated by large incumbent telecommunications equipment companies, such as Ericsson LM Telephone Company and Huawei Technologies Co. Ltd., all of which are our direct competitors. We also face competition from other telecommunications and networking companies, including AudioCodes Ltd., Cisco Systems, Inc., GENBAND Inc., Metaswitch and Oracle Corporation, that design competing products. These or other competitors may also merge, intensifying competition. Additional competitors with significant financial resources may enter our markets and further intensify competition.

Many of our current and potential competitors have significantly greater selling and marketing, technical, manufacturing, financial and other resources than we have. Further, some of our competitors sell significant amounts of other products to our current and prospective customers and have the ability to offer lower prices to win business. 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 quality;
- deploy and scale easily and efficiently;
- interoperate with existing network infrastructures and multivendor solutions;
- provide effective network management;
- are accompanied by comprehensive customer support and professional services;
- provide a cost-effective and space efficient solution for service providers; and
- meet price competition from low cost equipment providers.

If we are unable to compete successfully against our current and future competitors, we could experience price reductions, order cancellations, loss of customers and revenues, and our operating results could be adversely affected.

***If we do not anticipate and meet specific customer requirements or if our products do not interoperate with our customers' existing networks, we may not retain current customers or attract new customers.***

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 if we fail 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 canceled, which would seriously harm our gross margins and result in loss of revenues or customers. Additionally, our customers may decide to devote a significant portion of their budgets to evolving technology as they consider national or worldwide build-outs. Therefore, if the demand for our products is not strong and if our target customers do not adopt, purchase and successfully deploy our current or planned products, our revenues will not grow.

***Our large customers have substantial negotiating leverage, and they may require that we agree to terms and conditions that may have an adverse effect on our business.***

Large communications service providers have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may, among other things, require us to develop additional features, require penalties for failure to deliver such features, require us to partner with a certain reseller before purchasing our products and/or seek discounted product or service pricing. As we sell more products to this class of customer, we may be required to agree to terms and conditions that are less beneficial to us, which may affect the timing of revenue recognition, amount of deferred revenues or product and service margins and may adversely affect our financial position and cash flows in certain reporting periods.

***Our stock price has been and may continue to be volatile.***

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

- addition or loss of any major customer;
- continued significant declines in customer spending in the media gateway trunking business;
- consolidation and competition in the telecommunications industry;
- changes in the financial condition or anticipated capital expenditure purchases of any existing or potential major customer;
- economic conditions for the telecommunications, networking and related industries;
- quarterly variations in our bookings, revenues and operating results;
- changes in financial estimates by securities analysts;
- speculation in the press or investment community;
- announcements by us or our competitors of significant contracts, new products or acquisitions, distribution partnerships, joint ventures or capital commitments;
- activism by any single large stockholder or combination of stockholders;
- sales of common stock or other securities by us or by our stockholders in the future;
- securities and other litigation;
- repurchases under our stock buyback program;
- announcement of a stock split, reverse stock split, stock dividend or similar event; and/or
- emergence or adoption of new technologies or industry standards.

***Our business could be jeopardized if we are unable to protect our intellectual property; additionally, in some jurisdictions, our rights may not be as strong as we currently enjoy in the United States.***

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 where the laws may not protect our proprietary rights as fully as in the United States. The legal systems of many foreign countries do not protect or honor intellectual property rights to the same extent as the legal system of the United States. It may be very difficult, time-consuming and costly for us to attempt to enforce our intellectual property rights in these jurisdictions. If competitors are able to use our technology, our ability to compete effectively could be harmed.

***Claims that our current or future products infringe or misappropriate the proprietary rights of others could adversely affect our ability to sell those products and cause us to incur additional costs.***

Substantial litigation over intellectual property rights exists in the telecommunications industry. We expect that we could be increasingly subject to third-party infringement claims as our revenue increases, the number of competitors grows and the functionality of products and technology in different industry segments overlaps. Third parties may currently have, or may eventually be issued, patents on which our current or future products or technologies may infringe. For example, there has been an increase in the industry of third-party infringement claims brought by Non-Practicing Entities, also known as patent trolls.

In addition, we and our customers have received inquiries from intellectual property owners and may become subject to claims that we or our customers infringe the intellectual property rights of third parties. Any parties asserting that our products infringe upon their proprietary rights could force us to license their patents for substantial royalty payments or to defend

ourselves and possibly our customers or contract manufacturers in litigation. These claims and any resulting licensing arrangement or lawsuit, if successful, could subject us to significant royalty payments or 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 at acceptable prices, on acceptable terms, or at all; or
- redesign those products that use any allegedly infringing technology.

Patent litigation, regardless of its outcome, will likely result in the expenditure of significant financial resources and the diversion of management's time and resources. In addition, patent litigation may cause negative publicity, adversely impact prospective customers, cause product shipment delays, prohibit us from manufacturing, marketing or selling our current or future products, require us to develop non-infringing technology, make substantial payments to third parties or enter into royalty or license agreements, which may not be available on acceptable terms or at all. If a successful claim of infringement were made against us in a particular patent litigation and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our revenue may decrease substantially and we could be exposed to significant liability. A court could enter orders that temporarily, preliminarily or permanently enjoin us or our customers from making, using, selling, offering to sell or importing our current or future products, or could enter an order mandating that we undertake certain remedial activities. Although historically our costs to defend lawsuits relating to indemnification provisions in our product agreements have been insignificant, the costs may be significant in future periods.

***We may face risks related to litigation that could result in significant legal expenses and settlement or damage awards.***

From time to time, we are subject to claims and litigation regarding intellectual property rights or other claims, which could seriously harm our business and require us to incur significant costs. In the past, we have been named as a defendant in securities class action and derivative lawsuits. We are generally obliged, to the extent permitted by law, to indemnify our current and former directors and officers who are named as defendants in these lawsuits. Defending against litigation may require significant attention and resources of management. Regardless of the outcome, such litigation could result in significant legal expenses.

We may also be subject to employment claims in connection with employee terminations. In addition, companies in our industry whose employees accept positions with us may claim that we have engaged in unfair hiring practices. These 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. The cost of employment claims may also increase as a result of our increasing international expansion.

If we are a party to material litigation and if the defenses we claim are ultimately unsuccessful, or if we are unable to achieve a favorable settlement, we could be liable for large damage awards that could have a material adverse effect on our business and consolidated financial statements.

***Actions that may be taken by significant stockholders may divert the time and attention of our Board of Directors and management from our business operations.***

Campaigns by significant investors to effect changes at publicly-traded companies continue to be prevalent. In 2009, we entered into a letter agreement with our then-largest stockholder, pursuant to which we agreed to take certain actions related to our corporate governance. While we believe we have satisfied in full our obligations under such letter agreement, there can be no assurance that such stockholder and/or any other stockholder will not pursue actions to effect changes in our management and strategic direction, including through the solicitation of proxies from our stockholders. If a proxy contest were to be pursued by any stockholder, it could result in substantial expense to us, consume significant attention of our management and Board of Directors, and disrupt our business.

***Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders.***

Some provisions in our amended and restated certificate of incorporation, our amended and restated by-laws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that may be deemed undesirable by our Board of Directors but that a stockholder may consider favorable. These include provisions:

- authorizing the Board of Directors to issue shares of preferred stock;

- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder actions by written consent;
- permitting the Board of Directors to increase the size of the Board and to fill vacancies;
- providing indemnification to our directors and officers;
- controlling the procedures for conduct and scheduling of Board and stockholder meetings;
- requiring a super-majority vote of our stockholders to amend our amended and restated by-laws and certain provisions of our amended and restated certificate of incorporation; and
- establishing advance notice requirements for nominations for election to the Board of Directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

These provisions, alone or together, could delay hostile takeovers or changes in control of us or our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock.

In addition, we adopted a limited duration stockholder rights plan on June 26, 2008, which was amended on June 10, 2011 and again on June 21, 2013 to extend the expiration date of such plan until June 26, 2015. The rights are not intended to prevent a takeover, and we believe these rights will help us in our negotiations with any potential acquirers. However, if the Board of Directors believes that a particular acquisition of us is undesirable, the rights may have the effect of rendering more difficult or discouraging that acquisition. The rights may substantially dilute the stock ownership of a person or group that attempts to acquire us (or a significant percentage of our outstanding capital stock) on terms, or in a manner, not approved by our Board of Directors, except pursuant to an offer conditioned upon redemption of the rights.

Any provision of our amended and restated certificate of incorporation or amended and restated by-laws, our stockholder rights plan or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock. Although we believe that our amended and restated certificate of incorporation and our amended and restated bylaws, provisions of Delaware law and our stockholder rights plan provide an opportunity for the Board of Directors to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control that some stockholders may consider beneficial.

***We are exposed to fluctuations in currency exchange rates that could negatively impact our financial results and cash flows.***

Because a portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. An increase in the value of the dollar could increase the real cost to our customers of our products in those markets outside the United States where we often sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials from sources outside the United States.

***We may face risks associated with our international expansion that could impair our ability to grow our international revenues. If we fail to manage the operational and financial risks associated with our international operations, it could have a material adverse effect on our business and consolidated financial statements.***

We have expanded, and expect to continue to expand, our operations in international and emerging markets. International operations are a significant part of our business, and such operations will continue to require significant management attention and financial resources to successfully develop direct and indirect international sales and support channels. In addition, our international operations are subject to other inherent risks, including:

- reliance on channel partners;
- greater difficulty collecting accounts receivable and longer collection cycles;
- difficulties and costs of staffing and managing international operations;
- impacts of differing technical standards outside the United States;
- compliance with international trade, customs and export control regulations;
- reduced protection for intellectual property rights in some countries;
- foreign government regulations limiting or prohibiting potential sales or increasing the cost of doing business in such markets, including reversals or delays in the opening of foreign markets to new competitors or the introduction of new technologies;
- challenging pricing environments in highly competitive new markets;

- foreign currency exchange controls, restrictions on repatriation of cash and changes in currency exchange rates;
- potentially adverse tax consequences; and
- political, social and economic instability, including as a result of the current fragility of global financial markets, health pandemics or epidemics and/or acts of war or terrorism.

Our international revenue, both as a percentage of total revenue and absolute dollars, may vary from one period to the next, and accordingly, current data may not be indicative of future periods. If we are unable to support our business operations in international and emerging markets, or their further expansion, while balancing the higher operational and financial risks associated with these markets, our business and consolidated financial statements could be harmed.

In addition, we may not be able to develop international market demand for our products, which could impair our ability to grow our revenues. In many international markets, long-standing relationships between potential customers and their local suppliers and protective regulations, including local content requirements and approvals, create barriers to entry. We have limited experience marketing, distributing and supporting our products in certain international locations and, to do so, we expect that we will need to develop versions of our products that comply with local standards. Moreover, difficulties in foreign financial markets and economies and of foreign financial institutions, particularly in emerging markets, could adversely affect demand from customers in the affected countries.

***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. Additionally, in the event we elect to consolidate and/or change any of our manufacturers, qualifying a new contract manufacturer to commence commercial scale production or consolidating to a reduced number of contract manufacturers are expensive and time-consuming activities and could affect our business.***

While we currently work with three contract manufacturers, we primarily rely upon one large global manufacturer to assemble our products according to our specifications and to fulfill orders on a timely basis. Reliance on a third-party manufacturer involves a number of risks, including a lack of control over the manufacturing process, inventory management and the potential absence or unavailability of adequate capacity. We do not have the internal manufacturing capabilities to meet our customers' demands. Any difficulties or failures to perform by our contract manufacturers could cause delays in customer product shipments or otherwise negatively affect our results of operations.

During 2013, we reduced from five contract manufacturers to three contract manufacturers without any supply disruption. With the acquisition of PT, we have added one additional contract manufacturer such that we are currently working with four contract manufacturers. Additionally, we switched from one single-source manufacturer to another in 2009 as well as in 2011 without any supply disruptions during either of these transitions. However, any future changes to or consolidations of our current contract manufacturers could lead to material shortages or delays in the supply of our products. In the event we elect to continue to consolidate and/or change any of our manufacturers, qualifying a new contract manufacturer to commence commercial scale production or consolidating to a reduced number of contract manufacturers are expensive and time-consuming activities 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.

***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. Single-source and limited source manufacturing arrangements are of a nature that ordinarily accompanies the type of business we conduct. Nevertheless, depending upon the component, there may or may not be alternative sources of substitutes. We purchase these components on a purchase order basis. If we overestimate our component and finished goods 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. Additionally, if any of our contract manufacturers underestimates our requirements, they may not have an adequate supply, which could interrupt manufacturing of our products and result in delays in shipments. If any of our sole or limited source suppliers experiences capacity constraints, work stoppages or other reductions or disruptions in output, they may not be able to meet, or may choose not to meet, our delivery schedules. Moreover, we have agreed to compensate our contract manufacturers in the event of termination or cancellation of orders, discontinuance of product or excess material.

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. While we regularly monitor our inventory of supplies, 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.

Reliance on our suppliers exposes us to potential supplier production difficulties, quality variations and unforeseen price increases. Our customers rely upon our ability to meet committed delivery dates, and any disruption in the supply of key components would seriously adversely affect our ability to meet these dates and could result in loss of customers, harm to our ability to attract new customers, or legal action by our customers. Defense-expedited orders from the U.S. federal government, which by law receive priority, can also interrupt scheduled shipments to our other customers. Additionally, any unforeseen price increases could reduce our profitability or force us to increase our prices, which could result in a loss of customers or harm our ability to attract new customers and could have a material adverse effect on our consolidated financial statements.

Our customer contracts also generally allow customers to reschedule delivery dates or cancel orders within certain time frames before shipment without penalty and outside those time frames with a penalty. Because of these and other factors, there are risks of excesses or inadequate inventory that could negatively affect our expenses, revenue and earnings.

***The market for some of our products depends on the availability and demand for other vendors' products.***

Some of our products, particularly those addressing the Unified Communications market, are designed to function with other vendors' products. In these cases, demand for our products is dependent upon the availability, demand for, and sales of the other vendors' products, as well as the degree to which our products successfully interoperate with the other vendors' products and add value to the solution being provided to the customer. If the other vendors change the design of their products, delay the issuance of new releases, fail to adequately market their products, or are otherwise unsuccessful in building a market for their products, the demand for our products will be adversely affected.

***If we fail to hire and retain needed personnel, the implementation of our business plan could slow or our future growth could be jeopardized.***

Our business depends upon highly skilled technical, managerial, engineering, sales, marketing and customer support personnel. Competition for these personnel is intense, especially during times of economic recovery or growth. Any failure to hire, assimilate in a timely manner and retain needed qualified personnel, particularly engineering and sales personnel, could impair our growth and make it difficult to meet key objectives, such as timely and effective product introductions.

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. With the exception of certain key employees based in the European Union, none of our officers or key employees is 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 and achieve our business objectives.

We had two executive departures in 2013: on October 29, 2013, Maurice L. Castonguay resigned as the Company's Senior Vice President and Chief Financial Officer, effective November 1, 2013, and Matthew Dillon, our former Senior Vice President, Global Services and Systems Management, departed the Company effective August 15, 2013. We had two executive departures in 2012: the departures of our Senior Vice President of Engineering and Chief Technology Officer in August 2012 and our Vice President of Human Resources in September 2012. We had three executive departures in 2011: the departure of our Chief Financial Officer and our Vice President of Product Operations, both in August 2011, and the departure of our Vice President of Engineering and Chief Architect in April 2011. While we have since hired replacements and promoted certain individuals, there is always a risk of uncertainty and instability relating to our ability to find highly qualified successors for certain executive positions and to transition the duties and responsibilities of any departing key executive in an orderly manner.

***If in the future we do not have a sufficient number of shares available to issue to our employees, the limited number of shares we could issue may impact our ability to attract, retain and motivate key personnel.***

We historically have used stock options and restricted stock as a significant component of our employee compensation program in order to align our employees' interests with the interests of our stockholders, encourage employee retention and provide competitive compensation packages. In 2007, our stockholders approved a stock incentive plan which includes a limited



amount of shares to be granted under such plan. In 2010, our stockholders approved amendments to this plan to, among other things, increase the number of shares of our common stock that may be granted under this plan from 14,902,701 to 34,902,701. More recently, in 2013, our stockholders approved an amendment to this plan to increase the number of shares of our common stock that may be granted under this plan by 21,000,000, from 34,902,701 to 55,902,701. Additionally, in connection with the acquisition of NET, we assumed NET's 2008 Stock Incentive Plan, which provides for the award of stock options, restricted stock, performance-based awards and stock appreciation rights to Sonus employees who were previously NET employees and Sonus employees hired after August 24, 2012, the NET acquisition date. In connection with the acquisition of PT, we assumed PT's 2001 Stock Option Plan, 2003 Omnibus Incentive Plan and 2012 Omnibus Incentive Plan. PT's 2001 Stock Option Plan had expired for purposes of new options by its terms on May 31, 2011 but was assumed by us solely for the purpose of administering any outstanding options under this plan. Meanwhile, PT's 2003 Omnibus Incentive Plan was assumed by us solely for the purpose of administering any outstanding awards under such plan as of the PT closing. PT's 2012 Omnibus Incentive Plan provides for the award of stock options, restricted stock, stock appreciation rights and other stock-based awards to Sonus employees who were previously PT employees and Sonus employees hired after February 19, 2014, the PT acquisition date. All unissued shares reserved for further issuance under such plans will be substituted with shares of our common stock.

When the number of shares available for grant under our stock incentive plans becomes insufficient for our needs, it is not certain that our stockholders will approve an increase in the number of shares that we are authorized to issue under such plans. The limited number of shares available for use as equity incentives to employees may make it more difficult for us to attract, retain and motivate key personnel.

***We test our products before they are deployed. However, because our larger scale 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 larger scale products are sophisticated and are designed to be deployed in large and complex networks. We test our products before they are deployed. However, 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 may discover errors or defects in the software or hardware, or the products may not operate as expected after full deployment. As we continue to expand our distribution channel through distributors and resellers, we will need to rely on and support their service and support organizations. 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 or increased expense;
- loss of customers and market share;
- 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/or
- costly and time-consuming legal actions by our customers.

***If we are not able to obtain necessary licenses or on-going maintenance and support of third-party technology at acceptable prices, on acceptable terms, or at all, it could harm our operating results or business.***

We have incorporated third-party licensed technology, including open source software, 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 and on-going maintenance and support may not be available or continue to be available to us on commercially reasonable terms or may be available to us but only at significantly escalated pricing. Additionally, we may not be able to replace the functionality provided by third-party software currently offered with our products if that software becomes obsolete, defective or incompatible with future versions of our products or is not adequately maintained or updated. 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. Any significant interruption in the availability of these third-party software products or defects in these products could harm our sales unless and until we can secure an alternative source. Although we believe there are adequate alternate sources for the technology licensed to us, such alternate sources may not provide us with the same functionality as that currently provided to us.

***Because our larger scale products are deployed in large, complex networks around the world, failure to establish a support infrastructure and maintain required support levels could seriously harm our business.***

Our larger scale products are deployed in large and complex networks around the world. Our customers expect us to establish a support infrastructure and maintain demanding support standards to ensure that their networks maintain high levels of availability and performance. To continue to support our customers with these larger scale products, our support organization will need to provide service and support at a high level throughout the world. If we are unable to provide the expected level of support and service to our customers, we could experience:

- loss of customers and market share;
- failure to attract new customers in new geographies;
- increased service, support and warranty costs and a diversion of development resources; and/or
- network performance penalties.

***A portion of our revenue is generated from sales to U.S. federal government agencies, which is a new line of business for us due to our acquisition of NET in 2012 and our acquisition of PT on February 19, 2014. Disruptions to, or our failure to effectively develop, manage and maintain our government customer relationships could adversely affect our ability to generate revenue from the sales of certain of our products. Further, such government sales are subject to potential delays and cutbacks, require specific testing efforts, and impose significant compliance obligations.***

A portion of our total revenue from product sales comes from contracts with U.S. federal government agencies. None of our current government contracts include long-term purchase commitments. Government sales is a new line of business for us due to our acquisition of NET in 2012 and our acquisition of PT on February 19, 2014, and disruptions to, or our failure to effectively develop, manage and maintain our government customer relationships, could adversely affect our ability to generate revenue from the sales of our products.

Until recently, a majority of NET's government sales has involved the Promina product, for which sales have declined substantially in recent periods. While governmental agencies have purchased and are evaluating some of our new products for broader deployment, this new line of business may not develop quickly or be sufficient to offset future declines in sales of the Promina product. Spending by government customers fluctuates based on budget allocations and the timely passage of the annual federal budget. An impasse in federal government budget decisions could lead to substantial delays or reductions in federal spending. During 2011, the U.S. federal government was unable to reach agreement on budget reduction measures required by the Budget Control Act of 2011 (the "Budget Act"). The sequestration began on March 1, 2013 as a result of budget cuts enacted by the Budget Act, including automatic reductions in both defense and discretionary spending. To date, the effects of sequestration have been minimal on our government business. However, expected additional budget cuts in fiscal 2014 could have an adverse effect on spending on IT and communications products and services, which could result in lower revenue from government customers in the future.

The Department of Defense ("DOD") has issued specific requirements for IP networking products for features and interoperability. In order for a vendor's product to be used to connect to the DOD network, that product must pass a series of significant tests and be certified by the Joint Interoperability Test Command ("JITC"). Certain of our products obtained in the acquisition of NET are already certified by JITC. We have recently submitted all of the requisite paperwork to begin the process of testing of the SBC5000 product at JITC. However, if we are unable to obtain JITC certification as needed, our DOD sales, and hence our revenue and results of operations, may suffer.

A substantial portion of the revenue generated from our government customers is based on our contract with the General Services Administration ("GSA"). This contract imposes significant compliance and reporting obligations on us. The contract also establishes a fixed price under which government customers may purchase our products and provides for automatic mandatory price reductions upon certain events. In addition, the GSA can impose financial penalties for non-compliance.

***Consolidation in the telecommunications industry could harm our business.***

The telecommunications industry has experienced consolidation, including the acquisitions of Acme Packet, Inc. and Tekelec by Oracle Corporation in 2013, and we expect this trend to continue. Consolidation among our customers may cause delays or reductions in capital expenditure plans and/or increased competitive pricing pressures as the number of available customers declines and the relative purchasing power of customers increases in relation to suppliers. Any of these factors could adversely affect our business.

***We are exposed to the credit risk of some of our customers and to credit exposures in fragile financial markets, which could result in material losses.***

Due to our reliance on significant customers, we are dependent on the continued financial strength of our customers. If one or more of our significant customers experience financial difficulties, it could result in uncollectable accounts receivable and our loss of significant customers and anticipated service revenue.

Most of our sales are on an open credit basis, with typical payment terms of 30 to 60 days. We monitor individual customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts we believe our customers can pay and maintain reserves we believe are adequate to cover exposure for doubtful accounts. However, there can be no assurance that our open credit customers will pay the amounts they owe to us or that the reserves we maintain will be adequate to cover such credit exposure. Our customers' failure to pay and/or our failure to maintain sufficient reserves could have a material adverse effect on our consolidated financial statements. Additionally, in the event that turmoil in the credit markets makes it more difficult for some customers to obtain financing, those customers' ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business and consolidated financial statements.

A portion of our sales is derived through our distributors. As distributors tend to have more limited financial resources than other resellers and end-user customers, they generally represent sources of increased credit risk.

***The hardware products that we purchase from our third-party vendors have life cycles, and some of those products have reached the end of their life cycles. If we are unable to correctly estimate future requirements for these products, it could harm our operating results or business.***

Some of the hardware products that we purchase from our third-party vendors have reached the end of their life cycles. It may be difficult for us to maintain appropriate levels of the discontinued hardware to adequately ensure that we do not have a shortage or surplus of inventory of these products. If we do not correctly forecast the demand for such hardware, we could have excess inventory and may need to write off the costs related to such purchases. The write-off of surplus inventory could materially and adversely affect our operating results. However, if we underestimate our forecast and our customers place orders to purchase more products than are available, we may not have sufficient inventory to support their needs. If we are unable to provide our customers with enough of these products, it could make it difficult to retain certain customers, which could have a material and adverse effect on our business.

***Man-made problems, such as computer viruses, hacking or terrorism, and natural disasters may disrupt our operations and harm our operating results.***

Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Any attack on our servers could have a material adverse effect on our business and consolidated financial statements. Additionally, the information systems of our customers could be compromised due to computer viruses, break-ins and hacking, which could lead to unauthorized tampering with our products and may result in, among other things, the disruption of our customers' business, errors or defects occurring in the software due to such unauthorized tampering, and our products not operating as expected after such unauthorized tampering. Such consequences could affect our reputation and have a material adverse effect on our business and consolidated financial statements. Efforts to limit the ability of malicious third parties to disrupt the operations of the Internet or undermine our own security efforts may be met with resistance. In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the United States and other countries and create further uncertainties or otherwise materially harm our business and consolidated financial statements. Likewise, events such as work stoppages or widespread blackouts could have similar negative impacts. Such disruptions or uncertainties could result in delays or cancellations of customer orders or the manufacture or shipment of our products and have a material adverse effect on our business and consolidated financial statements.

Natural catastrophic events, such as earthquakes, fire, floods, or tornadoes, may also affect our or our customers' operations and could have a material adverse effect on our business. Moreover, one of our offices is located in the Silicon Valley area of Northern California, a region known for seismic activity. These facilities are located near the San Francisco Bay where the water table is quite close to the surface and where tenants in nearby facilities have experienced water intrusion problems. A significant natural disaster, such as an earthquake or flood, could have a material adverse effect on our business in this location.

***A breach of the security of our information systems or those of our third-party providers could adversely affect our operating results.***

We rely upon the security of our information systems and, in certain circumstances, those of our third-party providers, such as vendors, consultants and contract manufacturers, to protect our proprietary information and information of our customers.

Despite our security procedures and those of our third-party providers, our information systems and those of our third-party service providers may be vulnerable to threats such as computer hacking, cyber-terrorism or other unauthorized attempts by third parties to access, modify or delete our or our customers' proprietary information. Information technology system failures, including a breach of our or our third-party providers' data security measures, or the theft or loss of laptops, other mobile devices or electronic records used to back up our systems or our third-party providers' systems, could result in an unintentional disclosure of customer, employee or our information or otherwise disrupt our ability to function in the normal course of business by potentially causing, among other things, delays in the fulfillment or cancellation of customer orders or disruptions in the manufacture or shipment of products or delivery of services, any of which could have a material adverse effect on our operating results. Such consequences could be exacerbated if we or our third-party providers are unable to adequately recover critical systems following a systems failure.

***Failure or circumvention of our controls and procedures could impair our ability to report accurate financial results and could seriously harm our business.***

Even an effective internal control system, no matter how well designed, has inherent limitations - including the possibility of the circumvention or overriding of controls - and therefore, can provide only reasonable assurance with respect to financial statement preparation. The failure or circumvention of our controls, policies and procedures could impair our ability to report accurate financial results and could have a material adverse effect on our business and consolidated financial statements.

***Any changes to existing accounting pronouncements or taxation rules or practices may cause adverse fluctuations in our reported results of operations or affect how we conduct our business.***

A change in accounting pronouncements or taxation rules or practices can have a significant effect on our reported results and may affect our reporting of transactions completed before the change is effective. New accounting pronouncements, taxation rules and varying interpretations of accounting pronouncements or taxation rules have occurred in the past and may occur in the future. The change to existing rules, future changes, if any, or the need for us to modify a current tax position may adversely affect our reported financial results or the way we conduct our business. For example, a new revenue recognition standard is expected to be issued in the first half of 2014 which could be effective for companies as early as 2015, and could have a material impact on our consolidated financial statements.

***Changes in our business strategy related to product and maintenance offerings and pricing could affect revenue recognition.***

Our business strategy and competition within the industry could exert pricing pressure on our maintenance offerings. Changes in our product or maintenance offerings or packages and related pricing could affect the amount of revenue recognized in a reporting period.

***If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings.***

Under generally accepted accounting principles, we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Our intangible assets increased by approximately \$17 million in 2012 as a result of our acquisition of NET. Goodwill, which increased by approximately \$27 million as a result of our acquisition of NET, is tested for impairment at least annually. Additionally, we expect our goodwill to increase as a result of the recently completed acquisition of PT. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or intangible assets may not be recoverable include significant underperformance relative to plan or long-term projections, strategic changes in business strategy, significant negative industry or economic trends, significant change in circumstances relative to a large customer, significant decline in our stock price for a sustained period and decline in our market capitalization to below net book value.

***Failure by our strategic partners or by us in integrating products provided by our strategic partners could harm our business.***

Our solutions include the integration of products supplied by strategic partners, who offer complementary products and services. We rely on these strategic partners in the timely and successful deployment of our solutions to our customers. If the products provided by these partners have defects or do not operate as expected, if the services provided by these partners are not completed in a timely manner, or if we do not effectively integrate and support products supplied by these strategic partners, then we may have difficulty with the deployment of our solutions that may result in:

- loss of, or delay in, revenues;

- increased service, support and warranty costs and a diversion of development resources; and
- network performance penalties.

