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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001
COMMISSION FILE NUMBER 000-30229

SONUS NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	04-3387074
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5 CARLISLE ROAD, WESTFORD, MASSACHUSETTS	01886
(Address of principal executive offices)	(including Zip Code)

(978) 692-8999
(Registrant's telephone number, including area code)

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

As of May 3, 2001 there were 202,687,265 shares of Common Stock, $0.001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

SONUS NETWORKS, INC.
FORM 10-Q
QUARTER ENDED MARCH 31, 2001

TABLE OF CONTENTS

PART I--FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

SONUS NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	MARCH 31, 2001 (UNAUDITED)	DECEMBER 31, 2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 42,770	$ 87,108
Marketable securities	82,101	54,957
Accounts receivable, net	10,025	14,100
Inventories	22,499	20,668
Other current assets	5,953	2,893
Total current assets	163,348	179,726
Property and equipment, net	24,841	14,273
Goodwill and purchased intangibles, net	430,011	--
Other assets, net	1,258	836
	$619,458	$194,835
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term obligations	$ 1,335	$ --
Accounts payable	16,192	13,439
Accrued expenses	20,221	16,239
Deferred revenue	16,919	14,451
Total current liabilities	54,667	44,129
LONG-TERM OBLIGATIONS, less current portion	389	--
COMMITMENTS	--	--
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value, 5,000,000 shares authorized; none issued and outstanding	--	--
Common stock, $0.001 par value, 300,000,000 shares authorized; 203,211,298 and 184,244,474 shares issued and 202,438,798 and 183,471,974, outstanding at March 31, 2001 and December 31, 2000, respectively	203	184
Capital in excess of par value	844,713	266,488
Accumulated deficit	(166,445)	(83,966)
Stock subscriptions receivable	--	(238)
Deferred compensation	(114,004)	(31,697)
Treasury stock, at cost: 772,500 common shares	(65)	(65)
Total stockholders' equity	564,402	150,706
	$619,458	$194,835

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

SONUS NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2001	THREE MONTHS ENDED MARCH 31, 2000
REVENUES	$ 41,499	$ 1,093
Cost of revenues (1)	18,011	1,462
GROSS PROFIT (LOSS)	23,488	(369)
OPERATING EXPENSES:		
Research and development (1)	13,919	4,844
Sales and marketing (1)	8,488	3,358
General and administrative (1)	2,663	713
Stock-based compensation	15,423	6,979
Amortization of goodwill and purchased intangibles	27,207	--
In-process research and development	40,000	--
Total operating expenses	107,700	15,894
LOSS FROM OPERATIONS	(84,212)	(16,263)
Interest expense	(168)	(116)
Interest income	1,901	344
Net loss	$(82,479)	$(16,035)
NET LOSS PER SHARE (NOTE 1(G)):		
Basic and diluted	$ (0.51)	$ (0.69)
Pro forma basic and diluted		$ (0.14)
SHARES USED IN COMPUTING NET LOSS PER SHARE (NOTE 1(G)):		
Basic and diluted	162,091	23,229
Pro forma basic and diluted		116,765

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

	2001	2000
Cost of revenues	$ 317	$ 73
Research and development	8,576	3,647
Sales and marketing	4,174	2,739
General and administrative	2,356	520
	$ 15,423	$ 6,979

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

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

	COMMON STOCK		CAPITAL IN EXCESS OF PAR VALUE	ACCUMULATED DEFICIT	STOCK SUBSCRIPTIONS RECEIVABLE	DEFERRED COMPENSATION
	SHARES	PAR VALUE				
Balance, January 1, 2001	184,244,474	$184	$266,488	$ (83,966)	$(238)	$ (31,697)
Issuance of common stock in connection with the employee stock purchase program	512,806	1	3,387	--	--	--
Issuance of common stock in connection with acquisition (Note 2)	15,000,000	15	476,498	--	--	--
Issuance of restricted stock awards in connection with acquisition (Note 2)	3,000,000	3	75,127	--	--	(75,130)
Deferred compensation related to unvested stock options assumed in connection with acquisition (Note 2)	--	--	22,600	--	--	(22,600)
Exercise of stock options	454,018	--	613	--	--	--
Amortization of deferred compensation	--	--	--	--	--	15,423
Payment on subscriptions receivable	--	--	--	--	238	--
Net loss	--	--	--	(82,479)	--	--
Balance, March 31, 2001	203,211,298	$203	$844,713	$(166,445)	$ --	$(114,004)