In addition to cooperating with our strategic partners on specific customer projects, we also may compete in some areas with these same partners. If these strategic partners fail to perform or choose not to cooperate with us on certain projects, in addition to the effects described above, we could experience:

- loss of customers and market share; and
- failure to attract new customers or achieve market acceptance for our products.

***Our use and reliance upon research and development resources in India may expose us to unanticipated costs and/or liabilities.***

We have a significant research and development center in Bangalore, India and have increased headcount and development activity at this facility. The employees at this facility consist principally of research and development personnel. There is no assurance that our reliance upon development resources in India will enable us to achieve meaningful cost reductions or greater resource efficiency. Further, our development efforts and other operations in India involve significant risks, including:

- difficulty hiring and retaining appropriate engineering and management resources due to intense competition for such resources and resulting wage inflation;
- knowledge transfer related to our technology and resulting exposure to misappropriation of intellectual property or information that is proprietary to us, our customers and other third parties;
- heightened exposure to changes in economic, security and political conditions in India; and
- fluctuations in currency exchange rates and tax compliance in India.

Difficulties resulting from the factors noted above and other risks related to our operations in India could increase our expenses, impair our development efforts, harm our competitive position and damage our reputation.

***Failure to comply with the Foreign Corrupt Practices Act or the UK Bribery Act could subject us to significant civil or criminal penalties.***

We earn a significant portion of our total revenues from international sales generated through our foreign direct and indirect operations. As a result, we are subject to the Foreign Corrupt Practices Act of 1977, as amended, or the FCPA, and the UK Bribery Act of 2010, or the UKBA, which are laws that prohibit bribery in the conduct of business. The FCPA generally prohibits U.S. companies and their intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment, and requires companies to maintain adequate record-keeping and internal accounting practices to accurately reflect the transactions of the company. The FCPA applies to companies, individual directors, officers, employees and agents. The UKBA is much broader and prohibits all bribery, in both the public and private sectors. Although the UKBA does not contain a separate financial records provision, such a requirement is captured under other UK legislation. Under the FCPA and the UKBA, U.S. companies, their subsidiaries, employees, senior officers and/or directors may be held liable for actions taken by strategic or local partners or representatives. In addition, the U.S. government or the UK government, as applicable, may seek to hold us liable for successor liability violations committed by companies in which we acquire. If we or our intermediaries fail to comply with the requirements of the FCPA and the UKBA, governmental authorities in the United States and the United Kingdom, as applicable, could seek to impose civil and/or criminal penalties, which could have a material adverse effect on our reputation and consolidated financial statements.

***Compliance with new regulations regarding the use of conflict minerals may disrupt our operations and harm our operating results.***

In August 2012, under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Securities and Exchange Commission adopted new requirements for companies that use certain minerals and derivative metals (referred to as "conflict minerals" regardless of their actual country of origin) in their products. These metals, which include tantalum, tin, gold and tungsten, are central to the technology industry and are present in our products as component parts. As a result, we are required to investigate and disclose whether or not the conflict minerals that are used in our products originated from the Democratic Republic of the Congo or adjoining countries. There will be costs associated with these investigation and disclosure requirements, in addition to the potential costs of changes to products, processes or sources of supply as a consequence of such activities. In addition, the implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. Also, we may face reputational challenges if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we may implement or if we are unable to replace any conflict

minerals used in our products that are sourced from the Democratic Republic of the Congo or adjoining countries, as there may not be any acceptable alternative sources of the conflict minerals in question or alternative materials that have the properties we need for our products. We may also encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict-free. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier and we may have to write off inventory in the event that it cannot be sold. These changes could also have an adverse impact in our ability to manufacture and market our products.

***We are subject to governmental export and import controls that could subject us to liability, require a license from the U.S. government or impair our ability to compete in international markets.***

Our products are subject to U.S. export controls and may be exported outside the United States only with the required level of export license or through an export license exception because we incorporate encryption technology into our products. Under these laws and regulations, we are responsible for obtaining all necessary licenses or other approvals, if required, for exports of hardware, software and technology, as well as the provision of service. Obtaining export licenses can be difficult and time-consuming, and in some cases a license may not be available on a timely basis or at all.

In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or our customers' ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely have a material adverse effect on our business and consolidated financial statements.

***Regulation of the telecommunications industry could harm our operating results and future prospects.***

The telecommunications industry is highly regulated and our business and financial condition could be adversely affected by changes in the regulations relating to the telecommunications industry. Currently, there are few laws or regulations that apply directly to access to or delivery of voice services on IP networks. We could be adversely affected by regulation of IP networks and commerce in any country where we operate, including the United States. Such regulations could include matters such as voice over the Internet or using Internet protocol, encryption technology, and access charges for service providers. The adoption of such regulations could decrease demand for our products, and at the same time increase the cost of selling our products, which could have a material adverse effect on our business and consolidated financial statements.

#### **Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our corporate headquarters is located in a leased facility in Westford, Massachusetts, consisting of 97,500 square feet under a lease that expires in August 2018. In addition to our corporate headquarters, we maintained, as of December 31, 2013, the following active facilities:

<u>Location</u>	<u>Principal use</u>	<u>Square footage (approximate)</u>	<u>Lease expiration</u>
Fremont, California	Sales and customer support	97,700	December 2016*
Bangalore, India	Engineering/development	71,500	January 2016
Richardson, Texas	Customer support	23,700	January 2015
Freehold, New Jersey	Engineering/development	16,500	December 2017
Dulles, Virginia	Sales and customer support	14,600	August 2019
Tokyo, Japan	Sales and customer support	7,200	September 2015
Swindon, United Kingdom	Engineering/development and customer support	5,800	December 2014
Schaumburg, Illinois	Engineering/development	4,700	October 2019

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\* 2013 and 2012 restructuring expense included charges related to approximately two-thirds of this facility.

As of December 31, 2013, we also leased short-term office space in Australia, Bangladesh, China, the Czech Republic, France, Germany, Hong Kong, India, Malaysia, New Zealand, Singapore, Taiwan, the United Arab Emirates and the United Kingdom. We believe our existing facilities are adequate for our current needs and that suitable additional space will be available as needed.

**Item 3. Legal Proceedings**

We are often a party to disputes and legal proceedings that we consider routine and incidental to our business. Management does not expect the results of any of these actions to have a material effect on our business or consolidated financial statements.

**Item 4. Mine Safety Disclosures**

Not applicable.



**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

Our common stock is quoted on the NASDAQ Global Select Market under the symbol "SONS".

The following table sets forth, for the time periods indicated, the high and low sale prices of our common stock as reported on the NASDAQ Global Select Market.

	<b>High</b>	<b>Low</b>
<b>Fiscal 2013</b>		
First quarter	\$ 2.84	\$ 1.76
Second quarter	\$ 3.57	\$ 1.98
Third quarter	\$ 3.82	\$ 2.83
Fourth quarter	\$ 3.56	\$ 2.68
<b>Fiscal 2012</b>		
First quarter	\$ 3.11	\$ 2.35
Second quarter	\$ 3.00	\$ 2.01
Third quarter	\$ 2.23	\$ 1.56
Fourth quarter	\$ 1.96	\$ 1.36

**Holdings**

At February 15, 2014, there were approximately 487 holders of record of our common stock.

**Dividend Policy**

We have never declared or paid cash dividends and have no present intention to pay cash dividends in the foreseeable future.

**Recent Sales of Unregistered Securities**

None.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table summarizes repurchases of our common stock during the fourth quarter of 2013:

<b>Period</b>	<b>Total Number of Shares Purchased (1)</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)</b>	<b>Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (3)</b>
September 28, 2013 to October 25, 2013	—	\$ —	—	\$ 62,925,537
October 26, 2013 to November 22, 2013	3,198,033	\$ 2.88	3,191,573	\$ 53,743,305
November 23, 2013 to December 31, 2013	4,545,041	\$ 2.87	4,531,427	\$ 40,746,568
<b>Total</b>	<b>7,743,074</b>	<b>\$ 2.87</b>	<b>7,723,000</b>	<b>\$ 40,746,568</b>

(1) Upon vesting of restricted stock awards, our employees are permitted to return to us a portion of the newly vested shares to satisfy the tax withholding obligations that arise in connection with such vesting. During the fourth quarter of 2013, 20,074 shares of restricted stock were returned to us by employees to satisfy tax withholding obligations arising in connection with vesting of restricted stock, which shares are included in this column.

(2) Consists of purchases pursuant to a stock buyback program announced on July 29, 2013, under which our Board of Directors has authorized the repurchase of up to \$100 million of our common stock from time to time on the open market or in privately negotiated transactions (the "2013 Buyback Program"). The timing and amount of any shares repurchased will be determined by our management based on its evaluation of market conditions and other factors. We may elect to implement a 10b5-1 repurchase program, which would permit shares to be repurchased when we might otherwise be precluded from doing so under insider trading laws. The 2013 Buyback Program does not have a fixed expiration date but may be suspended or discontinued at any time. The 2013 Buyback Program is being funded using our working capital.

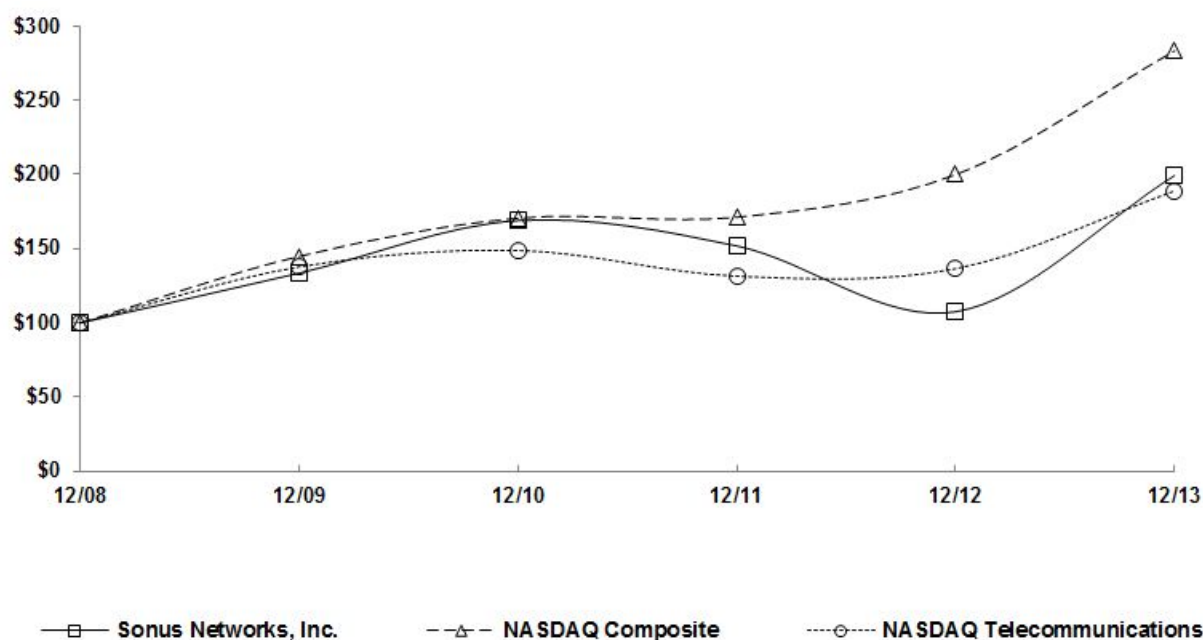
(3) Consists of amounts available for repurchases under the 2013 Buyback Program.

**Performance Graph**

The following performance graph compares the cumulative total return to stockholders for our common stock for the period from December 31, 2008 through December 31, 2013 with the cumulative total return over the same period on the NASDAQ Composite Index and the NASDAQ Telecommunications Index. The comparison assumes an investment of \$100 on December 31, 2008 in our common stock and in each of the indices and, in each case, assumes reinvestment of all dividends, if any. The performance shown is not necessarily indicative of future performance.

This graph is not deemed to be "filed" with the SEC or subject to the liabilities of Section 18 of the Exchange Act, and should not be deemed to be incorporated by reference into any of our prior or subsequent filings under the Securities Act or the Exchange Act.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
**Among Sonus Networks, Inc., the NASDAQ Composite Index**  
**and the NASDAQ Telecommunications Index**



\*\$100 invested on 12/31/08 in stock or index, including reinvestment of dividends.  
 Year ending December 31.

	December 31,					
	2008	2009	2010	2011	2012	2013
Sonus Networks, Inc.	\$ 100.00	\$ 133.54	\$ 168.99	\$ 151.90	\$ 107.59	\$ 199.37
NASDAQ Composite	\$ 100.00	\$ 144.88	\$ 170.58	\$ 171.30	\$ 199.99	\$ 283.39
NASDAQ Telecommunications	\$ 100.00	\$ 137.81	\$ 148.84	\$ 131.52	\$ 136.58	\$ 189.00

**ITEM 6. Selected Financial Data**

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K.

**Consolidated Statement of Operations Data**

(In thousands, except per share amounts)	Year ended December 31,				
	2013	2012 (1)	2011	2010	2009
<b>Revenue:</b>					
Product	\$ 167,272	\$ 153,326	\$ 154,373	\$ 146,583	\$ 136,276
Service	109,461	100,808	105,323	102,724	91,220
Total revenue	276,733	254,134	259,696	249,307	227,496
<b>Cost of revenue:</b>					
Product	59,235	58,109	57,929	48,163	38,893
Service	45,038	53,431	55,646	47,992	44,467
Total cost of revenue	104,273	111,540	113,575	96,155	83,360
Gross profit	172,460	142,594	146,121	153,152	144,136
<b>Operating expenses:</b>					
Research and development	69,559	67,341	64,410	62,786	59,864
Sales and marketing	78,365	76,341	59,279	51,033	48,929
General and administrative	40,107	34,283	34,957	49,391	43,217
Acquisition-related expense	93	5,496	—	—	—
Restructuring expense	5,411	7,675	—	1,501	3,510
Total operating expenses	193,535	191,136	158,646	164,711	155,520
Loss from operations	(21,075)	(48,542)	(12,525)	(11,559)	(11,384)
Interest and other income, net	408	814	1,287	1,561	3,993
Loss from continuing operations before income taxes	(20,667)	(47,728)	(11,238)	(9,998)	(7,391)
Income tax (provision) benefit	(1,452)	(2,441)	(1,465)	(693)	2,459
Net loss	\$ (22,119)	\$ (50,169)	\$ (12,703)	\$ (10,691)	\$ (4,932)
<b>Loss per share:</b>					
Basic	\$ (0.08)	\$ (0.18)	\$ (0.05)	\$ (0.04)	\$ (0.02)
Diluted	\$ (0.08)	\$ (0.18)	\$ (0.05)	\$ (0.04)	\$ (0.02)
<b>Shares used to compute loss per share:</b>					
Basic	278,428	280,090	278,540	275,470	273,730
Diluted	278,428	280,090	278,540	275,470	273,730

(1) Includes the results of operations of Network Equipment Technologies, Inc. for the period subsequent to its acquisition by the Company on August 24, 2012.

**Consolidated Balance Sheet Data**

(In thousands)	December 31,				
	2013	2012	2011	2010	2009
Cash and cash equivalents	\$ 72,423	\$ 88,004	\$ 105,451	\$ 62,501	\$ 125,323
Short-term marketable securities	\$ 138,882	\$ 161,905	\$ 224,090	\$ 258,831	\$ 239,223
Long-term investments	\$ 34,364	\$ 29,698	\$ 55,427	\$ 87,087	\$ 49,598
Working capital	\$ 223,879	\$ 286,745	\$ 336,619	\$ 323,477	\$ 352,409
Total assets	\$ 417,484	\$ 470,740	\$ 504,715	\$ 555,954	\$ 540,737
Current convertible subordinated note	\$ 2,380	\$ —	\$ —	\$ —	\$ —
Long-term deferred revenue, net of current portion	\$ 10,528	\$ 11,647	\$ 11,601	\$ 42,811	\$ 25,242
Long-term convertible subordinated note	\$ —	\$ 2,380	\$ —	\$ —	\$ —
Other long-term liabilities, net of current portion	\$ 4,371	\$ 5,706	\$ 3,599	\$ 4,138	\$ 1,127
Total stockholders' equity	\$ 312,252	\$ 376,046	\$ 415,301	\$ 418,956	\$ 414,238

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We are a leading provider of networked solutions for communications service providers (e.g., telecommunications, wireless and cable service providers) and enterprises to help them advance, protect and unify their communications and improve collaboration. We help many of the world's leading communications service providers and enterprises embrace the next generation of Session Initiation Protocol ("SIP")-based solutions, including Voice over Internet Protocol ("VoIP"), video and Unified Communications ("UC") through secure, reliable and scalable Internet Protocol ("IP") networks. Our products include session border controllers ("SBCs"), policy/routing servers, media and signaling gateways and network analytics tools. Our solutions address the need for communications service providers and enterprises to seamlessly link and leverage multivendor, multiprotocol communications systems and applications across their networks, around the world and in a rapidly changing ecosystem of IP-enabled devices such as smartphones and tablets. Our solutions help our customers realize the intended value and benefits of UC platforms such as Microsoft Lync by enabling disparate communications environments, commonplace in most enterprises today, to work seamlessly together. Likewise, our solutions facilitate the deployment and adoption of cloud-based communications.

Our target customers are comprised of both communications service providers and enterprises. Customers and prospective customers in the service provider space are traditional and emerging communications service providers, including long distance carriers, local exchange carriers, Internet service providers, wireless operators, cable operators, international telephone companies and carriers that provide services to other carriers. Enterprise customers include financial institutions, retailers, state and local governments and other multinational corporations. We collaborate with our customers to identify and develop new, advanced services and applications that can help to reduce costs, improve productivity and generate new revenue.

We have traditionally sold our products principally through a direct sales force located in North America, Europe, Asia-Pacific, Central/Latin America and the Middle East, with additional sales support from regional channel partners throughout the world. In 2012, we launched an expanded channel partner program, the Sonus Partner Assure Program, to address service provider and enterprise market opportunities. This move was prompted in part by the rise of complexity in enterprise communications and the return on investment that enterprises can realize by simplifying and unifying their communications (e.g., voice, video, instant message and business applications) over SIP-based systems. In 2013, we continued to expand this program.

In concert with our Sonus Partner Assure Program, we enhanced our flagship SBC 5200 to be more enterprise- and channel-centric and launched a new SBC, the SBC 5100, to address the requirements for smaller office and branch office requirements for VoIP and SIP deployments.

On August 24, 2012 (the "Acquisition Date"), we completed the acquisition of Network Equipment Technologies, Inc. ("NET"), a Delaware corporation, for a cash purchase price of \$1.35 per share of outstanding NET common stock, or \$41.5 million. The acquisition of NET expanded our SBC portfolio, opened new sales channels and added a government installed base to our customer base. The acquisition of NET also provided us with strong expertise in the Microsoft Lync market, and today we have more Lync-qualified SBCs than any other vendor. The financial results of NET are included in our financial results for the period subsequent to the acquisition.

In October 2013, we introduced the industry's first software-based SBC architected to feature unlimited scalability and advanced features, the Sonus SBC SWe (Software edition).

On February 19, 2014, we completed the acquisition of Performance Technologies, Incorporated ("PT"), a Delaware corporation, for \$3.75 per share, or approximately \$34 million in cash, net of PT's cash and excluding acquisition-related costs. We believe that this acquisition will enable us to expand and diversify our portfolio with an integrated, virtualized Diameter and SIP-based solution and deliver strategic value to service providers seeking to offer new multimedia services through mobile, cloud-based real-time communications.

On February 24, 2014, we announced our new Sonus SBC 7000 SBC (the "SBC 7000"), which is designed to address scalability requirements for real-time, multimedia communications with the capability to license up to 150,000 sessions. The SBC 7000 is purpose-built to support emerging services such as high definition ("HD") voice and video, Voice over Long-Term Evolution ("VoLTE") and Rich Communications Services ("RCS").

We continue to focus on the key elements of our strategy, which is designed to capitalize on our technology and market lead, and build a premier franchise in multimedia infrastructure solutions. We are currently focusing our major efforts on the following aspects of our business as we continue to transition our company to an SBC company:

- expanding our solutions to address emerging UC- and IP-based markets, such as SBC, in the enterprise and service provider markets;
- embracing the principles outlined by 3GPP, 4GPP2 and LTE architectures and delivering the industry's most advanced IMS (IP Multimedia Subsystem)-ready SBC product suite;
- leveraging our TDM (time division multiplexing)-to-IP gateway technology leadership with service providers to accelerate adoption of SIP-enabled Unified Communication services;
- expanding and broadening our customer base by targeting the enterprise market for SIP trunking and access solutions;
- assisting our customers' ability to differentiate themselves by offering a sophisticated application development platform and service creation environment;
- expanding our global sales distribution, marketing and support capabilities, including continued expansion of our indirect sales channel program;
- actively contributing to the SIP standards definition and adoption process;
- pursuing strategic transactions and alliances; and
- maintaining our planned path to profitability by continuing to improve our overall performance.

In August 2012, we announced that we were implementing a restructuring initiative to streamline operations and reduce our operating costs. In connection with this action, we recorded restructuring expense of \$5.4 million in 2013, comprised of \$5.1 million for severance and related costs and \$0.3 million related to facilities. In 2012 we recorded restructuring expense of \$7.7 million, comprised of \$4.2 million for the consolidation of certain facilities, \$3.2 million for severance and related costs and \$0.3 million for the write-off of assets associated with the reduced headcount and facilities consolidations.

We reported losses from operations of \$21.1 million for 2013, \$48.5 million for 2012 and \$12.5 million for 2011. We reported net losses of \$22.1 million in 2013, \$50.2 million in 2012 and \$12.7 million in 2011.

Our revenue was \$276.7 million in 2013, \$254.1 million in 2012 and \$259.7 million in 2011. Our gross profit was \$172.5 million in 2013, \$142.6 million in 2012 and \$146.1 million in 2011. Our gross profit as a percentage of revenue ("total gross margin") was 62.3% in 2013, 56.1% in 2012 and 56.3% in 2011. Our gross profit in 2012 was negatively impacted by the write-off of \$7.1 million of prepaid royalties for licensed technology related to products from which we do not expect to derive future sales, which reduced our total gross margin by approximately three percentage points.

Our operating expenses were \$193.5 million in 2013, compared to \$191.1 million in 2012 and \$158.6 million in 2011. Our 2013 operating expenses included \$0.1 million of incremental acquisition-related costs in connection with the acquisition of PT and \$5.4 million of restructuring expense. Our 2012 operating expenses included \$5.5 million of incremental acquisition-related costs in connection with the NET acquisition and \$7.7 million of restructuring expense. Our 2011 operating expenses included \$0.8 million of incremental costs related to the departure of our former Senior Vice President and Chief Financial Officer in August 2011 and \$0.7 million of expense for the early termination of our lease in Freehold, New Jersey.

We recorded stock-based compensation expense of \$17.9 million in 2013, \$9.0 million in 2012 and \$7.9 million in 2011. The stock-based compensation actions described below increased stock-based compensation expense while reducing cash salary and bonus expenses in 2013, and to a lesser extent in 2012, and we expect a similar effect in 2014.

Lower portfolio yield on our investments, coupled with lower amounts invested in cash equivalents and marketable securities, resulted in lower interest income, which was also a factor in our current year net loss, as was higher interest expense related to the subordinated notes assumed in connection with the NET acquisition.

See "Results of Operations" in this Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of these changes in our revenue and expenses.

On February 18, 2014, we announced that Matthew W. Bross and Richard J. Lynch had been appointed to our Board of Directors, expanding our Board from nine to eleven directors.

On October 24, 2013, Mark T. Greenquist accepted an offer of employment as Chief Financial Officer of the Company, effective November 1, 2013.



On October 9, 2013, we announced the Sonus SBC SWe, the industry's first software-based SBC that delivers unlimited scalability with the same advanced features and functionality found on our Sonus SBC 5000 series on a virtualized platform. The Sonus SBC SWe addresses service providers' requirements for network functions virtualization and software-defined networking-enabled SBC technology to scale cloud-based delivery platforms. We believe that the SBC SWe will allow our customers to move seamlessly between hardware and software solutions with assurance that their existing communications and network investments are fully protected.

On September 4, 2013, we announced that Pamela D.A. Reeve had been appointed to our Board of Directors, expanding our Board from eight to nine directors.

On July 29, 2013, we announced that Maurice L. Castonguay, our Senior Vice President and Chief Financial Officer ("Mr. Castonguay"), planned to leave the Company. To facilitate an orderly transition of his duties and responsibilities, Mr. Castonguay and the Company entered into a letter agreement on July 26, 2013 under which Mr. Castonguay agreed to remain with the Company through March 31, 2014. Under the July 26, 2013 letter agreement, Mr. Castonguay agreed to continue to perform the duties and responsibilities of his current roles as Senior Vice President, Chief Financial Officer, Treasurer and Principal Accounting Officer of the Company until the earlier of (i) the time that his successor is hired, at which time Mr. Castonguay agreed to relinquish his current positions and provide transition services at the Company's request in the role of Senior Consultant - Finance through March 31, 2014 and (ii) March 31, 2014. On October 29, 2013, Maurice L. Castonguay resigned as Senior Vice President and Chief Financial Officer, effective November 1, 2013.

On July 29, 2013, we announced that Matthew Dillon would step down as Senior Vice President, Global Services and Systems Management, effective August 15, 2013.

In March 2013, 21 of our executives, including Raymond P. Dolan, our President and Chief Executive Officer ("Mr. Dolan"), elected to receive bonuses with respect to 2013 (collectively, the "2013 Bonus"), if any were earned, in the form of shares of our common stock (collectively, the "2013 Bonus Shares"). The 2013 Bonus Shares, if any were granted, would be granted on a date concurrent with the timing of normal 2013 bonus payouts and would be fully vested as of the date of grant, with the number of 2013 Bonus Shares calculated by dividing amounts equal to 1.5 times the respective 2013 Bonus amounts earned, as determined by the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") by the closing price of the Company's common stock on the date of grant. The Company recorded stock-based compensation expense for the 2013 Bonus Shares commensurate with the expected achievement level represented by the Company's accrual for its company-wide cash bonus program, as the performance metrics for each are consistent. On February 11, 2014, the Compensation Committee determined the achievement level for the 2013 Bonus Shares and also that such shares would be granted and vest immediately on February 18, 2014. Accordingly, we granted approximately 1 million 2013 Bonus Shares on February 18, 2014, based on \$3.30 per share, the closing price of our common stock on the date of grant.

On February 15, 2013, Mr. Dolan elected to accept restricted shares of our common stock in lieu of his base salary for the period from January 1, 2013 through December 31, 2013. Mr. Dolan had previously not received any salary payments from us for this period. On February 15, 2013, we granted Mr. Dolan 183,824 shares of restricted common stock (the "2013 Salary Shares") having a total grant date fair value of \$500,000, equal to Mr. Dolan's base salary for the year ending December 31, 2013. The number of shares was calculated by dividing Mr. Dolan's base salary for the year by \$2.72, the closing price of our common stock on the date of grant. The 2013 Salary Shares were fully vested on December 31, 2013. We recorded stock-based compensation expense related to the 2013 Salary Shares ratably for the period of January 1, 2013 through December 31, 2013.

On February 14, 2013, the Compensation Committee determined that eight of our executives, excluding Mr. Dolan, would receive their bonuses with respect to 2012 in the form of restricted shares of our common stock equal to 100% of their respective target bonus amounts for 2012 (collectively, the "Executive Bonus Shares"). The number of shares granted to each executive was calculated by dividing his/her target bonus amount by the closing price of our common stock on February 15, 2013, the date of grant. The Executive Bonus Shares vested 50% on August 15, 2013 and the remaining 50% vested on February 15, 2014. We had accrued for the cash payment of bonuses at the expected company-wide cash payout percentage amount at December 31, 2012, which amounts were less than the target bonus amounts for each individual. We recorded the unamortized expense related to the Executive Bonus Shares as stock-based compensation expense through February 15, 2014.

On August 7, 2012, Mr. Dolan elected to accept shares of restricted stock (the "2012 Salary Shares") in lieu of his base salary for the period from August 10, 2012 through December 31, 2012 and to receive his 2012 target bonus, if earned, in the form of restricted shares (the "Dolan 2012 Bonus Shares"). We granted Mr. Dolan 108,398 Salary Shares, which had a total grant date fair value equal to the balance of Mr. Dolan's base salary for the year ending December 31, 2012, calculated by dividing Mr. Dolan's remaining base salary for the year by \$1.78, the closing price of our common stock on the date of grant.

The Salary Shares vested in full on December 31, 2012. We recorded compensation expense related to these awards ratably over the remaining vesting period through December 31, 2012. On August 10, 2012, we granted Mr. Dolan 421,348 Dolan 2012 Bonus Shares, which equaled Mr. Dolan's potential 2012 bonus at the maximum level of achievement (150% of Mr. Dolan's annual base salary), divided by 1.78, the closing price of our common stock on the date of grant. During 2012, we recorded stock-based compensation expense for the Dolan 2012 Bonus Shares commensurate with the expected achievement level represented by our accrual for our company-wide cash bonus program, as the performance metrics for each were consistent. On February 14, 2013, the Compensation Committee determined that Mr. Dolan had earned 280,899 Dolan 2012 Bonus Shares, of which 50% vested on August 15, 2013 and the remaining 50% vested on February 15, 2014. We recorded the unamortized expense related to the Dolan 2012 Bonus Shares, including incremental expense arising from the modification of this award, through February 15, 2014. Mr. Dolan forfeited the remaining 140,449 Dolan 2012 Bonus Shares on February 14, 2013.

Certain members of our Board of Directors elected to receive their annual cash retainer in shares of our common stock in lieu of cash payments. Accordingly, we granted approximately 73,000 shares in the aggregate under our 2007 Plan to such members of the Board of Directors, of which approximately 40,000 shares were granted on February 15, 2013 and approximately 33,000 shares were granted on June 17, 2013. All such shares vested immediately on the applicable grant date.

Effective in 2012, we began to report the first, second and third quarters of each year on a 4-4-5 basis. In 2013, our first quarter ended on March 29, 2013, our second quarter ended on June 28, 2013 and our third quarter ended on September 27, 2013. In 2012, our first quarter ended on March 30, 2012, our second quarter ended on June 29, 2012 and our third quarter ended on September 28, 2012. Our fiscal year-end continues to be December 31.

### Critical Accounting Policies and Estimates

Management's discussion and analysis of the financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience, knowledge of current conditions and beliefs of what could occur in the future given available information. We consider the following accounting policies to be both those most important to the portrayal of our financial condition and those that require the most subjective judgment. If actual results differ significantly from management's estimates and projections, there could be a material effect on our consolidated financial statements. The significant accounting policies that we believe are the most critical include the following:

- Revenue recognition;
- Valuation of inventory;
- Loss contingencies and reserves;
- Stock-based compensation;
- Business combinations;
- Goodwill and intangible assets; and
- Accounting for income taxes.

**Revenue Recognition.** We recognize revenue from sales when persuasive evidence of an arrangement exists, delivery has occurred, the sale price is fixed or determinable, and collectability of the related receivable is probable. When we have future obligations, including a requirement to deliver additional elements that are essential to the functionality of the delivered elements or when customer acceptance is required, we defer revenue recognition and related costs until those obligations are satisfied. Likewise, when fees for products or services are not fixed and determinable, we defer the recording of receivables, deferred revenue and revenue until such time as the fees become due or are collected. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return or refund provisions.

Revenue from maintenance and support services is generally recognized ratably over the service period. Maintenance revenue is deferred until the associated product is accepted by the customer and all other revenue recognition criteria have been met. Maintenance and support services include telephone support, return and repair support and unspecified rights to product upgrades and enhancements. Revenue from other professional services is typically recognized as the services are delivered if all other revenue recognition criteria have been met.

Our products typically have both software and non-software components that function together to deliver the products' essential functionality. Many of our sales involve multiple-element arrangements that include both software and hardware-

related products, maintenance and various professional services. Effective January 1, 2011, we prospectively adopted the provisions of Accounting Standards Update ("ASU") 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements* ("ASU 2009-14") and ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* ("ASU 2009-13") for new and materially modified arrangements originating on or after January 1, 2011. ASU 2009-14 amends industry-specific revenue accounting guidance for software and software-related transactions to exclude from its scope tangible products containing software components and non-software components that function together to deliver the product's essential functionality. All stand-alone software components will continue to be accounted for under the software revenue recognition guidance in Accounting Standards Codification ("ASC") 985-605, *Software - Revenue Recognition* ("ASC 985-605").

For multiple-element arrangements that include both software-only products and non-software products, we allocate the total arrangement consideration to the software-only deliverables as a group and to the individual non-software deliverables based on their relative selling prices. If an undelivered element (such as maintenance and support services) relates to both the software-only and non-software deliverables, we bifurcate the consideration allocated to the undelivered element (such as maintenance and support services) into a non-software component and the software-only component using the relative selling price method. The consideration allocated to the non-software and software-only deliverables is recognized in accordance with the applicable guidance as discussed within this critical accounting policy.

For transactions entered into prior to January 1, 2011 and prospectively for software-only sales, we recognize revenue in accordance with ASC 985-605. Under this guidance, revenue for any undelivered elements that are considered not essential to the functionality of the product and for which vendor-specific objective evidence of fair value ("VSOE") has been established, is deferred and recognized upon delivery utilizing the residual method. If we do not have VSOE for each undelivered element we defer all revenue on the entire arrangement until VSOE is established or until such elements are delivered, provided that all other revenue criteria are met.

For transactions entered into subsequent to the adoption of ASU 2009-13 that include multiple elements, arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy as required by ASU 2009-13.

Consistent with the methodology under the previous accounting guidance, we establish VSOE based upon the price charged when the same element is sold separately or established by management having the relevant pricing authority. We have VSOE for our maintenance and support services and certain professional services. When VSOE exists it is used to determine the selling price of a deliverable. We have not been able to establish VSOE on any of our products and for certain of our services because we have not sold such products or services on a stand-alone basis, not priced such products or services within a narrow range, or had limited sales history.

When VSOE is not established, we attempt to establish the selling price of each element based on third-party evidence ("TPE"). Our solution typically differs from that of our peers as there are no similar or interchangeable competitor products or services. Our various product, service and maintenance offerings contain a significant level of unique features and functionality and therefore, comparable pricing of competitors' products and services with similar functionality cannot be obtained. Accordingly, we are not able to determine TPE for our products or services.

When we are unable to establish selling price using VSOE or TPE, we use estimated selling price ("ESP") in our allocation of arrangement consideration for the relevant deliverables. The objective of ESP is to determine the price at which we would transact a sale if a product or service was sold on a stand-alone basis. We determine ESP for our products and certain services by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional-specific market factors, profit objectives and pricing practices for such deliverables. The determination of ESP is a formal process within the Company that includes review and approval by our management.

We sell the majority of our products directly to our end customers. For products sold to resellers and distributors, we recognize revenue on a sell-through basis.

**Valuation of Inventory.** We review inventory for both potential obsolescence and potential loss of value periodically. In this review, we make assumptions about the future demand for and market value of the inventory and, based on these assumptions, estimate the amount of any excess, obsolete or slow-moving inventory.

We write down our inventories if they are considered to be obsolete or at levels in excess of forecasted demand. In these cases, inventory is written down to estimated realizable value based on historical usage and expected demand. Inherent in our estimates of market value in determining inventory valuation are estimates related to economic trends, future demand for our

products and technical obsolescence of our products. If future demand or market conditions are less favorable than our projections, additional inventory write-downs could be required and would be reflected in the cost of revenue in the period the revision is made. To date, we have not been required to revise any of our assumptions or estimates used in determining our inventory valuations.

We write down our evaluation equipment at the time of shipment to our customers, as it is not probable that the inventory value will be realizable.

**Loss Contingencies and Reserves.** We are subject to ongoing business risks arising in the ordinary course of business that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to determine whether such amounts should be adjusted and record changes in estimates in the period they become known. We are subject to various legal claims. We reserve for legal contingencies and legal fees when the amounts are probable and reasonably estimable.

**Stock-Based Compensation.** Our stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is generally the vesting period.

We use the Black-Scholes valuation model for estimating the fair value on the date of grant of employee stock options. Determining the fair value of stock option awards at the grant date requires judgment regarding certain valuation assumptions, including the volatility of our stock price, expected term of the option, risk-free interest rate and expected dividends. Changes in such assumptions and estimates could result in different fair values and could therefore impact our earnings. Such changes would not impact our cash flows. The fair value of restricted stock and performance stock awards is based upon our stock price on the grant date.

The amount of stock-based compensation expense recorded in any period for unvested awards requires estimates of the amount of stock-based awards that are expected to be forfeited prior to vesting, as well as assumptions regarding the probability that performance awards will be earned. We recorded stock-based compensation expense related to performance-based stock awards in 2013 and 2012.

**Business Combinations.** We allocate the purchase price of acquired companies to identifiable assets acquired and liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed and represents the expected future economic benefits arising from other assets acquired in the business combination that are not individually identified and separately recognized. Significant management judgments and assumptions are required in determining the fair value of assets acquired and liabilities assumed, particularly acquired intangible assets which are principally based upon estimates of the future performance and cash flows expected from the acquired business and applied discount rates. While we use our best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at a business combination date, our estimates and assumptions are inherently uncertain and subject to refinement. If different assumptions are used, it could materially impact the purchase price allocation and our financial position and results of operations. Any adjustments to assets acquired or liabilities assumed subsequent to the purchase price allocation period are included in operating results in the period in which the adjustments is determined. Intangible assets typically are comprised of developed technology, trademarks and trade names, customer contracts/relationships, order backlog, internal use software and covenants not to compete.

**Goodwill and Intangible Assets.** Goodwill is not amortized, but instead is tested for impairment at least annually, or if indicators of potential impairment exist. Estimated fair value is based on either discounted future pretax operating cash flows, or appraised values. Intangible assets with estimated lives and other long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of intangible assets with estimated lives and other long-lived assets is measured by comparing the carrying amount of the asset to future net undiscounted pretax cash flows expected to be generated by the asset. If these comparisons indicate that an asset is not recoverable, we will recognize an impairment loss for the amount by which the carrying value of the asset exceeds the related estimated fair value.

Considerable judgment is required to estimate discounted future operating cash flows. Judgment is also required in determining whether an event has occurred that may impair the value of goodwill or identifiable intangible or other long-lived assets. Factors that could indicate an impairment may exist include significant underperformance relative to plan or long-term projections, strategic changes in business strategy, significant negative industry or economic trends, a significant change in

circumstances relative to a large customer, a significant decline in our stock price for a sustained period and a decline in our market capitalization to below net book value. We must make assumptions about future cash flows, future operating plans, discount rates and other factors in the models and valuation reports. To the extent these future projections and estimates change, the estimated amounts of impairment could differ from current estimates.

We adopted ASU 2011-08, *Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment* ("ASU 2011-08") for our 2013 annual impairment test. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that it is more likely than not that the fair value is less than the carrying value, then it is necessary to perform the currently prescribed two-step goodwill impairment test. Alternatively, if it is concluded that it is not more likely than not that the fair value exceeds carrying value, the currently prescribed two-step goodwill impairment test is not required.

Our annual testing for impairment of goodwill is completed as of November 30 of each year. We operate as a single operating segment with one reporting unit and consequently evaluate goodwill for impairment based on an evaluation of the fair value of our company as a whole. We performed our qualitative assessment for 2013 and concluded that it was not more likely than not that the fair value of our reporting unit was less than its carrying value. Our testing for 2012 and 2011 also indicated that no impairment of goodwill existed.

**Accounting for Income Taxes.** Our provision for income taxes is comprised of a current and a deferred portion. The current income tax provision is calculated as the estimated taxes payable or refundable on tax returns for the current year. We provide for deferred income taxes resulting from temporary differences between financial and taxable income. Such differences arise primarily from tax net operating loss and credit carryforwards, depreciation, deferred revenue, stock-based compensation expense, accruals and reserves.

We assess the recoverability of any tax assets recorded on the balance sheet and provide any necessary valuation allowances as required. In evaluating our ability to recover our deferred tax assets, we consider all available positive and negative evidence including our past operating results, the existence of cumulative income in the most recent years, changes in the business in which we operate and our forecast of future taxable income. In determining future taxable income, we are responsible for assumptions utilized, including the amount of state, federal and international pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage the underlying businesses. Such assessment is completed on a jurisdiction by jurisdiction basis.

At December 31, 2013, we had valuation allowances of approximately \$120 million to offset net deferred tax assets of approximately \$121 million. In the event we determine it is more likely than not that we will be able to use a deferred tax asset in the future in excess of its net carrying value, the valuation allowance would be reduced, thereby increasing net earnings and increasing equity in the period such determination is made. We have recorded net deferred tax assets in some of our international subsidiaries. These amounts could change in future periods based upon our operating results and changes in tax law.

We provide for income taxes during interim periods based on the estimated effective tax rate for the full year. We record a cumulative adjustment to the tax provision in an interim period in which a change in the estimated annual effective tax rate is determined.

We have not provided for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries, as we currently plan to permanently reinvest these amounts and have the intent and ability to do so. Cumulative undistributed foreign earnings were approximately \$17 million at December 31, 2013 and approximately \$19 million at December 31, 2012. Generally, the undistributed foreign earnings become subject to U.S. taxation upon the remittance of dividends and under certain other circumstances. We do not believe it is practicable to estimate with reasonable accuracy the hypothetical amount of the unrecognized deferred tax liability on our undistributed foreign earnings given the large number of tax jurisdictions involved and the many factors and assumptions required to estimate the amount of the U.S. federal income tax on the undistributed earnings after reduction for the available foreign tax credits.

We assess all material positions taken in any income tax return, including all significant uncertain positions, in all tax years that are still subject to assessment or challenge by relevant taxing authorities. Assessing an uncertain tax position begins with the initial determination of the position's sustainability and is measured at the largest amount of benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of each balance sheet date, unresolved uncertain tax positions must be reassessed, and we will determine whether (i) the factors underlying the sustainability assertion have changed and (ii) the amount of recognized tax benefit is still appropriate. The recognition and measurement of tax benefits require

significant judgment. Judgments concerning the recognition and measurement of a tax benefit might change as new information becomes available.

## Results of Operations

### Years Ended December 31, 2013 and 2012

**Revenue.** Revenue for the years ended December 31, 2013 and 2012 was as follows (in thousands, except percentages):

	Year ended December 31,		Increase from prior year	
	2013	2012	\$	%
Product	\$ 167,272	\$ 153,326	\$ 13,946	9.1%
Service	109,461	100,808	8,653	8.6%
Total revenue	\$ 276,733	\$ 254,134	\$ 22,599	8.9%

Product revenue is comprised of sales of our communication infrastructure products. The products typically incorporated into our trunking and communication application solutions include our GSX9000 and GSX4000 Open Services Switches and our ASX Voice Application Server. The products typically incorporated into our SBC solutions include our SBC 9000 (formerly the NBS 9000), SBC 5200 (formerly the NBS 5200), SBC 5100, SBC 5110 and SBC 5210 Session Border Controllers. On October 9, 2013, we announced the Sonus SBC SWe, the industry's first software-based SBC that is architected to deliver unlimited scalability with the same advanced features and functionality found on our Sonus SBC 5000 series on a virtualized platform.

Additionally, in connection with our acquisition of NET, we began selling the SBC 1000 (formerly the NET UX 1000), the SBC 2000 (formerly the NET UX 2000) and the SBC VX, a hybrid solution (formerly the NET VX). The SBC 1000 provides SBC SIP communication capability to the enterprise branch and small and medium businesses, while the SBC 2000 provides SBC SIP communication capability to the enterprise branch and medium to large businesses. The SBC VX is a hybrid solution sold to the U.S. federal government and its agencies. Certain of our products may be incorporated into either our trunking and communication applications or SBC solutions; these products include, but are not limited to, our PSX Policy & Routing Server, SGX Signaling Gateway, Sonus Management System and our suite of network analytical products.

Product revenue for the years ended December 31, 2013 and 2012 was comprised of the following (in thousands, except percentages):

	Year ended December 31,		Increase (decrease) from prior year	
	2013	2012	\$	%
Trunking and communication applications	\$ 69,841	\$ 85,694	\$ (15,853)	(18.5)%
SBC	97,431	67,632	29,799	44.1 %
	\$ 167,272	\$ 153,326	\$ 13,946	9.1 %

As we had anticipated, as a result of the transition of our customers and our business to SBC, our revenue from sales of our trunking and communication application products decreased in 2013 compared to 2012. This decline was more than offset by the growth in sales of our SBC products in the current year compared to prior year. As part of our transition to an SBC business, we expanded our sales channel program, including the launch of our Partner Assure Program in 2012 and increased participation by new channel partners in 2013. The 2012 acquisition of NET expanded our SBC solutions for enterprise customers, provided us with broader channel capability and a broad U.S. federal government installed base to leverage into SIP-enabled platforms. These strategic actions resulted in a 44.1% increase in SBC revenue in 2013 compared to 2012. Additionally, SBC revenue comprised 58.2% of our total product revenue in 2013, compared to 44.1% of total product revenue in 2012.

In 2013, approximately 20% of our product revenue recognized was from indirect sales through our channel program, compared to 8% of product revenue recognized from indirect sales in 2012. This increase is due to the aforementioned actions that we took to expand both our SBC portfolio and our sales opportunities.



In 2013, our product revenue from sales to enterprise customers was approximately 27% of our total product revenue. These sales were made both through our direct sales team and indirect sales channel partners. This compares to approximately 10% of revenue from enterprise customers in 2012.

In 2013, we recognized \$14.8 million of product revenue in the aggregate from 670 new customers, including 624 customers new to NET since the Acquisition Date. In 2012, we recognized \$7.8 million of product revenue in the aggregate from 201 new customers, including 172 customers new to NET since the Acquisition Date. The increase in new customers in 2013 compared to 2012 is the direct result of the strategic actions discussed above.

New customers are those from whom we recognize revenue for the first time in a reporting period, whether the sale was made directly to an end user or to an end user through our indirect sales program. Accordingly, the number of new customers we report includes those customers who have purchased products from our direct sales team, as well as our indirect sales team, comprised of distributors, resellers and partners.

The timing of the completion of customer projects, revenue recognition criteria satisfaction and customer payments included in multiple element arrangements may cause our product revenue to fluctuate from one period to the next. These complex arrangements are generally completed through our direct sales force.

We expect that our product revenue in 2014 will increase from 2013 levels, primarily due to increased sales of our SBC products resulting from our continued and increasing focus on expanding our solutions to address emerging Unified Communication and IP-based markets, such as SBC, in the enterprise and service provider markets.

Service revenue is primarily comprised of hardware and software maintenance and support (“maintenance revenue”) and network design, installation and other professional services (“professional services revenue”).

Service revenue for the years ended December 31, 2013 and 2012 was comprised of the following (in thousands, except percentages):

	Year ended December 31,		Increase from prior year	
	2013	2012	\$	%
Maintenance	\$ 84,698	\$ 76,423	\$ 8,275	10.8%
Professional services	24,763	24,385	378	1.6%
	<u>\$ 109,461</u>	<u>\$ 100,808</u>	<u>\$ 8,653</u>	<u>8.6%</u>

The increase in service revenue in 2013 compared to 2012 is primarily due to growth in maintenance revenue on expanded capacity and other projects implemented by our existing customer install base, coupled with our new customer growth in 2013. The timing of the completion of projects for revenue recognition, customer payments and maintenance contracts may cause our services revenue to fluctuate from one period to the next. We expect that our service revenue in 2014 will increase from 2013 levels.

The following customer contributed 10% or more of our revenue in the years ended December 31, 2013 and 2012:

Customer	Year ended December 31,	
	2013	2012
AT&T	15%	20%

International revenue was approximately 31% of revenue in 2013 and approximately 32% of revenue in 2012. Due to the timing of project completions, we expect that the domestic and international components as a percentage of our revenue will fluctuate from quarter to quarter and year to year.

Our deferred product revenue was \$14.8 million at December 31, 2013 and \$6.7 million at December 31, 2012. Our deferred service revenue was \$36.9 million at December 31, 2013 and \$42.0 million at December 31, 2012. Our deferred revenue balance may fluctuate as a result of the timing of revenue recognition, customer payments, maintenance contract renewals, contractual billing rights and maintenance revenue deferrals included in multiple element arrangements.

**Cost of Revenue/Gross Margin.** Our cost of revenue consists primarily of amounts paid to third-party manufacturers for purchased materials and services, royalties, manufacturing and professional services personnel and related costs, and provision for inventory obsolescence. Our cost of revenue and gross margins for the years ended December 31, 2013 and

2012 were as follows (in thousands, except percentages):

	Year ended December 31,		Increase (decrease) from prior year	
	2013	2012	\$	%
<b>Cost of revenue</b>				
Product	\$ 59,235	\$ 58,109	\$ 1,126	1.9 %
Service	45,038	53,431	(8,393)	(15.7)%
Total cost of revenue	\$ 104,273	\$ 111,540	\$ (7,267)	(6.5)%
<b>Gross margin</b>				
Product	64.6%	62.1%		
Service	58.9%	47.0%		
Total gross margin	62.3%	56.1%		

The increase in product gross margin in 2013 compared to 2012 was primarily due to changes in customer and product mix, which increased our product gross margin by approximately five percentage points, partially offset by higher manufacturing-related costs, which decreased our product gross margin by approximately two percentage points. Our 2013 product gross margin was negatively impacted by the inclusion of NET's historically lower gross margins for the full year, compared to four months in 2012. Our 2013 product gross margin benefited from the absence of the write-off of \$7.1 million of prepaid royalties for technology licenses related to products from which we do not expect to derive future sales, which reduced our 2012 product gross margin by approximately five percentage points.

The increase in service gross margin in 2013 compared to 2012 was primarily attributable to higher service revenue coupled with lower fixed service costs, which increased our service gross margin by approximately seven percentage points, and lower third-party service costs, which increased our service gross margin by approximately five percentage points. The decrease in our fixed service costs in 2013 compared to 2012 was primarily attributable to the impact of the restructuring initiative we initiated in 2012.

Our service cost of revenue is relatively fixed in advance of any particular quarter and therefore, changes in service revenue will typically have a significant impact on service gross margins.

We believe that our total gross margin over the next few years will improve from our current level.

**Research and Development Expenses.** Research and development expenses consist primarily of salaries and related personnel expenses and prototype costs related to the design, development, testing and enhancement of our products. Research and development expenses for the years ended December 31, 2013 and 2012 were as follows (in thousands, except percentages):

	Year ended December 31,		Increase from prior year	
	2013	2012	\$	%
	\$ 69,559	\$ 67,341	\$ 2,218	3.3%

The increase in research and development expenses in 2013 is attributable to \$2.4 million of higher employee-related costs and \$0.6 million related to the write-off of an intangible asset we determined was no longer technologically feasible, partially offset by \$0.4 million of lower expense for product development (third-party development, prototype and test equipment costs) and \$0.4 million of net decreases in other research and development expenses. The increase in employee-related expenses represents higher salary and related expenses aggregating \$1.3 million and \$1.3 million of higher stock-based compensation expense, partially offset by \$0.2 million of other employee-related costs. These increases were primarily the result of increased headcount.

Some aspects of our research and development efforts require significant short-term expenditures, the timing of which may cause significant variability in our expenses. We believe that rapid technological innovation is critical to our long-term success, and we are tailoring our investments to meet the requirements of our customers and market. We believe that our research and development expenses for 2014 will increase from 2013 levels due to our increased focus on new product development.

**Sales and Marketing Expenses.** Sales and marketing expenses consist primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions, customer trial and evaluations inventory and other marketing



and sales support expenses. Sales and marketing expenses for the years ended December 31, 2013 and 2012 were as follows (in thousands, except percentages):

Year ended December 31,		Increase from prior year	
2013	2012	\$	%
\$ 78,365	\$ 76,341	\$ 2,024	2.7%

The increase in sales and marketing expenses in 2013 is attributable to \$1.5 million of higher marketing and trade show expenses and \$1.4 million of amortization expense related to intangible assets acquired in connection with the NET acquisition. These increases were partially offset by \$0.9 million of lower expense for evaluation equipment. Stock-based compensation increased by \$2.7 million in 2013 compared to 2012, partially as a result of the election of certain members of our management to receive their 2013 bonuses in stock instead of cash, with a corresponding reduction in cash bonus expense.

We believe that our sales and marketing expenses will decrease slightly in 2014 from 2013 levels, primarily attributable to lower personnel and related costs, partially offset by increases related to our continued investment in our expanded sales and marketing programs.

**General and Administrative Expenses.** General and administrative expenses consist primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses and audit and professional fees. General and administrative expenses for the years ended December 31, 2013 and 2012 were as follows (in thousands, except percentages):

Year ended December 31,		Increase from prior year	
2013	2012	\$	%
\$ 40,107	\$ 34,283	\$ 5,824	17.0%

The increase in general and administrative expenses in 2013 is attributable to \$3.0 million of higher employee-related expenses, \$1.3 million of higher professional fees, \$0.4 million of expense related to our allowance for doubtful accounts, \$0.3 million of higher expense related to foreign currency translation and \$0.8 million of net increases in other general and administrative expenses. The increase in employee-related expenses includes \$4.5 million of higher stock-based compensation expense, partially offset by lower cash salary expense in connection with the aforementioned stock for salary and bonus cash transactions.

We believe that our general and administrative expenses will remain relatively flat in 2014 compared to 2013 levels.

**Acquisition-Related Expenses.** Acquisition-related expenses include those costs related to the February 2014 acquisition of PT and the August 2012 acquisition of NET that would otherwise not have been incurred by us. We recorded \$0.1 million of acquisition-related expenses in 2013 related to PT for professional and service fees. We recorded acquisition-related expenses related to the acquisition of NET aggregating \$5.5 million in 2012, comprised of \$3.6 million of professional and services fees and \$1.9 million related to change of control agreements. These costs are primarily comprised of professional and service fees, such as legal, audit, consulting, transfer agent and other fees, and expenses related to cash payments to former NET executives under their NET change of control agreements. We expect to incur additional acquisition-related expenses in 2014 aggregating approximately \$1.6 million in connection with the acquisition of PT.

**Restructuring Expense.** On August 7, 2012, we announced that we had committed to a restructuring initiative to streamline operations and reduce operating costs by closing and consolidating certain facilities and reducing its worldwide workforce. In connection with this initiative, we recorded \$5.4 million of restructuring expense in 2013, comprised of \$5.1 million related to severance and related costs and \$0.3 million related to facilities.

We recorded \$7.7 million of restructuring expense in the year ended December 31, 2012, comprised of \$3.2 million related to severance and related costs, \$4.2 million related to space reductions in three facilities and \$0.3 million for the write-off of assets associated with the aforementioned facility consolidations. The \$4.2 million related to facilities is comprised of \$4.0 million related to space reductions in NET's former corporate headquarters in California, \$0.1 million related to space reductions in the former NET facility in New Jersey and \$0.1 million to consolidate our offices in France.

Although we have eliminated positions as part of the restructuring initiative, we continue to hire in certain areas that we believe are important to our future growth. Restructuring expense is reported separately in the consolidated statements of

operations. We expect to complete the payments related to severance in 2014 and the payments related to facilities in 2016. The portion of restructuring payments due more than one year from the balance sheet date is included in Other long-term liabilities in the consolidated balance sheet. At December 31, 2013, the long-term portion of accrued restructuring was \$1.8 million.

**Interest Income, net.** Interest income and interest expense for the years ended December 31, 2013 and 2012 were as follows (in thousands, except percentages):

	Year ended December 31,		Decrease from prior year	
	2013	2012	\$	%
Interest income	\$ 502	\$ 814	\$ (312)	(38.3)%
Interest expense	(97)	(202)	(105)	(52.0)%
Interest income, net	\$ 405	\$ 612	\$ (207)	(33.8)%

Interest income consists of interest earned on our cash equivalents, marketable debt securities and long-term investments. Interest expense relates to interest on capital lease obligations and interest on the debt assumed in connection with the acquisition of NET. The decrease in interest income, net, in 2013 compared to 2012 is primarily attributable to a lower average portfolio yield on lower invested amounts in the current year.

**Income Taxes.** We recorded provisions for income taxes of \$1.5 million in 2013 and \$2.4 million in 2012, primarily related to foreign operations. The income tax benefits from the deferred tax assets recorded in connection with our current year domestic losses have been offset by an increase in the valuation allowance. During 2013 and 2012, we performed an analysis to determine if, based on all available evidence, we considered it more likely than not that some portion or all of the recorded deferred tax assets will not be realized in a future period. As a result of our evaluations, we concluded that there was insufficient positive evidence to overcome the more objective negative evidence related to our cumulative losses and other factors. Accordingly, we maintained a valuation against our domestic deferred tax asset.

#### Years Ended December 31, 2012 and 2011

**Revenue.** Revenue for the years ended December 31, 2012 and 2011 was as follows (in thousands, except percentages):

	Year ended December 31,		Decrease from prior year	
	2012	2011	\$	%
Product	\$ 153,326	\$ 154,373	\$ (1,047)	(0.7)%
Service	100,808	105,323	(4,515)	(4.3)%
Total revenue	\$ 254,134	\$ 259,696	\$ (5,562)	(2.1)%

Product revenue for the years ended December 31, 2012 and 2011 was comprised of the following (in thousands, except percentages):

	Year ended December 31,		Increase (decrease) from prior year	
	2012	2011	\$	%
Trunking and access	\$ 85,694	\$ 116,506	\$ (30,812)	(26.4)%
SBC	67,632	37,867	29,765	78.6 %
Total product revenue	\$ 153,326	\$ 154,373	\$ (1,047)	(0.7)%

In 2012, we recognized \$7.8 million of product revenue in the aggregate from 201 new customers, including 172 customers new to NET since the Acquisition Date. In 2011, we recognized \$33.7 million of product revenue in the aggregate from 20 new customers, including \$24.4 million of revenue from a project for Bahamas Telecommunications Company Ltd. ("Bahamas Telecom") that was completed in the first quarter of 2011.