	TREASURY STOCK		TOTAL STOCKHOLDERS' EQUITY
	SHARES	COST	
Balance, January 1, 2001	772,500	$(65)	$150,706
Issuance of common stock in connection with the employee stock purchase program	--	--	3,388
Issuance of common stock in connection with acquisition (Note 2)	--	--	476,513
Issuance of restricted stock awards in connection with acquisition (Note 2)	--	--	--
Deferred compensation related to unvested stock options assumed in connection with acquisition (Note 2)	--	--	--
Exercise of stock options			613
Amortization of deferred compensation	--	--	15,423
Payment on subscriptions receivable	--	--	238
Net loss	--	--	(82,479)
Balance, March 31, 2001	772,500	($65)	$564,402

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

SONUS NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (82,479)	$(16,035)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,019	759
Amortization of goodwill and purchased intangibles	27,207	--
In-process research and development	40,000	--
Amortization of deferred compensation	15,423	6,979
Changes in current assets and liabilities:		
Accounts receivable	6,097	--
Inventories	(1,350)	(1,470)
Other current assets	(1,920)	(269)
Accounts payable	1,897	2,361
Accrued expenses	(847)	1,940
Deferred revenue	(3,211)	14
Net cash provided by (used in) operating activities	3,836	(5,721)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(10,917)	(1,907)
Maturities of marketable securities	2,165	16,151
Purchases of marketable securities	(29,309)	(17,581)
Other assets	(513)	(479)
Cash used for acquisition, net of cash acquired	(5,743)	--
Net cash used in investing activities	(44,317)	(3,816)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of common stock	3,388	1,609
Proceeds from exercise of stock options	613	11
Net proceeds from issuance of preferred stock	--	24,710
Payments of stock subscriptions receivable	238	--
Proceeds from long-term obligations	--	298
Payments of long-term obligations	(96)	(288)
Payment of note payable to bank	(8,000)	--
Repurchase of common stock	--	(20)
Net cash provided by (used in) financing activities	(3,857)	26,320
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(44,338)	16,783
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	87,108	8,885
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 42,770	$ 25,668
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 168	$ 111
ACQUISITION OF TELECOM TECHNOLOGIES, INC:		
Tangible assets	$ 6,312	--
Liabilities assumed	(21,184)	--
Goodwill and purchased intangibles	497,218	--
Issuance of common stock in connection with the acquisition	(476,513)	--
Cash acquired	(90)	--
Cash used for acquisition, net of cash acquired	$ 5,743	--

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

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

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

(B) CASH EQUIVALENTS AND MARKETABLE SECURITIES

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

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

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

The financial instruments that potentially subject Sonus to concentrations of credit risk are cash, marketable securities and receivables. Sonus has no significant off-balance-sheet concentrations such as foreign exchange contracts, options contracts or other foreign hedging arrangements. Sonus' cash holdings are diversified between three financial institutions.

For the three months ended March 31, 2001, four customers each contributed more than 10% of revenues. As of March 31, 2001, two customers each contributed more than 10% of the Company's accounts receivable balance. Certain components and software licenses from third-parties used in Sonus' products are procured from a single source. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby adversely affect Sonus' revenues and operating results.

(D) REVENUE RECOGNITION

Sonus recognizes revenue from product sales to end users, resellers and distributors upon shipment, provided there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collection of the related receivable is probable. If uncertainties exist, Sonus recognizes revenue when those uncertainties are resolved. In

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
multiple element arrangements, in accordance with Statement of Position 97-2 and 98-9, Sonus uses the residual method when vendor specific evidence does not exist for one of the delivered elements in the arrangement. Service revenues are recognized as the services are provided. Maintenance revenues are recognized ratably over the term of the contract. Amounts collected prior to satisfying the revenue recognition criteria are reflected as deferred revenue. Warranty costs are estimated and recorded by Sonus at the time of product revenue recognition.