As we had anticipated, our revenue from sales of our trunking and communication application products declined in 2012 compared to 2011. This decline was offset by the growth in sales of our SBC products in 2012 compared to 2011.

Service revenue for the years ended December 31, 2012 and 2011 was comprised of the following (in thousands, except percentages):

	Year ended December 31,		Increase (decrease) from prior year	
	2012	2011	\$	%
Maintenance	\$ 76,423	\$ 76,418	\$ 5	— %
Professional services	24,385	28,905	(4,520)	(15.6)%
Total service revenue	\$ 100,808	\$ 105,323	\$ (4,515)	(4.3)%

In 2011 we recognized \$11.5 million of service revenue from the completion of the Bahamas Telecom project described above, which was comprised of \$1.2 million of maintenance revenue and \$10.3 million of professional services revenue. The completion of this large, multi-year project contributed to the decrease in total service revenue in 2012 compared to 2011.

The following customers each contributed 10% or more of our revenue in at least one of the years ended December 31, 2012 and 2011:

Customer	Year ended December 31,	
	2012	2011
Bahamas Telecommunications Company Ltd.	*	14%
AT&T	20%	12%

\* Represents less than 10% of revenue.

International revenue was approximately 32% of revenue in 2012 and approximately 40% of revenue in 2011.

Our deferred product revenue was \$6.7 million at December 31, 2012 and \$8.9 million at December 31, 2011. Our deferred service revenue was \$42.0 million at December 31, 2012 and \$41.3 million at December 31, 2011.

**Cost of Revenue/Gross Margin.** Cost of revenue and gross margins for the years ended December 31, 2012 and 2011 were as follows (in thousands, except percentages):

	Year ended December 31,		Increase (decrease) from prior year	
	2012	2011	\$	%
Cost of revenue				
Product	\$ 58,109	\$ 57,929	\$ 180	0.3 %
Service	\$ 53,431	\$ 55,646	\$ (2,215)	(4.0)%
Total cost of revenue	\$ 111,540	\$ 113,575	\$ (2,035)	(1.8)%
Gross margin				
Product	62.1%	62.5%		
Service	47.0%	47.2%		
Total gross margin	56.1%	56.3%		

The slight decrease in product gross margin in 2012 compared to 2011 was primarily due to the write-off of \$7.1 million of prepaid royalties for technology licenses related to products from which we did not expect to derive future sales, which reduced our product gross margin by approximately five percentage points, and higher manufacturing costs, which decreased our product gross margin by approximately two percentage points. These amounts were largely offset by changes in product mix and lower third-party costs, which increased our product gross margin by approximately seven percentage points. Our product gross margin in 2012 benefited from the absence of third-party costs related to the Bahamas Telecom project, which was completed in the first quarter of 2011, and which had negatively impacted our product gross margin in 2011 by approximately six percentage points.

The slight decrease in service gross margin in 2012 compared to 2011 was primarily attributable to higher costs within the service organization, which decreased our service gross margin by approximately five percentage points, partially offset by lower third-party costs, which increased our service gross margin by approximately five percentage points. Our service gross margin in 2012 benefited from the absence of costs for the lower gross margin Bahamas Telecom project, which had

negatively impacted our service gross margin for 2011 by approximately four percentage points. The higher costs within the service organization are primarily related to increased headcount in our customer support organization related to supporting our expanding customer base and new product initiatives.

**Research and Development Expenses.** Research and development expenses for the years ended December 31, 2012 and 2011 were as follows (in thousands, except percentages):

Year ended December 31,		Increase from prior year	
2012	2011	\$	%
\$ 67,341	\$ 64,410	\$ 2,931	4.6%

Our 2012 research and development expenses include \$4.1 million of expense attributable to NET for the period since the August 24, 2012 acquisition. The increase in research and development expenses in 2012 is attributable to \$3.9 million of higher employee-related costs, partially offset by \$0.9 million of lower expense for product development (third-party development, prototype and test equipment costs) and \$0.1 million of net decreases in other research and development expenses. The increase in employee-related expenses represents higher salary and related expenses primarily resulting from increased headcount.

**Sales and Marketing Expenses.** Sales and marketing expenses for the years ended December 31, 2012 and 2011 were as follows (in thousands, except percentages):

Year ended December 31,		Increase from prior year	
2012	2011	\$	%
\$ 76,341	\$ 59,279	\$ 17,062	28.8%

Our 2012 sales and marketing expenses include \$4.5 million of expense attributable to NET for the period since the acquisition. The increase in sales and marketing expenses in 2012 is attributable to \$17.6 million of higher employee-related expenses, \$0.6 million of higher marketing and trade show expenses and \$0.3 million of higher expense for evaluation equipment. These increases were partially offset by \$0.9 million of lower consulting fees and \$0.5 million of net decreases in other sales and marketing expenses. The increase in employee-related expense is primarily attributable to higher headcount related to our continued focus on expanded geographical coverage as well as the acquisition of NET, and is comprised of \$15.8 million of increased salary-related and commissions expense, \$1.6 million of increased employee recruiting, travel and training expenses, and \$0.2 million of increased stock-based compensation expense.

**General and Administrative Expenses.** General and administrative expenses for the years ended December 31, 2012 and 2011 were as follows (in thousands, except percentages):

Year ended December 31,		Decrease from prior year	
2012	2011	\$	%
\$ 34,283	\$ 34,957	\$ (674)	(1.9)%

Our 2012 general and administrative expenses include \$1.5 million of expense attributable to NET for the period since the acquisition. The decrease in general and administrative expenses in 2012 is attributable to \$0.7 million of lower expense related to foreign currency translation and \$0.5 million of lower audit and professional fees, partially offset by \$0.6 million of higher employee-related expenses. The increase in employee-related expenses is comprised of \$1.1 million of higher stock-based compensation, partially offset by \$0.5 million of lower salary and related expenses.

**Acquisition-Related Expenses.** Acquisition-related expenses include those costs related to the acquisition of NET that would otherwise not have been incurred by us. These costs are primarily comprised of professional and service fees, such as legal, audit, consulting, transfer agent and other fees, and expenses related to cash payments to former NET executives under their NET change of control agreements. We recorded acquisition-related expenses of \$5.5 million in 2012, comprised of \$3.6 million of professional and services fees and \$1.9 million related to change of control agreements.

**Restructuring Expense.** On August 7, 2012, we announced that we had committed to a restructuring initiative to streamline operations and reduce operating costs by closing and consolidating certain facilities and reducing its worldwide workforce. In connection with this initiative, we recorded \$7.7 million of restructuring expense in the year ended December 31, 2012, comprised of \$3.2 million related to severance and related costs, \$4.2 million related to space reductions in three

facilities and \$0.3 million for the write-off of assets associated with the aforementioned facility consolidations. The \$4.2 million related to facilities is comprised of \$4.0 million related to space reductions in NET's former corporate headquarters in California, \$0.1 million related to space reductions in the former NET facility in New Jersey and \$0.1 million to consolidate our offices in France.

We did not record restructuring expense in 2011.

**Interest Income, net.** Interest income and interest expense for the years ended December 31, 2012 and 2011 were as follows (in thousands, except percentages):

	Year ended December 31,		Decrease from prior year	
	2012	2011	\$	%
Interest income	\$ 814	\$ 1,159	\$ (345)	(29.8)%
(Interest expense)/reversal of interest expense	(202)	128	(330)	(257.81)%
Interest income, net	\$ 612	\$ 1,287	\$ (675)	(52.4)%

Interest expense in 2012 relates to interest on capital lease obligations and interest on the debt assumed in connection with the acquisition of NET. Interest expense in 2011 relates to interest on capital lease obligations. Interest expense in 2011 includes the reversal of expense recorded in a prior year related to tax penalties, which were settled in 2011, net of interest on capital lease obligations. The decrease in interest income, net, in 2012 compared to 2011 is attributable to a lower average portfolio yield on lower invested amounts in 2012, coupled with the aforementioned interest expense related to the assumed NET debt.

**Income Taxes.** We recorded provisions for income taxes of \$2.4 million in 2012 and \$1.5 million in 2011, primarily related to foreign operations. The income tax benefits from the deferred tax assets recorded in connection with our current year domestic losses have been offset by an increase in the valuation allowance. During 2012 and 2011, we performed an analysis to determine if, based on all available evidence, we considered it more likely than not that some portion or all of the recorded deferred tax assets will not be realized in a future period. As a result of our evaluations, we concluded that there was insufficient positive evidence to overcome the more objective negative evidence related to our cumulative losses and other factors. Accordingly, we maintained a valuation against our domestic deferred tax asset.

#### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial position, changes in financial position, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

#### Liquidity and Capital Resources

Our consolidated statements of cash flows are summarized as follows (in thousands):

	Year ended December 31,		Change
	2013	2012	
Net loss	\$ (22,119)	\$ (50,169)	\$ 28,050
Adjustments to reconcile net loss to cash flows used in operating activities	34,849	32,879	1,970
Changes in operating assets and liabilities	21,377	(22,019)	43,396
Net cash provided by (used in) operating activities	\$ 34,107	\$ (39,309)	\$ 73,416
Net cash provided by investing activities	\$ 7,540	\$ 52,402	\$ (44,862)
Net cash used in financing activities	\$ (56,534)	\$ (30,339)	\$ (26,195)

Our cash, cash equivalents, marketable securities and long-term investments totaled \$245.7 million at December 31, 2013 and \$279.6 million at December 31, 2012. We had cash and short-term investments held by our foreign subsidiaries aggregating approximately \$5 million at December 31, 2013 and approximately \$7 million at December 31, 2012. We do not intend to repatriate these funds, and as such, they are not available to fund our domestic operations. If we were to repatriate the funds, they would likely be treated as income for U.S. tax purposes, fully offset by the Company's net operating losses. We do not believe this has a material impact on our liquidity.

Our operating activities provided \$34.1 million of cash in 2013 and used \$39.3 million of cash in 2012.

Cash provided by operating activities in 2013 was primarily the result of decreases in other operating assets, inventory and accounts receivable, coupled with increases in accrued expenses and other long-term liabilities, and deferred revenue. The decrease in other operating assets was primarily related to lower prepaid expenses. Our increased focus on maintaining appropriate inventory levels was the primary contributor to the decrease in inventory. The decrease in accounts receivable primarily reflects our focus on cash collections. The increase in accrued expenses and other long-term liabilities was primarily related to employee-related expenses, including the 2013 company-wide bonus, which we expect to pay out in the first quarter of 2014, and restructuring and professional fee accruals. The increase in deferred revenue represents orders from which we expect to recognize revenue in future periods. Deferred revenue balances will fluctuate as a result of timing of invoicing and revenue recognition. Our net loss, adjusted for non-cash items such as depreciation, amortization, stock-based compensation and the impairment of an intangible asset, provided \$12.7 million of cash.

Cash used in operating activities in 2012 was primarily the result of increases in accounts receivable and inventory and decreases in accounts payable and deferred revenue, partially offset by a decrease in other operating assets and an increase in accrued expenses and other long-term liabilities. The increase in accounts receivable primarily represents end-of-year invoicing for which collections have not yet occurred. The increase in inventory levels is primarily due to purchases of materials to fulfill our expected shipments in the near-term. Our net loss, adjusted for non-cash items such as depreciation, amortization, stock-based compensation and the write-off of prepaid royalties, used \$17.3 million of cash.

Our investing activities provided \$7.5 million of cash in 2013 and \$52.4 million of cash in 2012. The 2013 amount is comprised of \$14.5 million of net maturities of marketable securities, partially offset by \$6.9 million of cash used for the purchase of property and equipment. The 2012 amount is comprised of \$98.5 million of net maturities of marketable securities, partially offset by \$35.5 million of cash paid, net of cash acquired, for the acquisition of NET on August 24, 2012 and \$10.5 million for investments in property and equipment.

Our financing activities used \$56.5 million of cash in 2013 and \$30.3 million of cash in 2012. The 2013 amount is comprised of \$59.7 million for the repurchase of common stock under our previously announced stock buyback program, \$1.3 million used to pay withholding obligations related to the net share settlement of restricted stock awards upon vesting and \$0.1 million for payments on our capital leases for office equipment. These amounts were partially offset by \$2.7 million of proceeds from the exercise of stock options and \$1.9 million of proceeds from the sale of our common stock in connection with our Amended and Restated 2000 Employee Stock Purchase Plan ("ESPP"). The 2012 amount is comprised of \$31.8 million in the aggregate for principal payments of the debentures assumed in connection with the NET acquisition, \$0.3 million of cash used to pay withholding obligations related to the net share settlement of restricted stock awards upon vesting and \$0.1 million for payments on our capital leases for office equipment. These amounts were partially offset by \$1.7 million of proceeds from the sale of our common stock in connection with our ESPP and \$0.3 million of proceeds from the exercise of stock options.

### Contractual Obligations

Our contractual obligations (both principal and interest) at December 31, 2013 consisted of the following (in thousands):

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Capital lease obligations	\$ 161	\$ 89	\$ 72	\$ —	\$ —
Operating lease obligations	17,173	5,824	8,037	3,086	226
Purchase obligations	27,229	27,033	188	8	—
Restructuring severance obligations *	1,333	1,333	—	—	—
Convertible subordinated note - principal	2,380	2,380	—	—	—
Convertible subordinated note - interest	89	89	—	—	—
Uncertain tax positions **	8,861	8,861	—	—	—
	<u>\$ 57,226</u>	<u>\$ 45,609</u>	<u>\$ 8,297</u>	<u>\$ 3,094</u>	<u>\$ 226</u>

\* The restructuring payments for facilities are included as a component of the Operating lease obligations in the table above.

\*\* This liability is not subject to fixed payment terms and the amount and timing of payments, if any, which we will make related to this liability are not known. See Note 18 to our consolidated financial statements appearing in this Annual Report on Form 10-K for additional information.

Based on our current expectations, we believe our current cash, cash equivalents, marketable debt securities and long-term investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least twelve months, including any future stock repurchases under the aforementioned stock buyback program. It is difficult to predict future liquidity requirements with certainty. The rate at which we will consume cash will be dependent on the cash needs of future operations, including changes in working capital, which will, in turn, be directly affected by the levels of demand for our products, the timing and rate of expansion of our business, the resources we devote to developing our products and any litigation settlements. We anticipate devoting substantial capital resources to continue our research and development efforts, to maintain our sales, support and marketing, to improve our controls environment, for other general corporate activities and to vigorously defend against existing and potential litigation. See Note 21 to our consolidated financial statements for a description of our other contingencies.

## Recent Accounting Pronouncements

On July 18, 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, *Presentation of a Liability for an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists* ("ASU 2013-11"), which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss ("NOL") carryforward, a similar tax loss or a tax credit carryforward exists. The FASB's objective in issuing ASU 2013-11 is to eliminate diversity in practice resulting from a lack of guidance on this topic in current generally accepted accounting principles in the United States. ASU 2013-11 requires that an entity present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss or a tax credit unless certain conditions exist. ASU 2013-11 is effective for us beginning January 1, 2014. We do not expect the adoption of ASU 2013-11 to have an impact on our consolidated financial statements, as we currently apply the methodology prescribed by ASU 2013-11.

On March 4, 2013, the FASB issued ASU 2013-05, *Foreign Currency Matters (Topic 830) - Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* ("ASU 2013-05"), which indicates that the entire amount of a cumulative translation adjustment ("CTA") related to an entity's investment in a foreign entity should be released when there has been either: (a) a sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in a foreign entity; (b) the loss of a controlling financial interest in an investment in a foreign entity (i.e., the foreign entity is deconsolidated); or (c) the step acquisition of a foreign entity (i.e., when the accounting for an entity has changed from applying the equity method for an investment in a foreign entity to consolidating the foreign entity). ASU 2013-05 does not change the requirement to release a pro rata portion of the CTA of the foreign entity into earnings for a partial sale of an equity method investment in a foreign entity. ASU 2013-05 is effective for us January 1, 2014. We do not expect the adoption of ASU 2013-05 to have a material impact on our consolidated financial statements.

On February 5, 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"), which requires entities to disclose changes in accumulated other comprehensive income balances by component (i.e., unrealized gains or losses on available-for-sale securities or foreign-currency items) and significant items reclassified out of accumulated other comprehensive income by component either on the face of the income statement or as a separate footnote to the financial statements. ASU 2013-02 does not change the current requirements for interim financial statement reporting of comprehensive income. ASU 2013-02 became effective for us beginning January 1, 2013. We do not have significant items reclassified out of accumulated other comprehensive income and accordingly, the adoption of ASU 2013-02 did not impact our consolidated financial statements.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to a variety of market risks, including changes in interest rates affecting the return on our investments and foreign currency fluctuations.

At December 31, 2013, our cash, cash equivalents, marketable securities and long-term investments totaled \$245.7 million. We maintain an investment portfolio of various holdings, types and maturities which may include money market funds, commercial paper, corporate notes, certificates of deposit and government debt securities. A sharp rise in market interest rates could have a material adverse impact on the fair value of our investment portfolio. Conversely, declines in market interest rates could have a material impact on the interest earnings of our investment portfolio. We do not currently hedge these interest rate exposures. We place our investments with high quality issuers and have policies limiting, among other things, the amount of credit exposure to any one issuer. We seek to limit default risk by purchasing only investment grade securities. We manage potential losses in fair value by investing in relatively short-term investments, thereby allowing us to hold our investments to

maturity. A hypothetical movement of plus or minus 50 basis points in market interest rates could affect the value of our investment portfolio by approximately \$0.4 million for the year ended December 31, 2013. However, we have the ability to hold our investments until maturity, and therefore do not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our investment portfolio.

Based on a hypothetical 10% adverse movement in all foreign currency exchange rates, our revenue for the year ended December 31, 2013 would have been adversely affected by approximately \$2.5 million and our net loss for the year ended December 31, 2013 would have been adversely affected by approximately \$0.1 million, although the actual effects may differ materially from this hypothetical analysis.



**Item 8. Financial Statements and Supplementary Data**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Sonus Networks, Inc.  
Westford, Massachusetts

We have audited the accompanying consolidated balance sheets of Sonus Networks, Inc. and subsidiaries (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Sonus Networks, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control-Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2014 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Boston, Massachusetts  
February 27, 2014

## SONUS NETWORKS, INC.

## Consolidated Balance Sheets

(in thousands, except share and per share data)

	December 31, 2013	December 31, 2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 72,423	\$ 88,004
Marketable securities	138,882	161,905
Accounts receivable, net	64,463	68,728
Inventory	21,793	25,614
Deferred income taxes	656	686
Other current assets	15,073	16,520
Total current assets	313,290	361,457
Property and equipment, net	19,102	23,767
Intangible assets, net	10,091	15,237
Goodwill	32,379	32,379
Investments	34,364	29,698
Deferred income taxes	2,121	1,011
Other assets	6,137	7,191
	<u>\$ 417,484</u>	<u>\$ 470,740</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 11,164	\$ 10,643
Accrued expenses	34,026	26,212
Current portion of deferred revenue	41,169	37,094
Convertible subordinated note	2,380	—
Current portion of long-term liabilities	672	763
Total current liabilities	89,411	74,712
Deferred revenue	10,528	11,647
Deferred income taxes	922	249
Convertible subordinated note	—	2,380
Other long-term liabilities	4,371	5,706
Total liabilities	105,232	94,694
Commitments and contingencies (Note 21)		
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; 266,226,845 shares issued and outstanding at December 31, 2013; 280,963,298 shares issued and outstanding at December 31, 2012	266	281
Additional paid-in capital	1,280,442	1,321,385
Accumulated deficit	(974,492)	(952,373)
Accumulated other comprehensive income	6,036	6,753
Total stockholders' equity	312,252	376,046
	<u>\$ 417,484</u>	<u>\$ 470,740</u>

See notes to the consolidated financial statements.

## SONUS NETWORKS, INC.

## Consolidated Statements of Operations

(in thousands, except per share data)

	Year ended December 31,		
	2013	2012	2011
Revenue:			
Product	\$ 167,272	\$ 153,326	\$ 154,373
Service	109,461	100,808	105,323
Total revenue	276,733	254,134	259,696
Cost of revenue:			
Product	59,235	58,109	57,929
Service	45,038	53,431	55,646
Total cost of revenue	104,273	111,540	113,575
Gross profit	172,460	142,594	146,121
Operating expenses:			
Research and development	69,559	67,341	64,410
Sales and marketing	78,365	76,341	59,279
General and administrative	40,107	34,283	34,957
Acquisition-related	93	5,496	—
Restructuring	5,411	7,675	—
Total operating expenses	193,535	191,136	158,646
Loss from operations	(21,075)	(48,542)	(12,525)
Interest income, net	405	612	1,287
Other income, net	3	202	—
Loss before income taxes	(20,667)	(47,728)	(11,238)
Income tax provision	(1,452)	(2,441)	(1,465)
Net loss	\$ (22,119)	\$ (50,169)	\$ (12,703)
Loss per share:			
Basic	\$ (0.08)	\$ (0.18)	\$ (0.05)
Diluted	\$ (0.08)	\$ (0.18)	\$ (0.05)
Shares used to compute loss per share:			
Basic	278,428	280,090	278,540
Diluted	278,428	280,090	278,540

See notes to the consolidated financial statements.

## SONUS NETWORKS, INC.

## Consolidated Statements of Comprehensive Loss

(in thousands)

	Year ended December 31,		
	2013	2012	2011
Net loss	\$ (22,119)	\$ (50,169)	\$ (12,703)
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	(672)	(535)	390
Unrealized gain (loss) on available-for-sale marketable securities, net of tax	(45)	(19)	22
Other comprehensive income (loss), net of tax	\$ (717)	\$ (554)	\$ 412
Comprehensive loss, net of tax	\$ (22,836)	\$ (50,723)	\$ (12,291)

See notes to the consolidated financial statements.

**SONUS NETWORKS, INC.**  
**Consolidated Statements of Stockholders' Equity**  
(in thousands, except share data)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
<b>Balances, January 1, 2011</b>	277,170,262	\$ 277	\$ 1,301,285	\$ (889,501)	\$ 6,895	\$ 418,956
Issuance of common stock in connection with employee stock purchase plan	637,403	1	1,779			1,780
Exercise of stock options	452,617		818			818
Vesting of restricted stock	1,269,393	1				1
Issuance of vested performance-based stock awards	312,556					—
Shares of restricted stock returned to the Company under net share settlements to satisfy tax withholding obligations	(523,835)		(1,439)			(1,439)
Stock-based compensation expense			7,476			7,476
Other comprehensive income					412	412
Net loss				(12,703)		(12,703)
<b>Balances, December 31, 2011</b>	<b>279,318,396</b>	<b>279</b>	<b>1,309,919</b>	<b>(902,204)</b>	<b>7,307</b>	<b>415,301</b>
Issuance of common stock in connection with employee stock purchase plan	826,907	1	1,989			1,990
Exercise of stock options	212,502		254			254
Vesting of restricted stock	767,523	1				1
Shares of restricted stock returned to the Company under net share settlements to satisfy tax withholding obligations	(162,030)		(342)			(342)
Stock-based compensation expense			8,673			8,673
Assumption of equity awards in connection with acquisition of Network Technologies, Inc.			892			892
Other comprehensive loss					(554)	(554)
Net loss				(50,169)		(50,169)
<b>Balances, December 31, 2012</b>	<b>280,963,298</b>	<b>281</b>	<b>1,321,385</b>	<b>(952,373)</b>	<b>6,753</b>	<b>376,046</b>
Issuance of common stock in connection with employee stock purchase plan	764,369	1	2,209			2,210
Exercise of stock options	1,304,918	1	2,668			2,669
Vesting of restricted stock	908,485	1				1
Issuance of vested performance-based stock awards	1,205,858	1				1
Shares of restricted stock returned to the Company under net share settlements to satisfy tax withholding obligations	(405,189)		(1,300)			(1,300)
Repurchase of common stock	(18,514,894)	(19)	(59,655)			(59,674)
Stock-based compensation expense			14,504			14,504
Reclassification of liability to equity for cash bonuses converted to equity awards			631			631
Other comprehensive loss					(717)	(717)
Net loss				(22,119)		(22,119)
<b>Balances, December 31, 2013</b>	<b>266,226,845</b>	<b>\$ 266</b>	<b>\$ 1,280,442</b>	<b>\$ (974,492)</b>	<b>\$ 6,036</b>	<b>\$ 312,252</b>

See notes to the consolidated financial statements.

**SONUS NETWORKS, INC.**
**Consolidated Statements of Cash Flows**
**(in thousands)**

	Year ended December 31,		
	2013	2012	2011
<b>Cash flows from operating activities:</b>			
Net loss	\$ (22,119)	\$ (50,169)	\$ (12,703)
<b>Adjustments to reconcile net loss to cash flows provided by (used in) operating activities:</b>			
Depreciation and amortization of property and equipment	12,329	12,891	11,629
Amortization of intangible assets	4,546	2,773	400
Stock-based compensation	17,873	9,003	7,865
Impairment of intangible assets	600	—	—
Write-off of prepaid royalties for software licenses	—	7,083	—
Loss on disposal of property and equipment	54	344	24
Deferred income taxes	(553)	785	66
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable	3,536	(8,924)	(217)
Inventory	4,150	(7,713)	22,900
Other operating assets	6,200	1,669	10,562
Accounts payable	(555)	(4,949)	(3,537)
Accrued expenses and other long-term liabilities	4,768	937	(7,377)
Deferred revenue	3,278	(3,039)	(35,522)
Net cash provided by (used in) operating activities	<u>34,107</u>	<u>(39,309)</u>	<u>(5,910)</u>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(6,949)	(10,540)	(13,173)
Business acquisition, net of cash acquired	—	(35,508)	—
Purchases of marketable securities	(182,491)	(159,828)	(219,800)
Sale/maturities of marketable securities	196,980	258,278	282,041
Increase in restricted cash	—	—	(310)
Net cash provided by investing activities	<u>7,540</u>	<u>52,402</u>	<u>48,758</u>
<b>Cash flows from financing activities:</b>			
Proceeds from sale of common stock in connection with employee stock purchase plan	1,888	1,693	1,513
Proceeds from exercise of stock options	2,669	254	818
Payment of tax withholding obligations related to net share settlements of restricted stock awards	(1,300)	(342)	(1,439)
Repurchase of common stock	(59,674)	—	—
Principal payments of capital lease obligations	(117)	(120)	(88)
Settlement of redeemable convertible subordinated debentures	—	(31,824)	—
Net cash (used in) provided by financing activities	<u>(56,534)</u>	<u>(30,339)</u>	<u>804</u>
Effect of exchange rate changes on cash and cash equivalents	(694)	(201)	(702)
Net (decrease) increase in cash and cash equivalents	<u>(15,581)</u>	<u>(17,447)</u>	<u>42,950</u>
Cash and cash equivalents, beginning of year	88,004	105,451	62,501
Cash and cash equivalents, end of year	<u>\$ 72,423</u>	<u>\$ 88,004</u>	<u>\$ 105,451</u>
<b>Supplemental disclosure of cash flow information:</b>			
Interest paid	\$ 89	\$ 780	\$ 10
Income taxes paid	\$ 1,569	\$ 2,388	\$ 926
Income tax refunds received	\$ 164	\$ 67	\$ 827
<b>Supplemental disclosure of non-cash investing activities:</b>			
Capital expenditures incurred, but not yet paid	\$ 1,446	\$ 305	\$ 550
Property and equipment acquired under capital lease	\$ 113	\$ 40	\$ 119
Business acquisition purchase consideration - assumed equity awards	\$ —	\$ 892	\$ —
<b>Supplemental disclosure of non-cash financing activities:</b>			
Total fair value of restricted stock awards, restricted stock units and performance-based stock awards on date vested	\$ 6,816	\$ 1,640	\$ 4,331

See notes to the consolidated financial statements.

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements****(1) NATURE OF THE BUSINESS**

Sonus Networks, Inc. ("Sonus" or the "Company") was incorporated in 1997 and is a leading provider of networked solutions for communications service providers (e.g., telecommunications, wireless and cable service providers) and increasingly, to enterprises to help them advance, protect and unify their communications and improve collaboration. Sonus helps many of the world's leading communications service providers and enterprises embrace the next generation of Session Initiation Protocol ("SIP")-based solutions, including Voice over Internet Protocol ("VoIP"), video and Unified Communications ("UC") through secure, reliable and scalable Internet Protocol ("IP") networks. Sonus products include session border controllers, policy/routing servers, media and signaling gateways and network analytics tools. Sonus solutions address the need for communications service providers and enterprises to seamlessly link and leverage multivendor, multiprotocol communications systems and applications across their networks, around the world and in a rapidly changing ecosystem of IP-enabled devices such as smartphones and tablets. Sonus solutions help the Company's customers realize the intended value and benefits of UC platforms such as Microsoft Lync by enabling disparate communications environments, commonplace in most enterprises today, to work seamlessly together. Likewise, Sonus solutions facilitate the deployment and adoption of cloud-based communications.

The Company utilizes both direct and indirect sales channels to reach its target customers. Customers and prospective customers in the service provider space are traditional and emerging communications providers, including long distance carriers, local exchange carriers, Internet service providers, wireless operators, cable operators, international telephone companies and carriers that provide services to other carriers. Enterprise customers and target enterprise customers include financial institutions, retailers, state and local governments, and other multinational corporations. The Company collaborates with its customers to identify and develop new, advanced services and applications that can help to reduce costs, improve productivity and generate new revenue.

**(2) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*****BASIS OF PRESENTATION***

The consolidated financial statements have been prepared in United States dollars, in accordance with accounting principles generally accepted in the United States ("GAAP").

Effective in 2012, the Company began to report its first, second and third quarters on a 4-4-5 basis, with the quarter ending on the Friday closest to the last day of each third month. In 2013, the Company's first quarter ended on March 29, 2013, the second quarter ended on June 28, 2013 and the third quarter ended on September 27, 2013. In 2012, the Company's first quarter ended on March 30, 2012, the second quarter ended on June 29, 2012 and the third quarter ended on September 28, 2012. The Company's fiscal year ends on December 31.

On August 24, 2012, the Company completed the acquisition of Network Equipment Technologies, Inc. ("NET"). The financial results of NET have been included in the Company's consolidated financial statements for the year ended December 31, 2013 and in the year ended December 31, 2012 for the period subsequent to its acquisition.

***SIGNIFICANT ACCOUNTING POLICIES*****Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of Sonus and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

**Use of Estimates and Judgments**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and judgments relied upon in preparing these consolidated financial statements include accounting for business combinations, revenue recognition for multiple element arrangements, inventory valuations, assumptions used to determine the



**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

fair value of stock-based compensation, intangible assets and goodwill valuations, legal contingencies and recoverability of Sonus' net deferred tax assets and the related valuation allowances. Sonus regularly assesses these estimates and records changes in estimates in the period in which they become known. Sonus bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results could differ from those estimates.

**Business Combinations**

The Company recognizes identifiable assets acquired and liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed and represents the expected future economic benefits arising from other assets acquired in the business combination that are not individually identified and separately recognized. While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill to the extent that it identifies adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the consolidated statements of operations.

**Revenue Recognition**

The Company recognizes revenue from sales when persuasive evidence of an arrangement exists, delivery has occurred, the sale price is fixed or determinable, and collectability of the related receivable is probable. In instances where customer acceptance is required, revenue is deferred until the acceptance has been achieved. When fees for products or services are not fixed and determinable, the Company defers the recording of receivables, deferred revenue and revenue until such time as the fees become due or are collected.

Revenue from maintenance and support services is recognized ratably over the service period. Maintenance revenue is deferred until the associated product is accepted by the customer and all other revenue recognition criteria have been met. Maintenance and support services include telephone support, return and repair support and unspecified rights to product upgrades and enhancements. Revenue from other professional services is typically recognized as the services are delivered if all other revenue recognition criteria have been met.

The Company's products typically have both software and non-software components that function together to deliver the products' essential functionality. In addition, hardware sold generally cannot be used apart from the software. Therefore, the Company considers its principal products to be both software and hardware-related. Many of the Company's sales involve multiple element arrangements that include product, maintenance and various professional services.

Beginning January 1, 2011, the Company adopted the provisions of ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* ("ASU 2009-13") and ASU No. 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements* ("ASU 2009-14") for new and materially modified arrangements that contain tangible products (hardware) with software elements, which comprise the majority of the Company's revenue transactions. For multiple element arrangements entered into subject to the guidance set forth in ASU 2009-13, arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy as required by ASU 2009-13. The Company limits the amount of revenue recognized for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return or refund privileges.

For multiple-element arrangements that include both software-only products and non-software products, the Company allocates the total arrangement consideration to the software-only deliverables as a group and to the individual non-software deliverables based on their relative selling prices. If an undelivered element (such as maintenance and support services) relates to both the software-only and non-software deliverables, the Company bifurcates the consideration allocated to the undelivered element (such as maintenance and support services) into a non-software component and the software-only component using the relative selling price method. The consideration allocated to the non-software and software-only deliverables is recognized in accordance with the guidance as discussed in this note.

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

For transactions entered into prior to January 1, 2011 and prospectively for software-only sales, the Company recognizes revenue in accordance with ASC No. 985-605, *Software - Revenue Recognition* (“ASC 985-605”). Under this guidance, revenue for any undelivered elements that are considered not essential to the functionality of the product and for which vendor-specific objective evidence of selling price (“VSOE”) has been established is deferred and recognized upon delivery utilizing the residual method. If the Company has undelivered product for which VSOE has not been established, it defers all revenue on the entire arrangement until VSOE is established or until such elements are delivered, provided that all other revenue recognition criteria are met. If the Company has undelivered services for which VSOE has not been established, the entire arrangement is recognized as revenue over the longest remaining service period from the point in time that all services have commenced and all products have been delivered, provided that all other revenue recognition criteria are met.

The Company establishes VSOE based upon the price charged when the same element is sold separately or established by management having the relevant pricing authority. The Company has VSOE for its maintenance and support services and certain professional services. When VSOE exists it is used to determine the selling price of a deliverable. The Company has not been able to establish VSOE of any of its products and for certain of its services because the Company has not sold such products or services on a stand-alone basis, has not priced its products or services within a narrow range, or has limited sales history.

When VSOE is not established, the Company attempts to establish the selling price of each element based on third-party evidence of selling price (“TPE”). The Company’s solution typically differs from that of its peers as there are no similar or interchangeable competitor products or services. The Company’s various product, service and maintenance offerings contain a significant level of unique features and functionality and therefore, comparable pricing of competitors’ products and services with similar functionality cannot be obtained. Accordingly, the Company is not able to determine TPE for its products or services.

When the Company is unable to establish selling price using VSOE or TPE, the Company uses estimated selling price (“ESP”) in its allocation of arrangement consideration for the relevant deliverables. The objective of ESP is to determine the price at which the Company would transact a sale if a product or service was sold on a stand-alone basis. The Company determines ESP for its products and certain services by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional-specific market factors, profit objectives and historical pricing practices for such deliverables. The determination of ESP is a formal process within the Company that includes review and approval by the Company’s management.

Deferred revenue typically includes customer deposits and amounts associated with partial product shipments and maintenance or service contracts. Deferred revenue expected to be recognized as revenue more than one year subsequent to the balance sheet date is reported with long-term liabilities in the condensed consolidated balance sheets. The Company defers recognition of incremental direct costs, such as cost of goods, third-party installations and commissions, until recognition of the related revenue. Such costs are classified as current assets if the deferred revenue is initially classified as current and noncurrent assets if the related deferred revenue is initially classified as long-term.

The Company excludes any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction (i.e., sales, use, value added) from its revenue and costs. Reimbursement received for out-of-pocket expenses and shipping costs is recorded as revenue.

The Company sells the majority of its products directly to its end customers. For products sold to resellers and distributors, the Company recognizes revenue on a sell-through basis.

**Financial Instruments**

The carrying amounts of Sonus’ financial instruments, which include cash equivalents, marketable securities, investments, accounts receivable, accounts payable and convertible subordinated debt approximate their fair values.

All investments in marketable securities are classified as available-for-sale and are reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in Accumulated other comprehensive income (loss), which is a component of stockholders’ equity. Unrealized losses that are determined to be other-than-temporary, based on current and

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

expected market conditions, are recognized in earnings. Declines in fair value determined to be credit-related are charged to earnings. The cost of marketable securities sold is determined by the specific identification method.

Financial instruments with remaining maturities or that are due within one year from the balance sheet date are classified as current. Financial instruments with remaining maturities or that are payable more than one year from the balance sheet date are classified as noncurrent.

**Cash and Cash Equivalents**

Cash equivalents are stated at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in Accumulated other comprehensive income (loss). Cash equivalents are liquid securities that have remaining maturities of three months or less at the date of purchase.

**Restricted Cash**

The Company classifies as restricted cash all cash pledged as collateral to secure long-term obligations and all cash whose use is otherwise limited by contractual provisions. Restricted cash is recorded within other assets on the consolidated balance sheet.

**Foreign Currency Translation**

For foreign subsidiaries where the functional currency is the local currency, assets and liabilities are translated into U.S. dollars at the current exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during each period. Translation adjustments for these subsidiaries are included in Accumulated other comprehensive income (loss).

For foreign subsidiaries where the functional currency is the U.S. dollar, monetary assets and liabilities are translated into U.S. dollars at the current exchange rate on the balance sheet date. Nonmonetary assets and liabilities are remeasured into U.S. dollars at historical exchange rates. Revenue and expense items are translated at average rates of exchange prevailing during each period.

Realized and unrealized foreign currency gains and losses arising from transactions denominated in currencies other than the subsidiary's functional currency are reflected in earnings with the exception of intercompany transactions considered to be of a long-term investment nature.

The components of foreign currency translation gains (losses), which are reported as a component of General and administrative expenses in the consolidated statements of operations, for the years ended December 31, 2013, 2012 and 2011 are as follows (in thousands):

	Year ended December 31,		
	2013	2012	2011
Transaction losses	\$ (746)	\$ (1,365)	\$ (1,293)
Remeasurement gains (losses)	(164)	767	9
	<u>\$ (910)</u>	<u>\$ (598)</u>	<u>\$ (1,284)</u>

**Inventory**

Inventory is recorded at the lower of cost or market value using the first-in, first-out convention. The Company reduces the carrying value of inventory for those items that are potentially excess, obsolete or slow-moving based on changes in customer demand, technology developments or other economic factors.

Sonus writes down evaluation equipment at the time of shipment to its customers, as it is probable that the inventory value will not be realized.

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

Deferred product costs represent deferred cost of revenue for product shipments to customers prior to satisfaction of Sonus' revenue recognition criteria. Such costs are classified as inventory if the related deferred revenue is initially classified as current. Deferred product costs are recorded in Other assets if the related deferred revenue is initially classified as long-term, and remain a component of noncurrent assets until such costs are recognized in the consolidated statement of operations.

**Property and Equipment**

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which range from two to five years. Leasehold improvements are amortized over the lesser of the lease term or five years. When an asset is sold or retired, the cost and related accumulated depreciation or amortization are eliminated, and the resulting gain or loss, if any, is recognized in income (loss) from operations in the consolidated statement of operations. The Company reviews property and equipment for impairment in the same manner as intangible assets discussed below.

Software development costs associated with internal use software are incurred in three stages of development: the preliminary project stage, the application development stage and the post-implementation stage. Costs incurred during the preliminary project and post-implementation stages are expensed as incurred. Certain internal and external qualifying costs incurred during the application development stage are capitalized as property and equipment. Internal use software is amortized on a straight-line basis over its estimated useful life of three years, beginning when the software is ready for its intended use.

**Intangible Assets and Goodwill**

Intangible assets are comprised of intellectual property purchased in 2010 which is amortized over its estimated useful life of five years, and intangible assets arising from the August 24, 2012 acquisition of NET, comprised of developed technology, customer relationships, order backlog and internal use software, which are amortized over their estimated useful lives of four months to approximately six years. Intangible assets are reviewed for impairment when events or changes in circumstances indicate that their carrying amounts may not be recoverable based upon the estimated undiscounted cash flows. Recoverability of intangible assets with estimated lives and other long-lived assets is measured by a comparison of the carrying amount of an asset or asset group to future net undiscounted cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable, the Company will recognize an impairment loss for the amount by which the carrying value of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future operating cash flows or appraised values, depending on the nature of the asset. In the second quarter of 2013, the Company recorded an impairment charge of \$0.6 million to write down the carrying value of one of its intellectual property intangible assets to zero. See Note 9 for additional information regarding this expense.

Goodwill is recorded when the consideration for an acquisition exceeds the fair value of net tangible and identifiable intangible assets acquired. Goodwill is not amortized, but instead is tested for impairment at least annually or if indicators of potential impairment exist by comparing the fair value of the Company's reporting unit to its carrying value.

The Company adopted ASU 2011-08, *Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment* ("ASU 2011-08") for its 2013 annual impairment test. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. This qualitative assessment included the review of macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance and other related facts and circumstances that could indicate that a more detailed assessment would be required. If it is concluded that it is more likely than not that the fair value is less than the carrying value, then it is necessary to perform the currently prescribed two-step goodwill impairment test. Alternatively, if it is concluded that it is not more likely than not that the fair value exceeds carrying value, the currently prescribed two-step goodwill impairment test is not required.

The Company's annual testing for impairment of goodwill is completed as of November 30 of each year. The Company operates as a single operating segment with one reporting unit and consequently evaluates goodwill for impairment based on an evaluation of the fair value of the Company as a whole. The Company performed its qualitative assessment for 2013 and concluded that it was not more likely than not that the fair value of our reporting unit was less than its carrying value. The Company's testing for 2012 and 2011 also indicated that no impairment of goodwill existed.

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)****Other Assets**

Other assets are primarily comprised of the long-term portion of deferred cost of goods sold, prepaid expenses and deposits. In the fourth quarter of 2012, the Company wrote off \$7.1 million of prepaid royalties related to products from which the Company does not expect to derive future sales. This amount is included as a component of Cost of revenue - product in the consolidated statement of operations for the year ended December 31, 2012.

**Stock-Based Compensation**

The Company's stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which generally represents the vesting period, and includes an estimate of the awards that will be forfeited. The Company uses the Black-Scholes valuation model for estimating the fair value on the date of grant of stock options. The fair value of stock option awards is affected by the Company's stock price as well as valuation assumptions, including the volatility of Sonus' stock price, expected term of the option, risk-free interest rate and expected dividends.

**Research and Development Costs**

Research and development costs are expensed as incurred.

**Software Development Costs**

The costs for the development of new software and substantial enhancements to existing software are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized until the product is available for general release. The Company has determined that technological feasibility is established at the time a working model of the software is completed. The Company's process for developing software is essentially completed concurrently with the establishment of technological feasibility. Accordingly, no costs have been capitalized to date.

**Concentrations of Credit Risk and Single Source Suppliers**

The financial instruments that potentially subject Sonus to concentrations of credit risk are cash, cash equivalents, marketable debt securities and accounts receivable. The Company's cash equivalents and marketable debt securities were managed by two financial institutions at both December 31, 2013 and 2012.

Certain components and software licenses from third parties used in Sonus' products are procured from single sources of supply. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby materially adversely affect Sonus' revenues and operating results.

Sonus had three contract manufacturers at December 31, 2013. Failure to manage the activities of these manufacturers or any disruption in these relationships could result in the disruption in the supply of its products and in delays in the fulfillment of the Company's customer orders.

**Advertising Costs**

Advertising costs are expensed as incurred. Advertising expenses were \$2.7 million for the year ended December 31, 2013, \$1.1 million for the year ended December 31, 2012 and \$0.2 million for the year ended December 31, 2011.

**Operating Segments**

The Company operates in a single segment. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, the chief operating decision maker has made such decisions and assessed performance at the company level, as one segment. The Company's chief operating decision maker is its President and Chief Executive Officer.

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)****Loss Contingencies and Reserves**

**Loss Contingencies.** Sonus is subject to ongoing business risks arising in the ordinary course of business that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. Sonus regularly evaluates current information available to determine whether such amounts should be adjusted and records changes in estimates in the period they become known.

**Allowance for Doubtful Accounts.** Sonus establishes billing terms at the time it negotiates purchase agreements with its customers. Sonus monitors its outstanding receivables for timely payments and potential collection issues. An allowance for doubtful accounts is estimated based on Sonus' assessment of the collectability of specific customer accounts.

**Accrual for Royalties.** Sonus accrues for royalties for technology that it licenses from vendors based on established royalty rates and usage. In certain cases, Sonus has been contacted by third parties who claim that Sonus' products infringe on certain intellectual property of the third party. Sonus evaluates these claims and accrues amounts only when it is probable that the obligation has been incurred and the amounts are reasonably estimable.

**Reserve for Litigation and Legal Fees.** Sonus is subject to various legal claims. Sonus reserves for legal contingencies and legal fees when it is probable that a loss has been incurred and the amounts are reasonably estimable.

**Accounting for Income Taxes**

Deferred tax assets and liabilities are recognized for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on the differences between the book and tax bases of assets and liabilities and operating loss carryforwards, using tax rates expected to be in effect for the years in which the differences are expected to reverse. Such differences arise primarily from stock-based compensation, depreciation, accruals and reserves, acquired intangible assets, deferred revenue, tax credits, net operating loss carryforwards and allowances for accounts receivable. Sonus records valuation allowances to reduce deferred income tax assets to the amount that is more likely than not to be realized.

Sonus has not provided for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries, as the Company plans to permanently reinvest these amounts. Cumulative undistributed foreign earnings were approximately \$17 million at December 31, 2013 and approximately \$19 million at December 31, 2012. Generally, the undistributed foreign earnings become subject to U.S. taxation upon the remittance of dividends and under certain other circumstances. The Company does not believe it is practicable to estimate with reasonable accuracy the hypothetical amount of the unrecognized deferred tax liability on its undistributed foreign earnings given the large number of tax jurisdictions involved and the many factors and assumptions required to estimate the amount of the U.S. federal income tax on the undistributed earnings after reduction for the available foreign tax credits.

The Company determines whether it is more likely than not that a tax position will be sustained upon examination. If it is not more likely than not that a position will be sustained, no amount of the benefit attributable to the position is recognized. The tax benefit to be recognized of any tax position that meets the more likely than not recognition threshold is calculated as the largest amount that is more than 50% likely of being realized upon resolution of the contingency. The Company accounts for interest and penalties related to uncertain tax positions as part of its provision for income taxes.

In September 2013, the U.S. Department of the Treasury and the Internal Revenue Service released final regulations relating to guidance on applying tax rules to amounts paid to acquire, produce or improve tangible personal property as well as rules for materials and supplies effective for tax years beginning on or after January 1, 2014. The Company is currently assessing these rules and the impact they will have on its consolidated financial statements, if any.

**Recent Accounting Pronouncements**

On July 18, 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, *Presentation of a Liability for an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit*

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

*Carryforward Exists* ("ASU 2013-11"), which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss ("NOL") carryforward, a similar tax loss or a tax credit carryforward exists. The FASB's objective in issuing ASU 2013-11 is to eliminate diversity in practice resulting from a lack of guidance on this topic in current GAAP. ASU 2013-11 requires that an entity present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss or a tax credit unless certain conditions exist. ASU 2013-11 is effective for the Company beginning January 1, 2014. The Company does not expect the adoption of ASU 2013-11 to have an impact on its consolidated financial statements, as the Company currently applies the methodology prescribed by ASU 2013-11.

On March 4, 2013, the FASB issued ASU 2013-05, *Foreign Currency Matters (Topic 830) - Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* ("ASU 2013-05"), which indicates that the entire amount of a cumulative translation adjustment ("CTA") related to an entity's investment in a foreign entity should be released when there has been either: (a) a sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in a foreign entity; (b) the loss of a controlling financial interest in an investment in a foreign entity (i.e., the foreign entity is deconsolidated); or (c) the step acquisition of a foreign entity (i.e., when the accounting for an entity has changed from applying the equity method for an investment in a foreign entity to consolidating the foreign entity). ASU 2013-05 does not change the requirement to release a pro rata portion of the CTA of the foreign entity into earnings for a partial sale of an equity method investment in a foreign entity. ASU 2013-05 is effective for the Company beginning January 1, 2014. The Company does not expect the adoption of ASU 2013-05 to have a material impact on its consolidated financial statements.

On February 5, 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"), which requires entities to disclose changes in accumulated other comprehensive income balances by component (i.e., unrealized gains or losses on available-for-sale securities or foreign-currency items) and significant items reclassified out of accumulated other comprehensive income by component either on the face of the income statement or as a separate footnote to the financial statements. ASU 2013-02 does not change the current requirements for interim financial statement reporting of comprehensive income. ASU 2013-02 became effective for the Company on January 1, 2013. The Company does not have significant items reclassified out of accumulated other comprehensive income and accordingly, the adoption of ASU 2013-02 did not impact the Company's consolidated financial statements.

**(3) ACQUISITION OF NET**

On August 24, 2012 (the "NET Acquisition Date"), the Company acquired all of the outstanding common stock of NET for cash consideration of \$41.5 million, or \$1.35 per share of NET common stock. The acquisition was effected through a merger of a wholly-owned subsidiary of the Company into NET with NET surviving the merger as a wholly-owned subsidiary of the Company. NET is a provider of networking equipment focused on secure real-time communications for UC, SIP trunking, enterprise mobility and IP-based multi-service networking. The Company acquired NET to enhance its position as an enabler of cloud-based UC. The acquisition of NET expanded the Company's portfolio of Session Border Controller ("SBC") solutions for enterprise customers and brought engineering resources, broader channel capability and a broad U.S. federal government installed base to leverage into SIP-enabled platforms.

The transaction has been accounted for as a business combination, and the financial results of NET have been included in the Company's consolidated financial statements for the period subsequent to its acquisition. The Company's financial results for year ended December 31, 2012 include \$17.3 million of revenue and \$9.5 million of net loss attributable to NET for the period subsequent to its acquisition.

The Company finalized the valuation of acquired assets, identifiable intangible assets, uncertain tax liabilities and certain accrued liabilities in the third quarter of 2013. Based on new information gathered about facts and circumstances that existed as of the NET Acquisition Date, the Company recorded retrospective adjustments as of December 31, 2012, which resulted in a net decrease to goodwill of \$1.4 million, a net increase to other current assets of \$0.9 million and a net decrease to current liabilities of \$0.5 million as set forth in the table below. The adjustments have been retrospectively applied to the December 31, 2012 balance sheet; however, these adjustments had no impact on the consolidated statements of operations, of comprehensive loss, of stockholders' equity or of cash flows.



## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

During the second quarter of 2013, the Company made an election under Section 338(g) of the Internal Revenue Code to have the NET transaction treated as an asset acquisition (i.e., a taxable transaction) with the goodwill being deductible for tax purposes over 15 years.

A summary of the allocation of the purchase consideration for NET is as follows (in thousands):

<b>Fair value of consideration transferred</b>	
Cash, net of cash acquired	\$ 35,508
Fair value of equity awards assumed (see Note 16)	892
Fair value of total consideration	<u>\$ 36,400</u>
<b>Fair value of assets acquired and liabilities assumed:</b>	
Marketable securities	\$ 5,359
Deferred income taxes	681
Other current assets	13,388
Property and equipment	4,694
Noncurrent investments	10,167
Intangible assets	16,810
Goodwill	27,317
Other noncurrent assets	1,843
Current liabilities	(9,350)
Debt	(34,208)
Other long-term liabilities	(301)
	<u>\$ 36,400</u>

The valuation of the acquired intangible assets is inherently subjective and relies on significant unobservable inputs. The Company used an income approach to value the acquired customer relationships and developed technology intangible assets. The valuation for each of these intangible assets was based on estimated projections of expected cash flows to be generated by the assets, discounted to the present value at discount rates commensurate with perceived risk. The valuation assumptions take into consideration the Company's estimates of contract renewal, technology attrition and revenue growth projections. The Company is amortizing the identifiable intangible assets in relation to the expected cash flows from the individual intangible assets over their respective useful lives (see Note 9).

The identifiable intangible assets as of the NET Acquisition Date are as follows (in thousands):

Developed technology	\$ 9,080
Customer relationships	6,140
Order backlog	860
Internal use software	730
	<u>\$ 16,810</u>

**Pro Forma Results**

The following unaudited pro forma information presents the condensed combined results of operations of the Company and NET for the years ended December 31, 2012 and 2011 as if the acquisition of NET had been completed on January 1, 2011 with adjustments to give effect to pro forma events that are directly attributable to the acquisition. These pro forma adjustments include a reduction of historical NET revenue for the fair value adjustment related to acquired deferred revenue, an increase in amortization expense for the acquired identifiable intangible assets, a decrease in historical NET interest expense reflecting the extinguishment of certain of NET's debt as a result of the acquisition and the elimination of transaction costs included in the Company's and NET's historical results, directly attributable to the acquisition from the year ended December 31, 2012 and inclusion of such costs in the year ended December 31, 2011.

The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the operations of the Company and NET. Accordingly, these unaudited pro forma results are presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the combined



## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

company that would have been achieved had the acquisition occurred at the beginning of each period presented, nor are they intended to represent or be indicative of future results of operations (in thousands, except per share amounts):

	Year ended December 31,	
	2012	2011
Revenue	\$ 284,970	\$ 308,660
Net loss	\$ (62,148)	\$ (60,984)
Loss per share	\$ (0.22)	\$ (0.22)

**Acquisition-Related Costs**

Acquisition-related costs include those costs related to the acquisition that would otherwise not have been incurred by the Company. These costs include professional and services fees, such as legal, audit, consulting, paying agent and other fees and expenses related to cash payments to former NET executives under their NET change of control agreements.

The components of acquisition-related costs included in the Company's results of operations for the year ended December 31, 2012 are as follows (in thousands):

Professional and services fees	\$ 3,571
Change of control agreements	1,925
	<u>\$ 5,496</u>

**(4) EARNINGS (LOSS) PER SHARE**

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the period. For periods in which the Company reports net income, diluted net income per share is determined by using the weighted average number of common and dilutive common equivalent shares outstanding during the period unless the effect is antidilutive.

The calculations of shares used to compute basic and diluted loss per share are as follows (in thousands):

	Year ended December 31,		
	2013	2012	2011
Weighted average shares outstanding—basic	278,428	280,090	278,540
Potential dilutive common shares	—	—	—
Weighted average shares outstanding—diluted	278,428	280,090	278,540

Options to purchase the Company's common stock and unvested shares of restricted stock and performance-based stock awards aggregating 35.4 million shares for the year ended December 31, 2013, 25.7 million shares for the year ended December 31, 2012 and 24.9 million shares for the year ended December 31, 2011 have not been included in the computation of diluted loss per share because their effect would have been antidilutive.

**(5) CASH EQUIVALENTS, MARKETABLE SECURITIES AND INVESTMENTS**

The Company invests in debt and equity instruments, primarily U.S. government-backed, municipal and corporate obligations, which management believes to be high quality (investment grade) credit instruments.

The Company did not sell any of its available-for-sale securities during the years ended December 31, 2013, 2012 or 2011, and accordingly, no gains or losses were realized.

Marketable securities and investments with continuous unrealized losses for one year or greater at December 31, 2013 were nominal; however, since the Company does not intend to sell these securities and does not believe it will be required to sell any securities before they recover in value, it does not believe these declines are other-than-temporary.

**SONUS NETWORKS, INC.**
**Notes to Consolidated Financial Statements (Continued)**

On a quarterly basis, the Company reviews its marketable securities and investments to determine if there have been any events that could create a credit impairment. Based on its reviews, the Company does not believe that any impairment existed with its current holdings at December 31, 2013.

The amortized cost, gross unrealized gains and losses and fair value of the Company's marketable debt and equity securities and investments at December 31, 2013 and 2012 were comprised of the following (in thousands):

	December 31, 2013			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<i>Cash equivalents</i>	\$ 50,404	\$ —	\$ —	\$ 50,404
<i>Marketable securities</i>				
U.S. government agency notes	\$ 47,895	\$ 15	\$ —	\$ 47,910
Corporate debt securities	81,993	35	(8)	82,020
Commercial paper	5,647	2	—	5,649
Certificates of deposit	3,300	3	—	3,303
	<u>\$ 138,835</u>	<u>\$ 55</u>	<u>\$ (8)</u>	<u>\$ 138,882</u>
<i>Investments</i>				
U.S. government agency notes	\$ 9,254	\$ 3	\$ —	\$ 9,257
Foreign government notes	1,250	—	—	1,250
Corporate debt securities	23,848	17	(8)	23,857
	<u>\$ 34,352</u>	<u>\$ 20</u>	<u>\$ (8)</u>	<u>\$ 34,364</u>

	December 31, 2012			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<i>Cash equivalents</i>	\$ 69,389	\$ —	\$ —	\$ 69,389
<i>Marketable securities</i>				
U.S. government agency notes	\$ 53,646	\$ 22	\$ —	\$ 53,668
Foreign government notes	2,000	1	—	2,001
Corporate debt securities	84,047	34	(5)	84,076
Commercial paper	7,492	5	—	7,497
Certificates of deposit	14,650	13	—	14,663
	<u>\$ 161,835</u>	<u>\$ 75</u>	<u>\$ (5)</u>	<u>\$ 161,905</u>
<i>Investments</i>				
U.S. government agency notes	\$ 19,358	\$ 20	\$ —	\$ 19,378
Corporate debt securities	10,306	20	(6)	10,320
	<u>\$ 29,664</u>	<u>\$ 40</u>	<u>\$ (6)</u>	<u>\$ 29,698</u>

The Company's available-for-sale debt securities that are classified as Investments in the consolidated balance sheet mature after one year but within two years or less from the balance sheet date.