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

(E) STOCK-BASED COMPENSATION

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

(F) COMPREHENSIVE LOSS

Sonus applies Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 130, REPORTING COMPREHENSIVE INCOME. The comprehensive loss for the period for the three months ended March 31, 2001 and 2000 does not differ from the reported loss.

(G) NET LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of unrestricted common stock outstanding during the period. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of unrestricted common stock and potential common stock outstanding during the period, if dilutive. Potential common stock consists of restricted shares of common stock, common shares issuable upon the exercise of stock options, and shares of common stock issued in connection with our acquisition of telecom technologies, inc. (TTI) which are subject to the achievement of milestones and employee retention (Note 2). For both basic and diluted net loss per share, shares of common stock issuable upon the conversion of Sonus' redeemable convertible preferred stock have been excluded from the date of issuance until conversion into common stock.

Pro forma basic and diluted net loss per share for the three months ended March 31, 2000 is computed using the weighted average number of unrestricted common shares outstanding, including the pro forma effects of the automatic conversion of Sonus' Series A, B, C and D redeemable convertible preferred stock into shares of Sonus' common stock which occurred upon the closing of Sonus' initial public offering, as if such conversion occurred at the date of original issuance. There were no dilutive shares of potential common stock for these periods as the Company incurred a net loss in each period.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

	THREE MONTHS ENDED MARCH 31, 2001	THREE MONTHS ENDED MARCH 31, 2000
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Net loss	$(82,479)	$(16,035)
HISTORICAL--		
Weighted average common shares outstanding	192,757	66,929
Less weighted average restricted common shares outstanding	(30,666)	(43,700)
Shares used in computing basic and diluted net loss per share	162,091	23,229
Basic and diluted net loss per share	$ (0.51)	$ (0.69)
PRO FORMA--		
Shares used in computing historical basic and diluted net loss per share		23,229
Weighted average number of shares assumed upon conversion of redeemable convertible preferred stock		93,536
Shares used in computing pro forma basic and diluted net loss per share		116,765
Pro forma basic and diluted net loss per share		$ (0.14)

Excluded from the computation of diluted net loss per share in the above table are options to purchase 17,766,738 and 9,381,096 shares of common stock for the quarters ended March 31, 2001 and 2000, respectively, as their effects would have been anti-dilutive. Had Sonus recorded net income for the quarter ended March 31, 2001 and used the treasury stock method in accordance with SFAS No. 128, EARNINGS PER SHARE, approximately 206,000,000 weighted average shares of common stock would have been used in the computation of diluted earnings per share.

NOTE 2. ACQUISITION OF TELECOM TECHNOLOGIES, INC.

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

NOTE 2. ACQUISITION OF TELECOM TECHNOLOGIES, INC. (CONTINUED)

Sonus has also issued contingent awards of 3,000,000 shares of common stock under the 2000 Retention Plan (the Plan) to certain employees of TTI who became employees of Sonus as a result of the acquisition. These awards will vest in equal installments on each of October 31, 2002, November 30, 2002, January 31, 2003 and February 28, 2003, if (i) the recipients do not voluntarily terminate employment with TTI or Sonus prior to such vesting dates and (ii) the business expansion and product development escrow release conditions are satisfied in whole or in part. The portion of the total number of shares of Sonus common stock awarded to each employee that will be deemed vested on each vesting date will not exceed the proportion of all of the shares escrowed in the acquisition subject to the satisfaction of the business expansion and product development escrow release conditions that have been released prior to such vesting date. Generally, any awards forfeited by employees who terminate employment with TTI, other than a termination by Sonus or TTI without cause, prior to the date on which they would otherwise vest, may be reallocated to remaining TTI employees, awarded to replacement hires or returned to Sonus as provided by the terms of the Plan. As of March 31, 2001, the value of the 3,000,000 shares awarded under the Plan is $75,130,000. This amount is being expensed during the approximate two-year vesting period and is adjusted for changes in the fair value of Sonus common stock on the date the related milestone release conditions are earned for accounting purposes.