**Fair Value Hierarchy**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. The three-tier fair value hierarchy is based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is as follows:

**SONUS NETWORKS, INC.**
**Notes to Consolidated Financial Statements (Continued)**

*Level 1.* Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

*Level 2.* Level 2 applies to assets or liabilities for which there are inputs that are directly or indirectly observable in the marketplace, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets).

*Level 3.* Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The following table shows the fair value of the Company's financial assets at December 31, 2013 and 2012. These financial assets are comprised of the Company's available-for-sale debt and equity securities and reported under the captions Cash and cash equivalents, Marketable securities and Investments in the consolidated balance sheets (in thousands):

	Total carrying value at December 31, 2013	Fair value measurements at December 31, 2013 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<i>Cash equivalents</i>	\$ 50,404	\$ 50,404	\$ —	\$ —
<i>Marketable securities</i>				
U.S. government agency notes	\$ 47,910	\$ —	\$ 47,910	\$ —
Corporate debt securities	82,020	—	82,020	—
Commercial paper	5,649	—	5,649	—
Certificates of deposit	3,303	—	3,303	—
	\$ 138,882	\$ —	\$ 138,882	\$ —
<i>Investments</i>				
U.S. government agency notes	\$ 9,257	\$ —	\$ 9,257	\$ —
Foreign government notes	1,250	—	1,250	—
Corporate debt securities	23,857	—	23,857	—
	\$ 34,364	\$ —	\$ 34,364	\$ —

	Total carrying value at December 31, 2012	Fair value measurements at December 31, 2012 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<i>Cash equivalents</i>	\$ 69,389	\$ 68,389	\$ 1,000	\$ —
<i>Marketable securities</i>				
U.S. government agency notes	\$ 53,668	\$ —	\$ 53,668	\$ —
Foreign government notes	2,001	—	2,001	—
Corporate debt securities	84,076	—	84,076	—
Commercial paper	7,497	—	7,497	—
Certificates of deposit	14,663	—	14,663	—
	\$ 161,905	\$ —	\$ 161,905	\$ —
<i>Investments</i>				
U.S. government agency notes	\$ 19,378	\$ —	\$ 19,378	\$ —
Corporate debt securities	10,320	—	10,320	—
	\$ 29,698	\$ —	\$ 29,698	\$ —

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

The Company's marketable securities and investments have been valued on the basis of valuations provided by third-party pricing services, as derived from such services' pricing models. Inputs to the models may include, but are not limited to, reported trades, executable bid and asked prices, broker/dealer quotations, prices or yields of securities with similar characteristics, benchmark curves or information pertaining to the issuer, as well as industry and economic events. The pricing services may use a matrix approach, which considers information regarding securities with similar characteristics to determine the valuation for a security. The Company is ultimately responsible for the consolidated financial statements and underlying estimates. Accordingly, the Company assesses the reasonableness of the valuations provided by the third-party pricing services by reviewing actual trade data, broker/dealer quotes and other similar data, which are obtained from quoted market prices or other sources.

**(6) ACCOUNTS RECEIVABLE, NET**

Accounts receivable, net, consist of the following (in thousands):

	December 31,	
	2013	2012
Accounts receivable, gross	\$ 64,620	\$ 68,728
Allowance for doubtful accounts	(157)	—
Accounts receivable, net	<u>\$ 64,463</u>	<u>\$ 68,728</u>

The activity in the Company's allowance for doubtful accounts is as follows (in thousands):

Year ended December 31,	Balance at beginning of year	Charges to expense	Write-offs	Balance at end of year
2013	\$ —	\$ 415	\$ (258)	\$ 157
2012	\$ —	\$ —	\$ —	\$ —
2011	\$ 313	\$ —	\$ (313)	\$ —

**(7) INVENTORY**

Inventory consists of the following (in thousands):

	December 31,	
	2013	2012
On-hand final assemblies and finished goods inventories	\$ 19,070	\$ 22,009
Deferred cost of goods sold	4,387	5,704
	<u>23,457</u>	<u>27,713</u>
Less current portion	(21,793)	(25,614)
Noncurrent portion (included in Other assets)	<u>\$ 1,664</u>	<u>\$ 2,099</u>

**SONUS NETWORKS, INC.**
**Notes to Consolidated Financial Statements (Continued)**
**(8) PROPERTY AND EQUIPMENT**

Property and equipment consists of the following (in thousands):

	Useful Life	December 31,	
		2013	2012
Equipment	3 years	\$ 80,710	\$ 78,517
Software	2-3 years	15,410	14,852
Furniture and fixtures	3-5 years	855	983
Leasehold improvements	Shorter of the life of the lease or estimated useful life (1-5 years)	10,659	11,747
		107,634	106,099
Less accumulated depreciation and amortization		(88,532)	(82,332)
Property and equipment, net		\$ 19,102	\$ 23,767

The Company recorded depreciation and amortization expense related to property and equipment of \$12.3 million for the year ended December 31, 2013, \$12.9 million for the year ended December 31, 2012 and \$11.6 million for the year ended December 31, 2011.

Property and equipment under capital leases included in the amounts above are as follows (in thousands):

	December 31,	
	2013	2012
Cost	\$ 326	\$ 326
Less accumulated depreciation	(220)	(194)
Property and equipment under capital leases, net	\$ 106	\$ 132

The net book values of the Company's property and equipment by geographic area are as follows (in thousands):

	December 31,	
	2013	2012
United States	\$ 13,960	\$ 16,110
Asia/Pacific	4,665	6,811
Europe	453	792
Other	24	54
	\$ 19,102	\$ 23,767

**(9) INTANGIBLE ASSETS AND GOODWILL**

The Company's intangible assets at December 31, 2013 and 2012 consist of the following (in thousands):

December 31, 2013	Weighted average amortization period (years)	Cost	Accumulated amortization	Net carrying value
Intellectual property	5.00	\$ 999	\$ 999	\$ —
Developed technology	5.03	9,080	2,729	6,351
Customer relationships	5.30	6,140	2,806	3,334
Internal use software	3.00	730	324	406
	4.35	\$ 16,949	\$ 6,858	\$ 10,091

**SONUS NETWORKS, INC.**
**Notes to Consolidated Financial Statements (Continued)**

<u>December 31, 2012</u>	Weighted average amortization period (years)	Cost	Accumulated amortization	Net carrying value
Intellectual property	5.00	\$ 2,999	\$ 2,199	\$ 800
Developed technology	5.03	9,080	730	8,350
Customer relationships	5.30	6,140	702	5,438
Order backlog	0.33	860	860	—
Internal use software	3.00	730	81	649
	4.35	<u>\$ 19,809</u>	<u>\$ 4,572</u>	<u>\$ 15,237</u>

Amortization expense for intangible assets for the years ended December 31, 2013, 2012 and 2011 was as follows (in thousands):

	Year ended December 31,			Statement of operations classification
	2013	2012	2011	
Intellectual property	\$ 200	\$ 400	\$ 400	Research and development
Developed technology	1,999	730	—	Cost of revenue - product
Customer relationships	2,104	702	—	Sales and marketing
Order backlog	—	860	—	Cost of revenue - product
Internal use software	243	81	—	Cost of revenue - product
	<u>\$ 4,546</u>	<u>\$ 2,773</u>	<u>\$ 400</u>	

In connection with the preparation of its financial statements for the second quarter of 2013, the Company reviewed its intangible assets and other long-lived assets for impairment indicators. The Company determined that a triggering event had occurred relative to one of its intellectual property intangible assets that had been acquired during 2010. During 2013, the Company discontinued its development of this technology and determined that there were no alternative uses of the technology within either its existing or future product lines. Additionally, based on the age and resulting obsolescence of such technology, the Company concluded that the fair value was nominal based on a discounted cash flow model. As a result, the Company recorded an impairment charge of \$0.6 million in the three months ended June 28, 2013 to write down the carrying value of the asset to zero. This expense is included as a component of research and development expense in the Company's consolidated statements of operations for the year ended December 31, 2013. The nonrecurring fair value measurement of the impairment of the intellectual property was categorized in Level 3 of the fair value hierarchy.

Estimated future amortization expense for the Company's intangible assets at December 31, 2013 is as follows (in thousands):

<u>Years ending December 31,</u>	
2014	\$ 3,234
2015	2,368
2016	1,934
2017	1,901
2018	393
Thereafter	261
	<u>\$ 10,091</u>

Goodwill is recorded when the consideration for an acquisition exceeds the fair value of net tangible and identifiable intangible assets acquired. The changes in the carrying value of the Company's goodwill in the years ended December 31, 2013 and 2012 are as follows (in thousands):

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

	Year ended December 31,	
	2013	2012
Balance at January 1:		
Goodwill	\$ 35,485	\$ 8,168
Accumulated impairment losses	(3,106)	(3,106)
	32,379	5,062
Acquisition of NET	—	27,317
Balance at December 31	\$ 32,379	\$ 32,379

The components of the Company's goodwill balances at December 31, 2013 and 2012 are as follows:

	December 31,	
	2013	2012
Balance:		
Goodwill	\$ 35,485	\$ 35,485
Accumulated impairment losses	(3,106)	(3,106)
	\$ 32,379	\$ 32,379

**(10) ACCRUED EXPENSES**

Accrued expenses consist of the following (in thousands):

	December 31,	
	2013	2012
Employee compensation and related costs	\$ 20,683	\$ 15,799
Other	13,343	10,413
	\$ 34,026	\$ 26,212

**(11) RESTRUCTURING ACCRUAL**

On August 7, 2012, the Company announced that it had committed to a restructuring initiative to streamline operations and reduce operating costs by closing and consolidating certain facilities and reducing its worldwide workforce. In connection with this initiative, the Company recorded \$5.4 million of restructuring expense in the year ended December 31, 2013, comprised of \$5.1 million for severance and related costs in connection with reducing the Company's workforce and \$0.3 million related to facilities.

The Company recorded \$7.7 million of restructuring expense in the year ended December 31, 2012, comprised of \$3.2 million for severance and related costs, \$4.2 million related to space reductions in three facilities and \$0.3 million for the write-off of assets associated with the aforementioned facility consolidations. The \$4.2 million recorded in the year ended December 31, 2012 related to facilities is comprised of \$4.0 million related to space reductions in NET's former corporate headquarters in California, \$0.1 million related to space reductions in the former NET facility in New Jersey and \$0.1 million to consolidate the Company's offices in France.

Restructuring expense is reported separately in the Company's consolidated statements of operations. The Company expects to complete the payments related to severance in the second half of 2014 and the payments related to facilities in 2016.

The portion of restructuring payments due more than one year from the balance sheet date is included in Other long-term liabilities in the Company's consolidated balance sheets. At December 31, 2013, the long-term portion of accrued restructuring was \$1.8 million.

**SONUS NETWORKS, INC.**
**Notes to Consolidated Financial Statements (Continued)**

The tables below summarize the restructuring accrual activity for the years ended December 31, 2013 and 2012 (in thousands):

	Balance at January 1, 2013	Initiatives charged to expense	Cash payments	Foreign exchange	Balance at December 31, 2013
Severance	\$ 1,135	\$ 5,102	\$ (4,904)	\$ —	\$ 1,333
Facilities	4,100	309	(1,397)	—	3,012
	<u>\$ 5,235</u>	<u>\$ 5,411</u>	<u>\$ (6,301)</u>	<u>\$ —</u>	<u>\$ 4,345</u>

	Initiatives charged to expense	Cash payments	Foreign exchange	Balance at December 31, 2012
Severance	\$ 3,237	\$ (2,097)	\$ (5)	\$ 1,135
Facilities	4,133	(35)	2	4,100
Restructuring accrual activity	7,370	<u>\$ (2,132)</u>	<u>\$ (3)</u>	<u>\$ 5,235</u>
Asset write-offs	305			
Total restructuring expense	<u>\$ 7,675</u>			

**(12) DEBT**

In connection with the Company's acquisition of NET, NET remained obligated under its 3 3/4 % Convertible Senior Notes due December 15, 2014 (the "2007 Notes") and 7 1/4 % Redeemable Convertible Subordinated Debentures due May 15, 2014 (the "1989 Debentures") outstanding at the NET Acquisition Date, subject to the transactions discussed below.

The Company has determined that the estimated fair value of its outstanding debt at both December 31, 2013 and 2012 equals its carrying value. Although the debt can be publicly traded, there have been no trading transactions since 2010 and accordingly, the Company has categorized it as a Level 2 within the fair value hierarchy.

**3¾% Convertible Senior Notes**

In December 2007, NET issued \$85.0 million of 2007 Notes in a private placement, of which \$10.5 million in principal remained outstanding at the NET Acquisition Date, and under which NET remained obligated after the acquisition. The 2007 Notes bear interest at a rate of 3 3/4 % per annum and mature on December 15, 2014. The 2007 Notes are unsecured senior obligations of NET, ranking equal in right of payment to all existing and future senior indebtedness of NET, and senior in right of payment to any existing and future subordinated indebtedness of NET. The 2007 Notes are effectively subordinated to existing and future secured indebtedness of NET to the extent of the assets securing such indebtedness and structurally subordinated to the claims of all existing and future indebtedness and other liabilities of NET's subsidiaries. In connection with the acquisition, the Company neither assumed nor guaranteed NET's obligations under the 2007 Notes. The 2007 Notes are not redeemable by NET prior to the stated maturity date.

Prior to the acquisition, a 2007 Note could be converted by a holder, at its option, into shares of NET common stock at a conversion rate of 73.3689 shares of NET common stock per \$1,000 principal amount, subject to adjustment in certain events. On August 24, 2012, in connection with the consummation of the acquisition and as provided in the merger agreement, NET entered into a supplemental indenture for the 2007 Notes, which provided, among other things, that, in lieu of being convertible into shares of NET common stock, the 2007 Notes will be convertible into the kind and amount of merger consideration that would have been receivable upon the consummation of the acquisition by a holder of the number of shares of NET common stock issuable upon conversion of such 2007 Notes immediately preceding the effective time of the acquisition. The merger consideration was \$1.35 in cash per share of NET common stock.

Upon the occurrence of certain fundamental changes including, without limitation, an acquisition of voting control of NET, the liquidation of NET, or NET's common stock ceasing to be traded on a U.S. national securities exchange, a holder of 2007 Notes obtained the right to require NET to purchase for cash all or any part of its 2007 Notes at a purchase price equal to



## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

100% of the principal amount plus any accrued and unpaid interest (including additional interest, if any) up until, but not including, the fundamental change purchase date. The acquisition of NET by the Company constituted a "fundamental change" under the indenture governing the 2007 Notes. Accordingly, as required by the indenture governing the 2007 Notes and as provided in the merger agreement, on August 27, 2012, a fundamental change notice was sent to each holder of 2007 Notes, indicating that each such holder had the right to have all or a portion of its 2007 Notes purchased at a price in cash equal to 100% of the principal amount of the 2007 Notes (or portion thereof), plus any accrued and unpaid interest to, but excluding the fundamental change purchase date of October 12, 2012. In response to the fundamental change notice, \$8.1 million in aggregate principal amount of 2007 Notes were tendered for purchase. The remaining \$2.4 million in aggregate principal amount is due on December 15, 2014.

**7¼% Redeemable Convertible Subordinated Debentures**

In May 1989, NET issued \$75.0 million of 1989 Debentures, of which \$23.7 million in aggregate principal amount remained outstanding as of the NET Acquisition Date, and under which NET remained obligated after the acquisition. The 1989 Debentures bore interest at a rate of 7 1/4 % per annum and matured according to their terms on May 15, 2014. In connection with the acquisition, the Company neither assumed nor guaranteed NET's obligations under the 1989 Debentures.

Prior to the acquisition, each 1989 Debenture was convertible at the option of the holder into NET common stock at a conversion price of \$31.50 per share and was redeemable at the option of NET. The 1989 Debenture holders were entitled to a sinking fund which began May 15, 2000, of 14 annual payments of 5% of the aggregate principal amount of the 1989 Debentures issued (\$3.8 million annually), reduced by any redemption or conversion of the 1989 Debentures. As a result of previous redemptions, the total remaining sinking fund requirement was \$1.2 million at the NET Acquisition Date, which, assuming no further redemptions would be due as a final sinking fund payment on May 15, 2014.

On August 24, 2012, in connection with the consummation of the acquisition and as provided in the merger agreement, NET entered into a supplemental indenture for the 1989 Debentures, which provided, among other things, that, in lieu of being convertible into shares of NET common stock, the 1989 Debentures would be convertible into the kind and amount of merger consideration that would have been received upon the consummation of the acquisition by a holder of the number of shares of NET common stock issuable upon conversion of such 1989 Debenture immediately preceding the effective time of the acquisition. The merger consideration was \$1.35 per share.

On August 24, 2012, NET sent a notice to the holders of the 1989 Debentures, notifying them that NET had elected to redeem the entire outstanding aggregate principal amount of the 1989 Debentures. The date for the redemption was September 26, 2012. On the redemption date, the entire outstanding principal amount of the 1989 Debentures became due and payable at a redemption price equal to 100% of the principal amount of the 1989 Debentures plus accrued and unpaid interest to the redemption date. NET paid the aggregate principal amount of \$23.7 million plus \$0.6 million in accrued interest to the holders of the 1989 Debentures on September 26, 2012 and accordingly, at December 31, 2012, no obligation remained in connection with the Debentures.

**(13) LONG-TERM LIABILITIES**

Long-term liabilities consist of the following (in thousands):

	December 31,	
	2013	2012
Capital lease obligations	\$ 154	\$ 170
Deferred rent	3,057	3,551
Restructuring	4,345	5,235
	7,556	8,956
Current portion *	(3,185)	(3,250)
Long-term liabilities, net of current portion	\$ 4,371	\$ 5,706

\* Includes \$2.5 million at December 31, 2013 and \$2.5 million at December 31, 2012 of current accrued restructuring reported as a component of Accrued expenses in the consolidated balance sheets.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

The future minimum annual payments under capital leases at December 31, 2013 are as follows (in thousands):

<u>Years ending December 31,</u>	
2014	\$ 89
2015	70
2016	2
Total minimum lease payments	161
Less amount representing interest	(7)
Present value of minimum lease payments	154
Less current portion	(84)
Long-term liabilities portion	<u>\$ 70</u>

**(14) STOCKHOLDER RIGHTS PLAN**

On June 21, 2013, the Company entered into an amendment to its stockholder rights agreement (the "Rights Plan") to extend the expiration date of the rights in such Rights Plan from June 26, 2013 to June 26, 2015. The amendment was not in response to any acquisition proposal and no other amendments were made to the Rights Plan. The Rights Plan was originally adopted on June 26, 2008 and was subsequently initially extended on June 10, 2011 to June 26, 2013.

Under the Rights Plan, preferred stock purchase rights (the "Rights") were distributed as a dividend at the rate of one Right per share of common stock of the Company held by stockholders of record as of the close of business on July 7, 2008. Each Right entitles the stockholder to purchase from the Company a unit consisting of one one-thousandth of a share (a "Unit") of preferred stock at a purchase price of \$25.00 per Unit, subject to adjustment.

The Rights generally will be exercisable only if a person or group acquires beneficial ownership of 15% or more of the Company's common stock (which includes for this purpose shares of common stock referenced in derivative transactions or securities), or commences or publicly announces a tender or exchange offer upon consummation of which they would beneficially own 15% or more of the Company's common stock. Subject to certain conditions, a person or group who beneficially owned 15% or more of the outstanding shares of the Company's common stock prior to the adoption of the Rights Plan did not cause the Rights to become exercisable upon adoption of the Rights Plan. Should the Rights become exercisable, the effect would be to dilute the ownership of the beneficial owner(s) who triggered the Rights, as that beneficial owner or group of owners would not receive the Units.

**(15) COMMON STOCK REPURCHASES**

On July 29, 2013, the Company announced that its Board of Directors had authorized a stock buyback program to repurchase up to \$100 million of the Company's common stock from time to time on the open market or in privately negotiated transactions. The timing and amount of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions and other factors. The Company may elect to implement a 10b5-1 repurchase program, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The buyback program does not have a fixed expiration date but may be suspended or discontinued at any time. The buyback program is being funded using the Company's working capital.

During the year ended December 31, 2013, the Company spent \$59.7 million, including transaction fees, to repurchase and retire 18.5 million shares of its common stock under the buyback program.

**(16) STOCK-BASED COMPENSATION PLANS****2007 Stock Incentive Plan**

The Company's 2007 Stock Incentive Plan (the "2007 Plan") was approved at the Company's Annual Meeting of Stockholders held on November 12, 2007, and became effective on that date. The 2007 Plan provides for the award of options to purchase the Company's common stock ("stock options"), stock appreciation rights ("SARs"), restricted common stock

## SONUS NETWORKS, INC.

### Notes to Consolidated Financial Statements (Continued)

("restricted stock"), performance-based awards, restricted stock units ("RSUs") and other stock-based awards to employees, officers, directors (including those directors who are not employees or officers of the Company), consultants and advisors of the Company and its subsidiaries.

At its June 12, 2013 annual meeting of stockholders, the Company's stockholders approved an amendment to the 2007 Plan (the "Amended 2007 Plan"), which increased the number of shares available for future grant by 21 million shares.

At December 31, 2013, there were 16.4 million shares available for future issuance under the Amended 2007 Plan. Under the fungible share pool formula, the number of total shares available for future awards under the Amended 2007 Plan would be reduced by the fungible share pool multiple of 1.5 for each share of common stock included in an award other than a stock option or SAR award. Accordingly, the total number of shares awarded in the future under the Amended 2007 Plan could be less than the number of shares currently available for issuance.

#### 2008 Stock Incentive Plan

In connection with the acquisition of NET, the Company assumed NET's 2008 Equity Incentive Plan (the "NET 2008 Plan"), which provides for the award of stock options, SARs, restricted stock, performance-based awards and RSUs), and the number of shares available for grant under the 2008 Plan were converted to like Sonus equity awards (the "converted awards") using a conversion factor of 0.75, which was calculated based on the acquisition consideration of \$1.35 per share of NET common stock divided by the average of the closing price of Sonus common stock for the ten consecutive days ending with the third trading day that preceded the closing date. This conversion factor was also used to convert the exercise prices of NET stock options to Sonus stock option exercise prices. The converted awards will vest under the same schedules as the respective NET stock options and NET RSUs.

The fair values of the NET stock options assumed were estimated using a Black-Scholes option pricing model. The Company recorded \$0.9 million as additional purchase consideration for the fair value of the assumed equity awards. The fair value of the assumed awards attributable to future stock-based compensation expense totaled \$0.4 million, which was recorded over a weighted average period of approximately eight months.

In December 2012, the Company's Board of Directors approved the re-naming of the NET 2008 Plan to the 2008 Stock Incentive Plan (the "2008 Plan"). At December 31, 2013, there were 2.1 million shares available for future issuance under the 2008 Plan. Under the fungible pool formula, the number of total shares available for future awards under the 2008 Plan would be reduced by the fungible share pool multiple of 1.25 for each share of common stock included in an award other than a stock option or SAR award. Accordingly, the total number of shares awarded in the future under the 2008 Plan could be less than the number of shares currently available for issuance.

#### Executive and Board of Directors Equity Arrangements

In March 2013, 21 executives of the Company, including Raymond P. Dolan, the Company's President and Chief Executive Officer ("Mr. Dolan"), elected to receive bonuses with respect to 2013 (collectively, the "2013 Bonus"), if any were earned, in the form of shares of the Company's common stock (collectively, the "2013 Bonus Shares"). The 2013 Bonus Shares, if any were granted, would be granted on a date concurrent with the timing of normal 2013 bonus payouts and would be fully vested as of the date of grant, with the number of 2013 Bonus Shares calculated by dividing amounts equal to 1.5 times the respective 2013 Bonus amounts earned, as determined by the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") by the closing price of the Company's common stock on the date of grant. The Company is recording stock-based compensation expense for the 2013 Bonus Shares commensurate with the expected achievement level represented by the Company's accrual for its company-wide cash bonus program, as the performance metrics for each are consistent. On February 11, 2014, the Compensation Committee determined the achievement level for the 2013 Bonus Shares and also that such shares would be granted and vest on effective February 18, 2014. Accordingly, the Company granted approximately 1 million 2013 Bonus Shares on February 18, 2014, based on \$3.30 per share, the closing price of the Company's common stock on the date of grant. Because no shares were granted in connection with the 2013 Bonus in the year ended December 31, 2013, there are no shares related to the 2013 Bonus reported in the restricted stock grant table below.

On February 15, 2013, Mr. Dolan elected to accept restricted shares of the Company's common stock in lieu of his base salary for the period from January 1, 2013 through December 31, 2013. Mr. Dolan had previously not received any salary

**SONUS NETWORKS, INC.****Notes to Consolidated Financial Statements (Continued)**

payments from the Company for this period. On February 15, 2013, the Company granted Mr. Dolan 183,824 shares of restricted common stock (the "2013 Salary Shares") having a total grant date fair value of \$500,000, equal to Mr. Dolan's base salary for the year ending December 31, 2013. The number of shares was calculated by dividing Mr. Dolan's base salary for the year by \$2.72, the closing price of the Company's common stock on the date of grant. The 2013 Salary Shares were fully vested on December 31, 2013. The Company recorded stock-based compensation expense related to the 2013 Salary Shares ratably for the period of January 1, 2013 through December 31, 2013. The 2013 Salary Shares are included in the amounts reported both as "Granted" and "Vested" in the restricted stock grant table below.

On February 14, 2013, the Compensation Committee determined that eight executives of the Company, excluding Mr. Dolan, would receive their bonuses with respect to 2012 in the form of restricted shares of the Company's common stock equal to 100% of their respective target bonus amounts for 2012 (collectively, the "Executive Bonus Shares"). The number of shares granted to each executive was calculated by dividing his/her target bonus amount by the closing price of the Company's common stock on February 15, 2013, the date of grant. The Executive Bonus Shares vested 50% on August 15, 2013 and the remaining 50% vested on February 15, 2014. The Company accrued for the cash payment of bonuses at the expected company-wide cash payout percentage amount at December 31, 2012, which amounts were less than the target bonus amounts for each individual. The Company is recording the unamortized expense related to the Executive Bonus Shares as stock-based compensation expense through February 15, 2014. These shares are reported as "Granted" in the restricted stock grant table below.

On August 7, 2012, Mr. Dolan elected to accept shares of restricted stock (the "2012 Salary Shares") in lieu of base salary for the period from August 10, 2012 through December 31, 2012 and to receive his year 2012 target bonus, if earned, in the form of restricted shares (the "Dolan 2012 Bonus Shares"). The Company granted Mr. Dolan 108,398 2012 Salary Shares, which have a total grant date fair value equal to the balance of Mr. Dolan's base salary for the year ending December 31, 2012, calculated by dividing Mr. Dolan's remaining base salary for the year by \$1.78, the closing price of the Company's common stock on the date of grant. The 2012 Salary Shares vested in full on December 31, 2012. The Company recorded compensation expense related to these awards ratably over the remaining vesting period through December 31, 2012. The 2012 Salary Shares are included in the amount reported both as "Granted" and "Vested" in the Restricted Stock Awards table below. On August 10, 2012, the Company granted Mr. Dolan 421,348 Dolan 2012 Bonus Shares, which equaled Mr. Dolan's potential 2012 bonus at the maximum level of achievement (150% of Mr. Dolan's annual base salary), divided by \$1.78, the closing price of the Company's common stock on the date of grant. During 2012, the Company recorded stock-based compensation expense for the Dolan 2012 Bonus Shares commensurate with the expected achievement level represented by the Company's accrual for its company-wide cash bonus program, as the performance metrics for each were consistent. The Dolan Bonus Shares represented the performance-based stock award shares reported as "Unvested balance at January 1, 2013" in the performance-based stock awards table below. On February 14, 2013, the Compensation Committee determined that Mr. Dolan had earned 280,899 Dolan 2012 Bonus Shares, of which 50% vested on August 15, 2013 and the remaining 50% vested on February 15, 2014. The Company is recording the unamortized expense related to the Dolan 2012 Bonus Shares, including incremental expense arising from the modification of this award, through February 15, 2014. Mr. Dolan forfeited the remaining 140,449 Dolan 2012 Bonus Shares on February 14, 2013, and these shares are reported as "Forfeited" in the performance-based stock awards table below.

Certain members of the Company's Board of Directors elected to receive their annual cash retainer in shares of the Company's common stock in lieu of cash payments. Accordingly, the Company granted approximately 73,000 shares in the aggregate under the Amended 2007 Plan to such members of the Board of Directors, of which approximately 40,000 shares were granted on February 15, 2013 and approximately 33,000 shares were granted on June 17, 2013. All such shares vested immediately on the applicable grant date. The shares are reported as both "Granted" and "Vested" in the restricted stock grants table below.

**Stock Options**

Options are issued to purchase shares of common stock of the Company at prices that are equal to the fair market value of the shares on the date the option is granted. Options generally vest over a period of four years, with 25% of the shares subject to the option vesting on the first anniversary of the grant date and the remaining 75% vesting in equal monthly increments thereafter through the fourth anniversary of the grant date. Options granted under the Amended 2007 Plan generally expire ten years from the date of grant. Options granted under the 2008 Plan generally expire seven years from the date of grant. The grant date fair value of options, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the requisite service period, which is generally the vesting period. Forfeitures are estimated based on historical experience.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

The activity related to the Company's outstanding stock options during the year ended December 31, 2013 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2013	25,116,398	\$ 3.46		
Granted	13,957,856	\$ 2.92		
Exercised	(1,304,918)	\$ 2.04		
Forfeited	(2,018,807)	\$ 2.67		
Expired	(2,614,417)	\$ 4.92		
Outstanding at December 31, 2013	33,136,112	\$ 3.22	6.81	\$ 12,157
Vested or expected to vest at December 31, 2013	30,348,416	\$ 3.26	6.62	\$ 11,082
Exercisable at December 31, 2013	14,914,561	\$ 3.73	4.47	\$ 4,853

The grant date fair values of options to purchase common stock granted in the years ended December 31, 2013, 2012 and 2011 were estimated using the Black-Scholes valuation model with the following assumptions:

	Year ended December 31,		
	2013	2012	2011
Risk-free interest rate	0.82%-1.71%	0.67%-0.89%	0.95%-2.12%
Expected dividends	—	—	—
Weighted average volatility	63.2%	67.4%	67.6%
Expected life (years)	4.5-6.0	4.5	4.5

The risk-free interest rate used is the average U.S. Treasury Constant Maturities Rate for the expected life of the award. The expected dividend yield of zero is based on the fact that the Company has never paid dividends and has no present intention to pay cash dividends. The expected life for stock options is based on a combination of the Company's historical option patterns and expectations of future employee actions.

The weighted average grant-date fair values of options granted during the year were \$1.48 for the year ended December 31, 2013, \$1.39 for the year ended December 31, 2012 and \$1.37 for the year ended December 31, 2011.

The total intrinsic values of options exercised during the year were \$1.3 million for the year ended December 31, 2013, \$0.2 million for the year ended December 31, 2012 and \$0.9 million for the year ended December 31, 2011.

The Company received cash from option exercises of \$2.7 million in the year ended December 31, 2013, \$0.3 million in the year ended December 31, 2012 and \$0.8 million in the year ended December 31, 2011.

#### Restricted Stock Grants - Restricted Stock Awards and Restricted Stock Units

The Company's outstanding restricted stock grants consist of both restricted stock awards ("RSAs") and RSUs. During the years ended December 31, 2013, 2012 and 2011, the Company had no unvested RSUs other than those converted in connection with the NET acquisition; all of which were fully vested by December 31, 2013. Recipients of RSAs have voting rights and rights to receive dividends, if declared. RSAs generally vest 25% on the first anniversary of the grant date, with the remaining 75% vesting in equal increments semi-annually thereafter. The grant date fair value of restricted stock grants, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the requisite service period. The fair value of restricted stock grants is determined based on the market value of the Company's shares on the date of grant.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

The activity related to the Company's unvested restricted stock grants for the year ended December 31, 2013 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested balance at January 1, 2013	617,203	\$ 2.45
Granted	1,584,086	\$ 2.83
Vested	(908,485)	\$ 2.60
Forfeited	(54,039)	\$ 2.66
Unvested balance at December 31, 2013	<u>1,238,765</u>	<u>\$ 2.82</u>

The total fair value of restricted stock grant shares vested was \$2.4 million in the year ended December 31, 2013, \$1.8 million in the year ended December 31, 2012 and \$3.2 million in the year ended December 31, 2011.

**Performance-Based Stock Awards**

Similar to recipients of RSAs, recipients of performance-based stock awards have voting rights and rights to dividends, if declared. The Company begins to record stock-based compensation expense for performance-based stock awards at the time that it becomes probable that the respective performance conditions will be achieved. The Company continues to recognize the grant date fair value of performance-based stock awards through the vest date of the respective awards so long as it remains probable that the related performance conditions will be satisfied.

The activity related to the Company's performance-based stock awards for the year ended December 31, 2013 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested balance at January 1, 2013	421,348	\$ 1.78
Granted	1,984,500	\$ 2.72
Vested	(1,205,858)	\$ 2.61
Forfeited	(140,449)	\$ 1.78
Unvested balance at December 31, 2013	<u>1,059,541</u>	<u>\$ 2.60</u>

On February 14, 2013, the Compensation Committee took certain actions regarding performance-based stock awards that had been awarded in previous years but for which the grant date criteria had not been met as of December 31, 2012. These actions included determining that a certain number of these performance-based shares would vest as of February 15, 2013 (the "Vested Performance Shares") and subjecting the remaining performance-based shares (the "Future Performance Shares") to further performance and service conditions. Accordingly, as of February 15, 2013 the grant date criteria were met for both the Vested Performance Shares and the Future Performance Shares and they are reported as "Granted" in the table above. The performance conditions for the Future Performance Shares related to either a portion of or the full 2013 year and the service conditions were implemented through vesting schedules individually assigned to each Future Performance Share award that provide for service-based vesting through 2015. On July 26, 2013, the Compensation Committee determined that the performance conditions related to the Future Performance Shares had been satisfied based on the Company's performance for the six months ended June 28, 2013 and, accordingly, all of the Future Performance Shares will vest contingent upon continued employment with the Company on the vesting dates. The Company had previously estimated that the conditions related to the Future Performance Shares would be satisfied by June 28, 2013 and had recorded expense in the first and second quarters of 2013 based on that estimate. The Company is recording the unamortized expense related to the Future Performance Shares based on the vesting dates of the respective awards.

**ESPP**

The Amended and Restated 2000 Employee Stock Purchase Plan (the "ESPP") is designed to provide eligible employees of the Company and its participating subsidiaries an opportunity to purchase common stock of the Company through accumulated payroll deductions.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

At December 31, 2013, the ESPP provides for six-month consecutive offering periods, with the purchase price of the stock equal to 85% of the market price on the last day of the offering period. Under the ESPP, because employees are entitled to purchase a variable number of shares for a fixed monetary amount, future awards are classified as share-based liabilities and recorded at fair value. The Company reclassifies these liabilities to Additional paid-in capital at the time of the share purchase, which is the date of the award. At the February 2014 meeting of the Board of Directors, the ESPP was amended, effective March 1, 2014, to provide for six-month consecutive offering periods with the purchase price of the stock equal to 85% of the lesser of the market price on the first or last day of the offering period. The maximum number of shares of common stock an employee may purchase during each offering period is 2,500, subject to certain adjustments pursuant to the ESPP.

On January 1 of each year, the aggregate number of shares of common stock available for purchase under the ESPP increases by the lesser of (i) 2% of the outstanding shares on December 31 of the preceding year or (ii) an amount determined by the Board of Directors of the Company. At December 31, 2013, 25.0 million shares were authorized and 11.6 million shares were available under the ESPP for future issuance.

**Stock-Based Compensation**

The consolidated statements of operations include stock-based compensation for the years ended December 31, 2013, 2012 and 2011 as follows (in thousands):

	Year ended December 31,		
	2013	2012	2011
Product cost of revenue	\$ 181	\$ 162	\$ 398
Service cost of revenue	1,050	813	1,203
Research and development	3,616	2,297	2,045
Sales and marketing	4,780	2,006	1,817
General and administrative	8,246	3,725	2,402
	<u>\$ 17,873</u>	<u>\$ 9,003</u>	<u>\$ 7,865</u>

There is no income tax benefit for employee stock-based compensation expense for the years ended December 31, 2013, 2012 and 2011 due to the valuation allowance recorded.

At December 31, 2013, there was \$22.6 million, net of expected forfeitures, of unrecognized stock-based compensation expense related to unvested stock options, RSAs and performance-based stock awards. This expense is expected to be recognized over a weighted average period of approximately three years.

**Common Stock Reserved**

Common stock reserved for future issuance at December 31, 2013 consists of the following:

Amended 2007 Plan	16,437,253
2008 Plan	2,066,069
ESPP	11,598,424
	<u>30,101,746</u>

The Company's policy is to issue authorized but unissued shares upon the exercise of stock options, grant restricted common stock and performance-based stock awards, and authorize the purchase of shares of the Company's common stock under the ESPP.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

**(17) EMPLOYEE DEFINED CONTRIBUTION PLAN**

Through December 31, 2012, the Company provided a matching contribution of 50% of employee contributions to its 401(k) savings plan, up to a maximum match of \$3,500 per employee per year. The Company elected not to make a matching contribution in 2013 and, accordingly, the Company did not record expense related to its 401(k) savings plan in the year ended December 31, 2013. The Company recorded expense related to its 401(k) savings plan of \$1.7 million in the year ended December 31, 2012 and \$1.4 million in the year ended December 31, 2011.

**(18) INCOME TAXES**

The components of income (loss) from continuing operations before income taxes consist of the following (in thousands):

	Year ended December 31,		
	2013	2012	2011
Loss before income taxes:			
United States	\$ (21,076)	\$ (49,337)	\$ (13,144)
Foreign	409	1,609	1,906
	<u>\$ (20,667)</u>	<u>\$ (47,728)</u>	<u>\$ (11,238)</u>

The provision (benefit) for income taxes from continuing operations consists of the following (in thousands):

	Year ended December 31,		
	2013	2012	2011
Provision (benefit) for income taxes:			
Current:			
Federal	\$ 14	\$ 14	\$ 14
State	150	105	183
Foreign	1,696	1,465	1,212
Total current	<u>1,860</u>	<u>1,584</u>	<u>1,409</u>
Deferred:			
Federal	(1,911)	(12,441)	(140)
State	(103)	(1,680)	696
Foreign	(1,081)	607	56
Change in valuation allowance	2,687	14,371	(556)
Total deferred	<u>(408)</u>	<u>857</u>	<u>56</u>
Total	<u>\$ 1,452</u>	<u>\$ 2,441</u>	<u>\$ 1,465</u>



**SONUS NETWORKS, INC.**  
**Notes to Consolidated Financial Statements (Continued)**

A reconciliation of the Company's effective tax rate for continuing operations to the statutory federal rate is as follows:

	Year ended December 31,		
	2013	2012	2011
U.S. statutory income tax rate	(35.0)%	(35.0)%	(35.0)%
State income taxes, net of federal benefit	0.4	(3.6)	6.0
Foreign income taxes	1.3	3.2	5.3
Capital loss expiration	24.0	—	—
Foreign deemed dividends	1.8	2.1	9.3
Stock-based compensation	7.6	3.4	14.9
Tax credits	(6.1)	(0.7)	3.2
Uncertain tax positions	—	—	0.1
Deferred cost of goods sold elimination	—	(1.2)	5.0
Valuation allowance	9.9	35.5	2.0
Goodwill amortization	3.3	0.5	—
Other, net	(0.2)	0.9	2.2
Effective income tax rate	7.0 %	5.1 %	13.0 %

The following is a summary of the significant components of deferred income tax assets and liabilities (in thousands):

	December 31,	
	2013	2012
<b>Assets:</b>		
Net operating loss carryforwards	\$ 64,811	\$ 62,257
Capital loss carryforwards	—	5,455
Research and development tax credits	21,401	19,627
Other tax credits	160	249
Intangible assets	2,530	1,332
Deferred revenue	4,143	3,915
Accrued expenses	10,519	7,871
Inventory	6,498	5,750
Stock-based compensation	9,263	7,881
Other temporary differences	3,642	4,863
	122,967	119,200
Valuation allowance	(119,616)	(116,929)
Total deferred tax assets	3,351	2,271
<b>Liabilities:</b>		
Purchased intangible assets	(922)	(249)
Unrealized gain on available-for-sale securities	(574)	(574)
Total deferred tax liabilities	(1,496)	(823)
Total net deferred tax assets	\$ 1,855	\$ 1,448
<b>Reported as:</b>		
Deferred income taxes - current	\$ 656	\$ 686
Deferred income taxes - noncurrent	1,199	762
	\$ 1,855	\$ 1,448

At December 31, 2013, the Company had cumulative net operating losses ("NOL") of \$200.6 million for federal income tax purposes and \$88.7 million for state income tax purposes. The federal NOL carryforwards expire at various dates from 2020 through 2033. The state NOL expires at various dates from 2014 through 2033. Of the federal NOL, \$127.0 million is attributable to stock option deductions. The Company's federal NOL carryforwards for tax return purposes are \$25.0 million greater than its recognized federal NOL for financial reporting purposes, primarily due to excess tax benefits (stock compensation deductions in excess of book compensation costs) not recognized for financial statement purposes until realized. The tax benefit of this loss would be recognized for financial statement purposes in the period in which the tax benefit reduces

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

income taxes payable, which will not be recognized until the Company recognizes a reduction in taxes payable from all other NOL carryforwards. In addition, the Company has \$9.3 million of deferred tax assets as of December 31, 2013 related to compensation expenses recognized for financial reporting purposes that are not deductible for tax purposes until options are exercised or shares vest. As employees will not exercise the underlying options unless the current market price exceeds the option exercise price and the Company's tax deduction for restricted shares is determined as the shares vest, the ultimate realization of the benefit related to stock options is directly associated with the price of the Company's common stock. At December 31, 2013, the Company's stock price of \$3.15 was below the weighted average exercise price of the Company's stock options of \$3.22.

With respect to non-U.S. NOL carryovers, the Company's United Kingdom subsidiary has a current year estimated NOL of approximately \$0.8 million and a carryover of approximately \$3.0 million from its acquisition of NET.

The Company also has available federal and state research and development credit carryforwards of approximately \$27 million that expire at various dates from 2015 through 2033.

During 2013, \$14.1 million of capital loss carryover resulting from the Company's sale of its Zynetix subsidiary on November 26, 2008 expired. The capital loss was only available to offset capital gains. Because it was not more likely than not that the Company would realize a benefit prior to the expiration of the capital loss carryforward, a full valuation allowance had been established against the \$5.5 million tax benefit associated with this capital loss.

During 2013 and 2012, the Company performed an analysis to determine if, based on all available evidence, it considered it more likely than not that some portion or all of the recorded deferred tax assets will not be realized in a future period. As a result of the Company's evaluation, the Company concluded that there was insufficient positive evidence to overcome the more objective negative evidence related to its cumulative losses and other factors. Accordingly, the Company has maintained a valuation allowance against its domestic deferred tax asset amounting to \$119.6 million at December 31, 2013 and \$116.9 million at December 31, 2012.

A reconciliation of the Company's unrecognized tax benefits is as follows (in thousands):

	2013	2012	2011
Unrecognized tax benefits at January 1	\$ 8,847	\$ 10,004	\$ 9,990
Increases related to current year tax positions	14	14	14
Decreases related to prior period tax positions	—	(1,171)	—
Settlements	—	—	—
Unrecognized tax benefits at December 31	<u>\$ 8,861</u>	<u>\$ 8,847</u>	<u>\$ 10,004</u>

The Company recorded liabilities for potential penalties and interest of \$14,000 for the year ended December 31, 2013, \$14,000 for the year ended December 31, 2012 and \$14,000 for the year ended December 31, 2011. The Company does not expect its unrecognized tax benefits to change materially over the next 12 months. Due to the Company's valuation allowance at December 31, 2013, none of the Company's unrecognized tax benefits, if recognized, would affect the effective tax rate.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, as well as various state and foreign jurisdictions. Generally, the tax years 2008 through 2013 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company's federal NOLs generated prior to 2003 could be adjusted on examination even though the year in which the loss was generated is otherwise closed by the statute of limitations. The Company's primary state jurisdiction, Massachusetts, has open periods from 2009 through 2013.

The acquisition of NET was accounted for as a nontaxable business combination and the Company carried over the existing tax basis of the acquired assets and liabilities. Deferred taxes were recorded as part of the business combination based on the differences between the tax basis of the acquired assets or liabilities and their reported amounts for financial reporting purposes. The Company concluded that there was insufficient positive evidence to overcome the more objective negative evidence related to cumulative losses and other factors. Accordingly, the Company recorded a valuation allowance against the majority of the acquired deferred tax assets.

With respect to the acquisition of NET, during the second quarter of 2013, the Company made an election under Section 338(g) of the Internal Revenue Code to have the acquisition transaction treated as an asset acquisition (i.e., a taxable transaction). The election is not considered part of the business combination and resulted in a step-up in the acquired assets and

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

liabilities to fair market value for tax purposes. During the third quarter of 2013, as a result of the election, the Company reversed all of the deferred taxes related to NET's assets, liabilities and net operating loss carryovers and the related valuation allowance that were recorded in the business combination. The resulting taxable gain from the election was fully offset by NET's operating loss carryovers and no taxes were paid by the Company as a result of the election.

**(19) MAJOR CUSTOMERS**

The following customers each contributed 10% or more of the Company's revenue in at least one of the years ended December 31, 2013, 2012 and 2011:

	Year ended December 31,		
	2013	2012	2011
Bahamas Telecommunications Company Ltd.	*	*	14%
AT&T	15%	20%	12%

\* Represents less than 10% of revenue

At December 31, 2013, one customer accounted for 10% or more of the Company's accounts receivable balance, representing approximately 13% of the Company's accounts receivable balance. At December 31, 2012, one customer accounted for 10% or more of the Company's accounts receivable balance, representing approximately 25% of the Company's accounts receivable balance. The Company performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. The Company maintains an allowance for doubtful accounts and such losses have been within management's expectations.

**(20) GEOGRAPHIC AND OPERATING SEGMENT INFORMATION**

The Company's classification of revenue by geographic area is determined by the location of the Company's customers. The following table summarizes revenue by geographic area as a percentage of total revenue:

	Year ended December 31,		
	2013	2012	2011
United States	69%	68%	60%
Europe, Middle East and Africa	12	13	12
Japan	12	14	11
Other Asia Pacific	5	4	2
Other	2	1	15
	100%	100%	100%

Bahamas Telecommunications Company Ltd. ("Bahamas Telecom") accounted for approximately 14% of the Company's revenue in the year ended December 31, 2011. Bahamas Telecom is located in the Caribbean and is included as a component of "Other" in the table above.

The Company's product revenue is comprised of the following (in thousands):

	Year ended December 31,		
	2013	2012	2011
Trunking and communication applications	\$ 69,841	\$ 85,694	\$ 116,506
SBC	97,431	67,632	37,867
	\$ 167,272	\$ 153,326	\$ 154,373

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

The Company's service revenue is comprised of the following (in thousands):

	Year ended December 31,		
	2013	2012	2011
Maintenance	\$ 84,698	\$ 76,423	\$ 76,418
Professional services	24,763	24,385	28,905
	<u>\$ 109,461</u>	<u>\$ 100,808</u>	<u>\$ 105,323</u>

**(21) COMMITMENTS AND CONTINGENCIES****Leases**

The Company leases its facilities under operating leases, which expire at various times through 2018. The Company is responsible for certain real estate taxes, utilities and maintenance costs under these leases. The Company's corporate headquarters is located in a leased facility in Westford, Massachusetts, consisting of 97,500 square feet under a lease that expires in August 2018.

Escalation clauses, free rent and other lease concessions are recognized on a straight-line basis over the minimum lease term. Rent expense was \$5.5 million for the year ended December 31, 2013, \$5.0 million for the year ended December 31, 2012 and \$5.3 million for the year ended December 31, 2011.

Future minimum payments under operating lease arrangements as of December 31, 2013 are as follows (in thousands):

Years ending December 31,	
2014	\$ 5,824
2015	4,721
2016	3,316
2017	1,951
2018	1,135
Thereafter	226
	<u>\$ 17,173</u>

**Litigation and Contingencies**

The Company is often a party to disputes and legal proceedings that it considers routine and incidental to its business. In the normal course of business, the Company enters into contractual commitments to purchase services, materials, components, and finished goods from suppliers. Under agreements with certain contract manufacturers, the Company may be liable for purchased raw materials procured for the Company by the contract manufacturer. Management does not expect the results of any of these actions to have a material effect on the Company's business or consolidated financial statements.

**(22) SUBSEQUENT EVENT**

On December 13, 2013, the Company announced that it had entered into a definitive merger agreement to acquire Performance Technologies, Incorporated ("PT") for \$3.75 per share, or approximately \$34 million in cash, net of PT's cash and excluding acquisition-related costs. The Company believes that this acquisition will enable Sonus to expand and diversify its portfolio with an integrated, virtualized Diameter and SIP-based solution and deliver strategic value to service providers seeking to offer new multimedia services through mobile, cloud-based, real-time communications. On February 19, 2014, the Company completed the acquisition of PT.

## SONUS NETWORKS, INC.

## Notes to Consolidated Financial Statements (Continued)

## (23) QUARTERLY RESULTS (UNAUDITED)

The following tables present the Company's quarterly operating results for the years ended December 31, 2013 and 2012. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited consolidated financial statements. In the opinion of management, all necessary adjustments, consisting only of normal recurring adjustments, have been included to present fairly the unaudited consolidated quarterly results when read in conjunction with the Company's audited consolidated financial statements and related notes.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(In thousands, except per share data)				
<b>Fiscal 2013</b>				
Revenue	\$ 63,288	\$ 69,193	\$ 68,099	\$ 76,153
Cost of revenue	25,486	25,185	25,835	27,767
Gross profit	<u>\$ 37,802</u>	<u>\$ 44,008</u>	<u>\$ 42,264</u>	<u>\$ 48,386</u>
Loss from operations	\$ (13,472)	\$ (4,633)	\$ (2,911)	\$ (59)
Net income (loss)	\$ (13,748)	\$ (4,870)	\$ (3,773)	\$ 272
Earnings (loss) per share (1):				
Basic	\$ (0.05)	\$ (0.02)	\$ (0.01)	\$ —
Diluted	\$ (0.05)	\$ (0.02)	\$ (0.01)	\$ —
Shares used in computing earnings (loss) per share:				
Basic	281,542	282,389	279,209	270,936
Diluted	281,542	282,389	279,209	273,490
(In thousands, except per share data)				
<b>Fiscal 2012</b>				
Revenue	\$ 64,339	\$ 57,610	\$ 57,049	\$ 75,136
Cost of revenue	22,585	24,815	24,607	39,533
Gross profit	<u>\$ 41,754</u>	<u>\$ 32,795</u>	<u>\$ 32,442</u>	<u>\$ 35,603</u>
Loss from operations	\$ (6,197)	\$ (11,792)	\$ (14,804)	\$ (15,749)
Net loss	\$ (6,438)	\$ (11,725)	\$ (15,619)	\$ (16,387)
Loss per share (1):				
Basic	\$ (0.02)	\$ (0.04)	\$ (0.06)	\$ (0.06)
Diluted	\$ (0.02)	\$ (0.04)	\$ (0.06)	\$ (0.06)
Shares used in computing loss per share:				
Basic	279,487	279,926	280,145	280,773
Diluted	279,487	279,926	280,145	280,773

(1) Earnings (loss) per share is calculated independently for each of the quarters presented; accordingly, the sum of the quarterly earnings (loss) per share amounts may not equal the total calculated for the year.

(2) Includes the results of NET for the period subsequent to August 24, 2012.

## **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

## **Item 9A. Controls and Procedures**

### **Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2013.

### **Management's Annual Report on Internal Control over Financial Reporting**

Our management, with the participation of our principal executive officer and principal financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making its assessment of internal control over financial reporting, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework* (1992). Based on this assessment, management concluded that, as of December 31, 2013, our internal control over financial reporting is effective.

Deloitte & Touche LLP, an independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on management's internal control over financial reporting, which is included in this Item 9A under the caption "Report of Independent Registered Public Accounting Firm."

### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting during the fiscal quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Sonus Networks, Inc.  
Westford, Massachusetts

We have audited the internal control over financial reporting of Sonus Networks, Inc. and subsidiaries (the "Company") as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013 of the Company and our report dated February 27, 2014 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Boston, Massachusetts  
February 27, 2014

**Item 9B. Other Information**

Not applicable.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this Item 10 is included under the captions "Executive Officers of the Registrant," "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," "Code of Ethics" and "Board Meetings and Committees" in our definitive Proxy Statement with respect to our 2014 Annual Meeting of Stockholders to be filed with the SEC no later than 120 days after the end of the fiscal year ended December 31, 2013 and is incorporated herein by reference.

**Item 11. Executive Compensation**

The information required by this Item 11 is included under the captions "Director Compensation," "Summary of Executive Compensation," "Plan-Based Awards," "Option Holdings," "Severance and Change-in-Control Arrangements," "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" in our definitive Proxy Statement with respect to our 2014 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year ended December 31, 2013 and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item 12 is included under the captions "Beneficial Ownership of Securities" and "Equity Compensation Plan Information" in our definitive Proxy Statement with respect to our 2014 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year ended December 31, 2013 and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item 13 is included, as applicable, under the captions "Severance and Change-in-Control Agreements," "Indemnification Agreements," "Director Independence" and "Transactions with Related Persons" in our definitive Proxy Statement with respect to our 2014 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year ended December 31, 2013 and is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item 14 is included under the captions "Fees for Independent Registered Public Accounting Firm during the years ended December 31, 2013 and 2012" and "Policy on Audit Committee Pre-approval of Audit and Non-audit Services" in our definitive Proxy Statement with respect to our 2014 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year ended December 31, 2013 and is incorporated herein by reference.



**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**1) Financial Statements**

The consolidated financial statements of the Company are listed in the index under Part II, Item 8, of this Annual Report on Form 10-K.

**2) Financial Statement Schedules**

None. All schedules are omitted because they are not applicable, not required under the instructions or the information is contained in the consolidated financial statements, or notes thereto, included herein.

**3) List of Exhibits**

The Exhibits filed as part of this Annual Report on Form 10-K are listed in the Exhibit Index immediately preceding such Exhibits, which Exhibit Index is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SONUS NETWORKS, INC.

February 27, 2014

By: /s/ Raymond P. Dolan  
 Raymond P. Dolan  
*President, Chief Executive Officer and Director*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ Raymond P. Dolan</u> Raymond P. Dolan	President, Chief Executive Officer and Director (Principal Executive Officer)	February 27, 2014
<u>/s/ Mark T. Greenquist</u> Mark T. Greenquist	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 27, 2014
<u>/s/ Howard E. Janzen</u> Howard E. Janzen	Chairman	February 27, 2014
<u>/s/ James K. Brewington</u> James K. Brewington	Director	February 27, 2014
<u>/s/ Matthew W. Bross</u> Matthew W. Bross	Director	February 27, 2014
<u>/s/ John P. Cunningham</u> John P. Cunningham	Director	February 27, 2014
<u>/s/ Beatriz V. Infante</u> Beatriz V. Infante	Director	February 27, 2014
<u>/s/ Richard J. Lynch</u> Richard J. Lynch	Director	February 27, 2014
<u>/s/ Pamela D.A. Reeve</u> Pamela D. A. Reeve	Director	February 27, 2014
<u>/s/ John A. Schofield</u> John A. Schofield	Director	February 27, 2014
<u>/s/ Scott E. Schubert</u> Scott E. Schubert	Director	February 27, 2014
<u>/s/ H. Brian Thompson</u> H. Brian Thompson	Director	February 27, 2014

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
2.1**	Agreement and Plan of Merger, dated as of June 18, 2012, by and among Sonus Networks, Inc., Navy Acquisition Subsidiary, Inc. and Network Equipment Technologies, Inc. (incorporated by reference to Exhibit 2.1 to the registrant's Current Report on Form 8-K, filed June 19, 2012 with the SEC).
2.2**	Agreement and Plan of Merger, dated as of December 12, 2013, by and among Sonus Networks, Inc., Performance Technologies, Incorporated and Purple Acquisition Subsidiary, Inc. (incorporated by reference to Exhibit 2.1 to the registrant's Current Report on Form 8-K, filed December 13, 2013 with the SEC).
3.1	Fourth Amended and Restated Certificate of Incorporation of Sonus Networks, Inc., as amended (incorporated by reference to Exhibit 3.3 to the registrant's Current Report on Form 8-K, filed June 22, 2009 with the SEC).
3.2	Certificate of Designation specifying the terms of the Series A Junior Participating Preferred Stock, par value \$0.01 per share (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K, filed June 27, 2008 with the SEC).
3.3	Amended and Restated By Laws of Sonus Networks, Inc. (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K, filed June 22, 2009 with the SEC).
4.1	Form of Stock Certificate representing shares of Sonus Networks, Inc. Common Stock (incorporated by reference to Exhibit 4.1 to Amendment No. 2 of the registrant's Registration Statement on Form S-1, filed May 19, 2000 with the SEC).
4.2	Rights Agreement, dated June 26, 2008, between Sonus Networks, Inc. and American Stock Transfer & Trust Company, LLC, which includes as Exhibit A thereto a form of Certificate of Designation for the Series A Junior Participating Preferred Stock, as Exhibit B thereto the Form of Rights Certificate and as Exhibit C thereto a Summary of Rights to Purchase Shares of Preferred Stock (incorporated by reference to Exhibit 4.1 to the registrant's Current Report on Form 8-K, filed June 27, 2008 with the SEC).
4.3	Amendment No. 1, dated as of June 10, 2011 to Rights Agreement, dated as of June 26, 2008, between Sonus Networks, Inc. and American Stock Transfer & Trust Company, LLC (incorporated by reference to Exhibit 4.2 to the registrant's Current Report on Form 8-K, filed June 13, 2011 with the SEC).
4.4	Amendment No. 2 dated as of June 21, 2013 to Rights Agreement first dated as of June 26, 2008 and as amended on June 2011, between Sonus Networks, Inc. and American Stock Transfer & Trust Company, LLC (incorporated by reference to Exhibit 4.3 to the registrant's Current Report on Form 8-K, filed June 24, 2013 with the SEC).
10.1	Registration Rights Agreement, dated as of November 2, 2000, by and among Sonus Networks, Inc. and the Stockholder parties thereto (incorporated by reference to Exhibit 10.1 to the registrant's Registration Statement on Form S-4, filed December 22, 2000 with the SEC).
10.2 +	Amended and Restated 1997 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 to the registrant's Registration Statement on Form S-1, filed March 10, 2000 with the SEC).
10.3 +	Form of Notice of Grant of Stock Options and Stock Option Agreement under the 1997 Stock Incentive Plan-Additional Terms and Conditions (incorporated by reference to Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q, filed August 20, 2004 with the SEC).
10.4 +	Form of Indemnity Agreement for Officers and Directors (incorporated by reference to Exhibit 10.2 to the registrant's Quarterly Report on Form 10-Q, filed August 20, 2004 with the SEC).
10.5 +	Form of Resale Restriction Agreement (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed December 28, 2005 with the SEC).
10.6 +	Form of Consent to Stock Option Amendment (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed December 29, 2006 with the SEC).
10.7 * +	Amended and Restated 2000 Employee Stock Purchase Plan, as amended.
10.8 +	Employment Agreement between Sonus Networks, Inc. and Richard N. Nottenburg accepted on May 16, 2008 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed May 20, 2008 with the SEC).
10.9 +	Executive Severance and Arbitration Agreement between Sonus Networks, Inc. and Matthew Dillon accepted on October 7, 2008 (incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K, filed October 8, 2008 with the SEC).
10.10	Letter Agreement dated January 9, 2009 by and among Sonus Networks, Inc. and Legatum Capital Limited and certain of its affiliates (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed January 12, 2009 with the SEC).
10.11 +	Sonus Networks, Inc. 2007 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed June 18, 2013 with the SEC).