The acquisition was accounted for using the purchase method of accounting in accordance with APB Opinion No. 16, BUSINESS COMBINATIONS. Accordingly, the total purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values. The purchase price has been determined by using the average market value of Sonus common stock for the period from two days before to two days after the announcement of the TTI acquisition ($41.61 per share) to value the 10,800,000 Sonus common shares issued to the TTI stockholders at the closing date and adding the fair value of liabilities assumed and expenses of the acquisition. Additionally, the purchase price is increased as escrowed shares subject to milestone conditions are earned for accounting purposes. As of March 31, 2001, the purchase price has been computed as follows, in thousands:

Fair market value of shares issued	$498,619
Liabilities assumed	21,184
Acquisition expenses	6,327
	$526,130

In accordance with APB Opinion No. 16 and with the assistance of valuation experts, the purchase price was allocated to the tangible and intangible assets acquired based upon their fair values. Based upon these appraisals, the purchase price allocation is as follows, in thousands:

Tangible assets	$ 6,312
Intangible assets:	
Workforce, developed technology and customer list	32,300
In-process research and development	40,000
Deferred compensation related to unvested options	22,600
Goodwill	424,918
	$526,130

NOTE 2. ACQUISITION OF TELECOM TECHNOLOGIES, INC. (CONTINUED)

To the extent that any of the escrowed shares are earned for accounting purposes, the purchase price and goodwill will be adjusted by the value of such shares on the date the relevant escrow release condition is satisfied.

Sonus engaged third-party appraisers to conduct a valuation of the tangible and intangible assets and to assist in the determination of useful lives for such assets. Based on the results of the appraisal, $40,000,000 was allocated to in-process research and development, which was expensed in the first quarter of fiscal 2001. The amounts allocated to developed technology, customer list, assembled workforce and goodwill are being amortized over their estimated useful lives of three years. During the first quarter of fiscal 2001, amortization of goodwill and purchased intangibles of approximately $27,207,000 was recorded. Deferred compensation was computed based on the intrinsic value of the unvested TTI options assumed by Sonus and will be expensed over the remaining vesting period of up to four years.

The valuation of in-process research and development was determined using the income method. Revenue and expense projections for the in-process development project were prepared by the management of Sonus through 2008 and the present value was computed using a discount rate of 22.5%. The in-process project is not expected to reach technological feasibility until the end of 2001, at an estimated cost to complete of approximately $5,000,000. In the event that the project is not completed and technological feasibility is not achieved, there is no alternative future use for the in-process technology. The assumptions used for the valuation of in-process research and development are the responsibility of management.

PRO FORMA INFORMATION

The following unaudited pro forma information presents a summary of the consolidated results of operations of Sonus and TTI as if the acquisition had occurred on January 1, 2000. The pro forma adjustments give effect to the amortization of goodwill and purchased intangibles and stock-based compensation expense but excludes the one-time write-off of in-process research and development.

	THREE MONTHS ENDED MARCH 31,	
	2001	2000
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Revenues	$ 41,833	$ 11,003
Net loss	(53,603)	(66,144)
Basic and diluted net loss per share	(0.32)	(1.94)
Pro forma basic and diluted net loss per share		(0.52)

The pro forma results are not necessarily indicative of what would have occurred if the acquisition had been in effect for the periods presented. In addition, they are not intended to be a projection of future results and do not reflect any synergies that might be achieved from combined operations.

NOTE 3. INVENTORIES

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

	MARCH 31, 2001	DECEMBER 31, 2000
Raw materials	$ 2,092	$ 3,082
Work in progress	4,392	3,021
Finished goods	16,015	14,565
	$22,499	$20,668

NOTE 4. STOCKHOLDERS' EQUITY

(A) STOCK SPLIT

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

(B) INITIAL PUBLIC OFFERING

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

(C) STOCK-BASED COMPENSATION

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

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

Upon the closing of our acquisition of TTI, Sonus recorded deferred stock-based compensation of $22,600,000 related to the intrinsic value of unvested TTI stock options assumed by Sonus. This deferred compensation will be recognized as an expense over the remaining vesting period of the underlying stock options of up to four years. Additionally, Sonus recorded $75,130,000 of deferred stock-based compensation on 3,000,000 restricted shares of common stock awarded to TTI employees under the Plan. This deferred compensation will be expensed over the approximate two-year vesting period of the retention shares and will be adjusted for changes in the fair value of Sonus common

NOTE 4. STOCKHOLDERS' EQUITY (CONTINUED)

stock on the date the related milestone release conditions are earned for accounting purposes. (See Note 2).

Sonus has valued the stock options and the issuances of restricted common stock to non-employees based upon the fair market value of the services rendered where Sonus believes the value of these services is more readily determinable than the value of the options or restricted stock. All other grants of options and issuances of restricted stock to non-employees are valued based upon the Black-Scholes option pricing model. As of March 31, 2001, Sonus has 135,000 stock options and 120,000 shares of restricted common stock outstanding to non-employees. In accordance with Emerging Issues Task Force 96-18, Sonus will record the value at the time the services are provided. Total stock-based compensation expense was $15,423,000 and $6,979,000 for the three months ended March 31, 2001 and 2000, respectively.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which are subject to a number of risks and uncertainties. These forward-looking statements are based on our current expectations, assumptions, estimates and projections about ourselves and our industry. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including the factors set forth in "Cautionary Statements" beginning on page 16 of this Quarterly Report on Form 10-Q. This discussion should be read in conjunction with the condensed consolidated unaudited financial statements and related notes for the periods specified. Further reference should be made to the Company's Annual Report on Form 10-K.

OVERVIEW

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

Since our inception, we have incurred significant losses and, as of March 31, 2001 had an accumulated deficit of $166.4 million. We have not achieved profitability on a quarterly or an annual basis, and anticipate that we will continue to incur net losses. We have a lengthy sales cycle for our products and, accordingly, we expect to incur sales and other expenses before we realize the related revenues. We expect to incur significant sales and marketing, research and development and general and administrative expenses and, as a result, we will need to generate significant revenues to achieve and maintain profitability.

We sell our products through a direct sales force, resellers and distributors. Customers' decisions to purchase our products to deploy in commercial networks involve a significant commitment of resources and a lengthy evaluation, testing and product qualification process. We believe these long sales cycles, as well as our expectation that customers will tend to sporadically place large orders with short lead times, will cause our revenues and results of operations to vary significantly and unexpectedly from quarter to quarter. We expect to recognize revenues from a limited number of customers for the foreseeable future.

We recognize revenue from product sales to end users, resellers and distributors upon shipment, provided there are no uncertainties regarding acceptance, persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collection of the related receivable is probable. If uncertainties exist, we recognize revenue when those uncertainties are resolved. Service revenue is recognized as the services are performed. Maintenance revenues are recognized ratably over the term of the contract. Amounts collected prior to satisfying our revenue recognition criteria are reflected as deferred revenue. We estimate and record warranty costs at the time of product revenue recognition. For the three months ended March 31, 2001, we recognized $41.5 million in revenue. As of March 31, 2001, we had a total of $16.9 million in deferred revenue. See note 1(d) to our unaudited condensed consolidated financial statements.

ACQUISITION OF TELECOM TECHNOLOGIES, INC.

On January 18, 2001, we acquired TTI. Upon the closing of this acquisition, we issued an aggregate of 10,800,000 shares of common stock in exchange for all outstanding capital stock of TTI. Of the 10,800,000 shares issued to the TTI shareholders, 1,200,000 shares were placed into escrow as security for indemnity obligations under the merger agreement, and will be released to TTI shareholders upon expiration of those indemnity obligations, expected to be on the first anniversary of the closing date. In addition, TTI shareholders have the right to receive an aggregate of 4,200,000 additional shares of common stock which have been placed in escrow in the event that TTI achieves certain specified business expansion and product development milestones from time to time prior to December 31, 2002. In connection with our acquisition of TTI, we adopted our 2000 Retention Plan and issued 3,000,000 shares of common stock under this plan to certain employees of TTI who became employees of Sonus, which are subject to continued employment and the attainment of business expansion and product development milestones.