- 10.12 + Senior Management Cash Incentive Plan, as amended on March 28, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed April 1, 2013 with the SEC).
- 10.13 + Executive Severance and Arbitration Agreement between Sonus Networks, Inc. and Wayne Pastore accepted on October 2, 2008 (incorporated by reference to Exhibit 10.21 to the registrant's Annual Report on Form 10-K, filed February 25, 2010 with the SEC).
- 10.14 + Amendment to Employment Letter between Sonus Networks, Inc. and Wayne Pastore accepted on February 19, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's Annual Report on Form 10-K, filed February 25, 2010 with the SEC).
- 10.15 + Amendment to Employment Letter between Sonus Networks, Inc. and Wayne Pastore accepted on April 29, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed May 3, 2010 with the SEC).
- 10.16 + Retention Letter between Sonus Networks, Inc. and Richard N. Nottenburg accepted on May 18, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed May 20, 2010 with the SEC).
- 10.17 + Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan accepted on October 8, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed October 12, 2010 with the SEC).
- 10.18 Lease, dated August 11, 2010, between Michelson Farm-Westford Technology Park IV Limited Partnership and Sonus Networks, Inc. with respect to the property located at 4 Technology Park Drive, Westford, Massachusetts (incorporated by reference to Exhibit 10.2 to the registrant's Quarterly Report on Form 10-Q, filed November 2, 2010 with the SEC).
- 10.19 First Amendment to Lease, dated October 27, 2010, between Michelson Farm-Westford Technology Park IV Limited Partnership and Sonus Networks, Inc. with respect to the property located at 4 Technology Park Drive, Westford, Massachusetts (incorporated by reference to Exhibit 10.2 to the registrant's Quarterly Report on Form 10-Q, filed November 2, 2010 with the SEC).
- 10.20 + Employment Agreement between Sonus Networks, Inc. and Wayne Pastore accepted on December 28, 2007 (incorporated by reference to Exhibit 10.29 to the registrant's Annual Report on Form 10-K filed March 10, 2011 with the SEC).
- 10.21 + Amendment to Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan, accepted on February 14, 2011 (incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K, filed February 16, 2011 with the SEC).
- 10.22 + Employment Agreement between Sonus Networks, Inc. and Maurice Castonguay, accepted on August 24, 2011 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed August 25, 2011 with the SEC).
- 10.23 + Amendment to Employment Agreement between Sonus Networks, Inc. and Maurice Castonguay, dated October 25, 2011 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K/A, filed October 25, 2011 with the SEC).
- 10.24 + Form of Nonstatutory Stock Option Award Agreement Granted under the 2007 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 10.30 to the registrant's Annual Report on Form 10-K, filed February 24, 2012 with the SEC).
- 10.25 + Form of Restricted Stock Award Agreement Granted under the 2007 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 10.31 to the registrant's Annual Report on Form 10-K, filed February 24, 2012 with the SEC).
- 10.26 + Employment Agreement between Sonus Networks, Inc. and Todd Abbott accepted on May 3, 2011 (incorporated by reference to Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q, filed April 30, 2012 with the SEC).
- 10.27 + Amendment to Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan, accepted August 7, 2012 (incorporated by reference to the registrant's Current Report on Form 8-K, filed August 8, 2012 with the SEC).
- 10.28 + 2008 Stock Incentive Plan (incorporated by reference to Exhibit 99.1 to the registrant's Registration Statement on Form S-8, filed August 27, 2012 with the SEC).
- 10.29 + Form of Nonstatutory Stock Option Award Agreement Granted under the 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.29 to the registrant's Annual Report on Form 10-K, filed March 6, 2013 with the SEC).
- 10.30 + Form of Restricted Stock Award Agreement Granted under the 2008 Stock Incentive Plan (incorporated by reference to Exhibit 10.30 to the registrant's Annual Report on Form 10-K, filed March 6, 2013 with the SEC).
- 10.31 + Amendment to Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan, accepted on February 15, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed February 19, 2013 with the SEC).

10.32	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Maurice Castonguay, accepted on February 15, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed February 19, 2013 with the SEC).
10.33	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Todd Abbott, accepted on February 15, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed February 19, 2013 with the SEC).
10.34	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Matthew Dillon, accepted on February 15, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed February 19, 2013 with the SEC).
10.35	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan, accepted March 28, 2013 (incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K, filed April 1, 2013 with the SEC).
10.36	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Todd Abbott, accepted March 28, 2013 (incorporated by reference to Exhibit 10.4 to the registrant's Current Report on Form 8-K, filed April 1, 2013 with the SEC).
10.37		Stockholder Voting Agreement dated as of December 12, 2013, by and between Sonus Networks, Inc. and John M. Slusser (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed December 13, 2013 with the SEC).
10.38	+	Amendment to Employment Agreement between Sonus Networks, Inc. and Raymond P. Dolan, accepted January 2, 2014 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed January 6, 2014 with the SEC).
10.39	+	Form of Letter Agreement between Sonus Networks, Inc. and each of Raymond P. Dolan, Mark Greenquist, Todd Abbott and Anthony Scarfo (incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K, filed January 6, 2014 with the SEC).
10.40	+	Employment Agreement between Sonus Networks, Inc. and Mark T. Greenquist, accepted on October 24, 2013 (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed October 29, 2013 with the SEC).
14.1		Code of Conduct (incorporated by reference to Exhibit 14.1 to the registrant's Current Report on Form 8-K, filed June 7, 2011 with the SEC).
21.1	*	Subsidiaries of the Registrant.
23.1	*	Consent of Independent Registered Public Accounting Firm, Deloitte & Touche LLP
31.1	*	Certificate of Sonus Networks, Inc. Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	*	Certificate of Sonus Networks, Inc. Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	*	Certificate of Sonus Networks, Inc. Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	*	Certificate of Sonus Networks, Inc. Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS		XBRL Instance Document
101.SCH		XBRL Taxonomy Extension Schema
101.CAL		XBRL Taxonomy Extension Calculation Linkbase
101.DEF		XBRL Taxonomy Extension Definition Linkbase
101.LAB		XBRL Taxonomy Extension Label Linkbase
101.PRE		XBRL Taxonomy Extension Presentation Linkbase

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\* Filed herewith.

+ Management contract or compensatory plan or arrangement filed in response to Item 15(a)(3) of the Instructions to the Annual Report on Form 10-K.

\*\* Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrant hereby undertakes to furnish copies of any of the omitted schedules and exhibits upon request by the U.S. Securities and Exchange Commission.

**SONUS NETWORKS, INC.**  
**AMENDED AND RESTATED**  
**2000 EMPLOYEE STOCK PURCHASE PLAN, AS AMENDED**  
**EFFECTIVE AS OF MARCH 1, 2008\***

\* Amended by the Board of Directors of the Company on February 11, 2014

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**SONUS NETWORKS, INC.**

**AMENDED AND RESTATED  
2000 EMPLOYEE STOCK PURCHASE PLAN, as Amended  
(As Amended Effective February 11, 2014)**

The following constitute the provisions of the Amended and Restated 2000 Employee Stock Purchase Plan, as Amended, of Sonus Networks, Inc., effective as of February 11, 2014.

**1. Purpose**

The purpose of the Plan is to provide employees of the Company and its Designated Subsidiaries with an opportunity to purchase Common Stock of the Company. It is the intention of the Company to have the Plan qualify as an "Employee Stock Purchase Plan" under Section 423 of the Code. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

**2. Definitions**

2.1 Board means the Board of Directors of the Company.

2.2 Code means the Internal Revenue Code of 1986, as amended.

2.3 Common Stock means the Common Stock, par value \$0.001 per share, of the Company.

2.4 Company means Sonus Networks, Inc., a Delaware corporation.

2.5 Compensation means all regular straight time compensation including commissions but shall not include payments for overtime, shift premium, incentive compensation, incentive payments, bonuses and other irregular or infrequent compensation or benefits.

2.6 Continuous Status as an Employee means the absence of any interruption or termination of service as an Employee. Continuous Status as an Employee shall not be considered interrupted in the case of (i) sick leave; (ii) military leave; (iii) any other leave of absence approved by the Administrator, provided that such leave is for a period of not more than 90 days, unless reemployment upon the expiration of such leave is guaranteed by contract or statute, or unless provided otherwise pursuant to Company policy adopted from time to time; or (iv) transfers between locations of the Company or between the Company and its Designated Subsidiaries.

2.7 Contributions means all amounts credited to the account of a participant pursuant to the Plan.



2.8 Corporate Transaction means a merger or consolidation of the Company with and into another person or the sale, transfer, or other disposition of all or substantially all of the Company's assets to one or more persons (other than any wholly-owned subsidiary of the Company) in a single transaction or series of related transactions, unless securities possessing more than 50% of the total combined voting power of the survivor's or acquiror's outstanding securities, or the securities of any parent thereof, are held by a person or persons who held the voting securities of the Company immediately prior to such transaction.

2.9 Designated Subsidiaries means the Subsidiaries which have been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan.

2.10 Employee means any person, including an Officer, who is customarily employed for at least twenty (20) hours per week and more than five (5) months in a calendar year by the Company or one of its Designated Subsidiaries.

2.11 Exchange Act means the Securities Exchange Act of 1934, as amended.

2.12 Offering Date means the first business day of each Offering Period of the Plan.

2.13 Offering Period means a period of six (6) months commencing on March 1 and September 1 of each year.

2.14 Officer means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

2.15 Plan means this Employee Stock Purchase Plan.

2.16 Purchase Date means the last day of each Offering Period of the Plan.

2.17 Purchase Price means with respect to an Offering Period an amount equal to the lesser of: (i) 85% of the Fair Market Value (as defined in Section 7.2 below) of a Share of Common Stock on the Offering Date or (ii) 85% of the Fair Market Value of a Share of Common Stock on the Purchase Date.

2.18 Share means a share of Common Stock, as adjusted in accordance with Section 19 of the Plan.

2.19 Subsidiary means a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a Subsidiary.

### **3. Eligibility**

3.1 Any person who is an Employee as of the Offering Date of a given Offering Period shall be eligible to participate in such Offering Period under the Plan, subject to the requirements of Section 5.1 and the limitations imposed by Section 423(b) of the Code.

3.2 Any provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) if, immediately after the grant, such Employee (or any other person whose stock would be attributed to such Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase stock possessing five percent (5%) or more of the total combined voting power or value of all classes of stock of the Company or of any subsidiary of the Company, or (ii) if such option would permit his or her rights to purchase stock under all employee stock purchase plans (described in Section 423 of the Code) of the Company and its Subsidiaries to accrue at a rate which exceeds Twenty-Five Thousand Dollars (\$25,000) of the Fair Market Value (as defined in Section 7.2 below) of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time.

### **4. Offering Periods**

The Plan shall be generally implemented by a series of Offering Periods of six (6) months' duration, with new Offering Periods commencing on or about March 1 and September 1 of each year (or at such other time or times as may be determined by the Board of Directors). The Plan shall continue until terminated in accordance with Section 19 hereof. The Board of Directors of the Company shall have the power to change the duration and/or the frequency of Offering Periods with respect to future offerings without stockholder approval if such change is announced to Employees at least five (5) days prior to the scheduled beginning of the first Offering Period to be affected.

### **5. Participation**

5.1 An eligible Employee may become a participant in the Plan by completing a subscription agreement on the form provided by the Company and filing it with the Company's stock admin department prior to the applicable Offering Date, unless a later time for filing the subscription agreement is set by the Board for all eligible Employees with respect to a given Offering Period. The subscription agreement shall set forth the percentage of the participant's Compensation (subject to Section 6.1 below) to be paid as Contributions pursuant to the Plan.

5.2 Payroll deductions shall commence on the first payroll following the Offering Date and shall end on the last payroll paid on or prior to the Purchase Date for such Offering Period to which the subscription agreement is applicable, unless sooner terminated by the participant as provided in Section 10.

## **6. Method of Payment of Contributions**

6.1 A participant shall elect to have payroll deductions made on each payday during the Offering Period in an amount not less than one percent (1%) and not more than twenty percent (20%) (or such other percentage as the Board may establish from time to time before an Offering Date) of such participant's Compensation on each payday during the Offering Period. All payroll deductions made by a participant shall be credited to his or her account under the Plan. A participant may not make any additional payments into such account.

6.2 A participant may discontinue his or her participation in the Plan as provided in Section 10. In addition, if Board of Directors of the Company has so announced to Employees at least five (5) days prior to the scheduled beginning of the next Offering Period to be affected, a participant may, on one occasion only during each Offering Period, change the rate of his or her Contributions with respect to the Offering Period by completing and filing with the Company a % change form authorizing a change in the payroll deduction rate. Any such change in rate shall be effective as of the beginning of the next Offering Period following the date of filing of the % change form.

6.3 Notwithstanding the foregoing, to the extent necessary to comply with Section 423(b)(8) of the Code and Section 3.2 herein, a participant's payroll deductions may be decreased during any Offering Period scheduled to end during the current calendar year to 0%. Payroll deductions shall re-commence automatically at the rate provided in such participant's subscription agreement at the beginning of the next Offering Period which is scheduled to end in the following calendar year, unless terminated by the participant as provided in Section 10.

## **7. Grant of Option**

7.1 On the Offering Date of each Offering Period, each eligible Employee participating in such Offering Period shall be granted an option to purchase on each Purchase Date a number of Shares of the Company's Common Stock determined by dividing such Employee's Contributions accumulated prior to such Purchase Date and retained in the participant's account as of the Purchase Date by the applicable Purchase Price; provided however that the maximum number of Shares an Employee may purchase during each Offering Period shall be 2,500 Shares (subject to any adjustment pursuant to Section 18 below), and provided further that such purchase shall be subject to the limitations set forth in Sections 3.2 and 12.

7.2 The fair market value of the Company's Common Stock on a given date (the "Fair Market Value") shall be determined by the Board in its discretion based on the closing sales price of the Common Stock for such date (or, in the event that the Common Stock is not traded on such date, on the immediately preceding trading date), as reported by the National Association of Securities Dealers Automated Quotation ("Nasdaq") Global Select Market or, if such price is not reported, the mean of the bid and asked prices per share of

the Common Stock as reported by Nasdaq or, in the event the Common Stock is listed on a stock exchange, the Fair Market value per share shall be the closing sales price on such exchange on such date (or, in the event that the Common Stock is not traded on such date, on the immediately preceding trading date), as reported in The Wall Street Journal.

## **8. Exercise of Option**

Unless a participant withdraws from the Plan as provided in Section 10, his or her option for the purchase of Shares will be exercised automatically on the Purchase Date for each Offering Period, and the maximum number of full Shares subject to the option will be purchased at the applicable Purchase Price with the accumulated Contributions in his or her account. No fractional Shares shall be issued. The Shares purchased upon exercise of an option hereunder shall be deemed to be transferred to the participant on the Purchase Date. During his or her lifetime, a participant's option to purchase Shares hereunder is exercisable only by him or her.

## **9. Delivery**

As promptly as practicable after each Purchase Date of each Offering Period, the Company shall arrange the delivery to each participant. These shares will be deposited into the participant's stock plan account. Any payroll contributions accumulated in a participant's account after a Purchase Date shall be returned to the participant.

## **10. Voluntary Withdrawal; Termination of Employment**

10.1 A participant may withdraw all but not less than all of the Contributions credited to his or her account under the Plan at any time prior to each Purchase Date by giving written notice to the Company. All of the participant's Contributions credited to his or her account will be paid to him or her promptly after receipt of his or her notice of withdrawal and his or her option for the current period will be automatically terminated, and no further Contributions for the purchase of Shares will be made during the Offering Period.

10.2 Upon termination of the participant's Continuous Status as an Employee prior to the Purchase Date of an Offering Period for any reason, including retirement or death, the Contributions credited to his or her account will be returned to him or her or, in the case of his or her death, to the person or persons entitled thereto under Section 14, and his or her option will be automatically terminated.

10.3 In the event an Employee fails to remain in Continuous Status as an Employee of the Company for at least twenty (20) hours per week during the Offering Period in which the employee is a participant, he or she will be deemed to have elected to withdraw from the Plan and the Contributions credited to his or her account will be returned to him or her and his or her option terminated.

10.4 A participant's withdrawal from an offering will not have any effect upon his or her eligibility to participate in a succeeding offering or in any similar plan which may hereafter be adopted by the Company.

## **11. Interest**

No interest shall accrue on the Contributions of a participant in the Plan.

## **12. Stock**

12.1 Subject to adjustment as provided in Section 18, the maximum number of Shares which shall be made available for sale under the Plan shall be 1,200,000 Shares plus an automatic annual increase on January 1, 2001 and each January 1 thereafter equal to the lesser of (i) two percent (2%) of the Shares outstanding on the last day of the immediately preceding fiscal year, and (ii) such number as the Board may determine. Notwithstanding the foregoing, and subject to adjustment in accordance with Section 18 no more than an aggregate of 25,000,000 Shares may be issued pursuant to this Plan. If the Board determines that, on a given Purchase Date, the number of shares with respect to which options are to be exercised may exceed (i) the number of shares of Common Stock that were available for sale under the Plan on the Offering Date of the applicable Offering Period, or (ii) the number of shares available for sale under the Plan on such Purchase Date, the Board may in its sole discretion provide that the Company shall make a pro rata allocation of the Shares of Common Stock available for purchase on such Offering Date or Purchase Date, as applicable, in as uniform a manner as shall be practicable and as it shall determine in its sole discretion to be equitable among all participants exercising options to purchase Common Stock on such Purchase Date. The Company may make pro rata allocation of the Shares available on the Offering Date of any applicable Offering Period pursuant to the preceding sentence, notwithstanding any authorization of additional Shares for issuance under the Plan by the Company's stockholders subsequent to such Offering Date.

12.2 The participant shall have no interest or voting right in Shares covered by his or her option until such option has been exercised.

12.3 Shares to be delivered to a participant under the Plan will be registered in the name of the participant or pursuant to Section 14 below.

## **13. Administration**

The Board, or a committee named by the Board, shall supervise and administer the Plan and shall have full power to adopt, amend and rescind any rules deemed desirable and appropriate for the administration of the Plan and not inconsistent with the Plan, to construe and interpret the Plan, and to make all other determinations necessary or advisable for the administration of the Plan. The Board's determinations made in good faith on matters referred to in this Plan shall be final, binding and conclusive on all persons having or claiming any interest under this Plan or an Award made pursuant hereto.

## **14. Designation of Beneficiary**

14.1 A participant may file a written designation of a beneficiary who is to receive any Shares and cash, if any, from the participant's account under the Plan in the event of such participant's death subsequent to the end of an Offering Period but prior to delivery to him or her of such Shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to the Purchase Date of an Offering Period.

14.2 Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such Shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such Shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

## **15. Transferability**

Neither Contributions credited to a participant's account nor any rights with regard to the exercise of an option or to receive Shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution, or as provided in Section 14) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds in accordance with Section 10.

## **16. Use of Funds**

All Contributions received or held by the Company under the Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such Contributions.

## **17. Reports**

Individual accounts will be maintained for each participant in the Plan.

## **18. Adjustments Upon Changes in Capitalization; Corporate Transactions**

18.1 Adjustment. Subject to any required action by the stockholders of the Company, the number of shares covered by each option under the Plan which has not yet been exercised and the number of Shares which have been authorized for issuance under the Plan but have not yet been placed under option (collectively, the "Reserves"), as well as the maximum number of shares of Common Stock which may be purchased by a participant in an Offering Period, the number of shares of Common Stock set forth in Section 12.1

above, and the price per Share of Common Stock covered by each option under the Plan which has not yet been exercised, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock (including any such change in the number of Shares of Common Stock effected in connection with a change in domicile of the Company), or any other increase or decrease in the number of Shares effected without receipt of consideration by the Company; provided however that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive.

18.2 Corporate Transactions. In the event of a dissolution or liquidation of the Company, any Offering Period then in progress will terminate immediately prior to the consummation of such action, unless otherwise provided by the Board. In the event of a Corporate Transaction, each option outstanding under the Plan shall be assumed or an equivalent option shall be substituted by the successor corporation or a parent or Subsidiary of such successor corporation. In the event that the successor corporation refuses to assume or substitute for outstanding options, each Offering Period then in progress shall be shortened and a new Purchase Date shall be set (the "New Purchase Date"), as of which date any Offering Period then in progress will terminate. The New Purchase Date shall be on or before the date of consummation of the transaction and the Board shall notify each participant in writing, at least ten (10) days prior to the New Purchase Date, that the Purchase Date for his or her option has been changed to the New Purchase Date and that his or her option will be exercised automatically on the New Purchase Date, unless prior to such date he or she has withdrawn from the Offering Period as provided in Section 10. For purposes of this Section 18, an option granted under the Plan shall be deemed to be assumed, without limitation, if, at the time of issuance of the stock or other consideration upon a Corporate Transaction, each holder of an option under the Plan would be entitled to receive upon exercise of the option the same number and kind of shares of stock or the same amount of property, cash or securities as such holder would have been entitled to receive upon the occurrence of the transaction if the holder had been, immediately prior to the transaction, the holder of the number of Shares of Common Stock covered by the option at such time (after giving effect to any adjustments in the number of Shares covered by the option as provided for in this Section 18); provided however that if the consideration received in the transaction is not solely common stock of the successor corporation or its parent (as defined in Section 424(e) of the Code), the Board may, with the consent of the successor corporation, provide for the consideration to be received upon exercise of the option to be solely common stock of the successor corporation or its parent equal in Fair Market Value to the per Share consideration received by holders of Common Stock in the transaction.

The Board may, if it so determines in the exercise of its sole discretion, also make provision for adjusting the Reserves, as well as the price per Share of Common Stock covered by each outstanding option, in the event that the Company effects one or more reorganizations, recapitalizations, rights offerings or other increases or reductions of Shares

of its outstanding Common Stock, and in the event of the Company's being consolidated with or merged into any other corporation.

## **19. Amendment or Termination**

19.1 The Board may at any time and for any reason terminate or amend the Plan. Except as provided in Section 18, no such termination of the Plan may affect options previously granted, provided that the Plan or an Offering Period may be terminated by the Board on a Purchase Date or by the Board's setting a new Purchase Date with respect to an Offering Period then in progress if the Board determines that termination of the Plan and/or the Offering Period is in the best interests of the Company and the stockholders or if continuation of the Plan and/or the Offering Period would cause the Company to incur adverse accounting charges as a result of the Plan. Except as provided in Section 18 and in this Section 19, no amendment to the Plan shall make any change in any option previously granted which adversely affects the rights of any participant.

19.2 Without stockholder consent and without regard to whether any participant rights may be considered to have been adversely affected, the Board (or its committee) shall be entitled to change the Offering Periods, limit the frequency and/or number of changes in the amount withheld during an Offering Period, establish the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars, permit payroll withholding in excess of the amount designated by a participant in order to adjust for delays or mistakes in the Company's processing of properly completed withholding elections, establish reasonable waiting and adjustment periods and/or accounting and crediting procedures to ensure that amounts applied toward the purchase of Common Stock for each participant properly correspond with amounts withheld from the participant's Compensation, and establish such other limitations or procedures as the Board (or its committee) determines in its sole discretion advisable which are consistent with the Plan.

## **20. Notices**

All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

## **21. Conditions Upon Issuance of Shares**

Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such Shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, applicable state securities laws and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.



As a condition to the exercise of an option, the Company may require the person exercising such option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned applicable provisions of law.

**22. Term of Plan; Effective Date**

The Plan shall become effective upon the effective date of the Registration Statement on Form S-1 for the initial public offering of the Company's Common Stock. It shall continue in effect for a term of twenty (20) years unless sooner terminated under Section 19.

SONUS NETWORKS, INC.  
SUBSIDIARIES OF THE REGISTRANT

<u>Name</u>	<u>Jurisdiction of Incorporation</u>
Sonus International, Inc.	Delaware
Network Equipment Technologies, Inc.	Delaware
N.E.T. APLA, Inc.	Delaware
Quintum Technologies, LLC	Delaware
Sonus Federal, Inc.	Delaware
Sonus Securities Corp.	Massachusetts
Sonus Networks Australia Pty Ltd.	Australia
Sonus Networks Brasil - Redes Tecnológicas Ltda.	Brazil
Quintum International Holdings (BVI) Limited	British Virgin Islands
Sonus Networks Corp.	Canada
Sonus Networks s.r.o.	Czech Republic
Sonus Networks EURL	France
N.E.T. Europe SAS	France
Sonus Networks GmbH	Germany
Sonus Networks (HK) Limited	Hong Kong
Quintum Technologies (Hong Kong) Ltd.	Hong Kong
Sonus Networks India Private Limited	India
Sonus Networks Trading Private Limited	India
Nihon Sonus Networks K.K.	Japan
N.E.T. Japan, Inc.	Japan
Sonus Networks Malaysia Sdn. Bhd.	Malaysia
Westford Networks Mexico, S. de R.L. de C.V.	Mexico
Sonus Networks (Shanghai) Limited	Shanghai, PRC
Sonus Networks Pte. Ltd.	Singapore
N.E.T. Southeast Asia Pte. Ltd.	Singapore
Sonus Networks España, S.R.L.	Spain
Sonus Networks AB	Sweden
Sonus Networks Switzerland GmbH	Switzerland
Sonus Networks Ltd.	United Kingdom
N.E.T. Europe Ltd.	United Kingdom

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-61940 and 333-66982 on Form S-3 and Registration Statement Nos. 333-43334, 333-53970, 333-54932, 333-105215, 333-124777, 333-150022, 333-163684, 333-170285, 333-183562 and 333-190318 on Form S-8 of our reports dated February 27, 2014, relating to the financial statements of Sonus Networks, Inc., and the effectiveness of Sonus Networks, Inc.'s internal control over financial reporting, appearing in this Annual Report on Form 10-K of Sonus Networks, Inc. for the year ended December 31, 2013.

/s/ Deloitte & Touche LLP

Boston, Massachusetts  
February 27, 2014

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Raymond P. Dolan, certify that:

1. I have reviewed this Annual Report on Form 10-K of Sonus Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2014

/s/ RAYMOND P. DOLAN

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Raymond P. Dolan  
*President and Chief Executive Officer*  
*(Principal Executive Officer)*

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark T. Greenquist, certify that:

1. I have reviewed this Annual Report on Form 10-K of Sonus Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2014

/s/ MARK T. GREENQUIST

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Mark T. Greenquist  
*Chief Financial Officer (Principal Financial Officer)*

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Sonus Networks, Inc. (the "Company") for the period ended December 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Raymond P. Dolan, President and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 27, 2014

/s/ RAYMOND P. DOLAN

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Raymond P. Dolan  
President and Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Sonus Networks, Inc. (the "Company") for the period ended December 31, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Mark T. Greenquist, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 27, 2014

/s/ MARK T. GREENQUIST

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Mark T. Greenquist  
Chief Financial Officer  
(Principal Financial Officer)