We have accounted for the acquisition as a purchase for financial reporting purposes. Accordingly, Sonus' financial statements for the quarter ended March 31, 2001 reflect the results of operations of TTI since the date of acquisition. The purchase price was allocated to TTI's assets and liabilities based on the fair value of the assets acquired and the liabilities assumed. Any excess of the purchase price over the fair value of the net tangible assets and identifiable intangible assets acquired has been classified as goodwill. In addition, a portion of the purchase price has been allocated to in-process research and development. Goodwill and other intangibles are being amortized by charges to operations over their estimated useful lives of three years and purchased in-process research and development was charged to operations at the time of closing. The in-process project is not expected to reach technological feasibility until the end of 2001, at an estimated cost to complete of approximately $5,000,000. Sonus has recorded deferred stock-based compensation relating to the issuance of awards under our 2000 Retention Plan. The amount of charges for stock-based compensation, in-process research and development and amortization of goodwill and other intangibles will be significant and will therefore have a material negative impact on the combined company's future operating results. See Note 2 to our condensed consolidated financial statements.

Over our next several quarters the sources from which TTI has historically derived revenue are expected to decline significantly as we shift TTI's focus to the development and deployment of its INtelligentIP softswitch product line. In addition, as a result of TTI's sale of its network testing software product line, we expect revenues related to these products to decline or cease in 2001. As of March 31, 2001, Sonus recognized its first revenues related to the INtelligentIP softswitch product line.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2001 AND 2000

REVENUES. Revenues were $41.5 million for the first quarter of 2001, an increase of $40.4 million, from $1.1 million for the first quarter of 2000. The increase in revenues was the result of a significant increase in the sale of voice infrastructure products including initial revenues associated with the INtelligentIP softswitch product line acquired from TTI. For the first quarter of 2001, four customers each contributed more than 10% of our revenues.

COST OF REVENUES. Costs of revenues consist primarily of amounts paid to contract manufacturers, manufacturing and service personnel and related costs. Cost of revenues were $18.0 million, or 43.4% of revenues, for the first three months of 2001, an increase of $16.5 million from $1.5 million in the first quarter of 2000. The increase is primarily the result of an increase in product manufacturing and personnel costs associated with revenues recorded in fiscal 2001. We expect cost of revenues to decrease modestly as a percentage of revenues based on product mix changes and improved efficiencies as our revenue increases.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses consist primarily of salaries and related personnel costs, recruiting expenses and prototype costs related to the design, development, testing and enhancement of our products. We expense our research and development costs as incurred. Research and development expenses were $13.9 million in the first three months of 2001, an increase of $9.1 million from $4.8 million in the first quarter of 2000. The increase reflects costs primarily associated with a significant increase in personnel and personnel-related expenses including our acquisition of TTI, and, to a lesser extent, prototype and software expenses for the development of our products. We believe that the rapid technological innovation is critical to our long-term success and we intend to continuously enhance our products and technologies to meet the evolving requirements of our customers and markets.

SALES AND MARKETING EXPENSES. Sales and marketing expenses consist primarily of salaries and related personnel expenses, commissions, travel and entertainment expenses, promotions, customer evaluations and other marketing expenses. Sales and marketing expenses were $8.5 million in the first quarter of 2001, an increase of $5.1 million from $3.4 million in the first quarter of 2000. The increase reflects costs primarily associated with the hiring of additional U.S. and international sales and marketing personnel including our acquisition of TTI, commissions and the opening of international sales offices and, to a lesser extent, travel-related expenses, marketing program costs and trade shows. We intend to continue to expand our domestic and international sales force and marketing efforts, and as a result, expect that the dollar amounts of sales and marketing expenses will increase in future periods.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of salaries and related expenses for executive and administrative personnel, recruiting expenses and professional fees. General and administrative expenses were $2.7 million in the first quarter of 2001, an increase of $2.0 million from $0.7 million in the first quarter of 2000. The increase reflects the hiring of additional general and administrative personnel including our acquisition of TTI, and, to a lesser extent, costs associated with being a public company. We expect that the dollar amounts of general and administrative expenses will increase in future periods as a result of expansion of business activity and the costs associated with being a publicly-traded company.

STOCK-BASED COMPENSATION EXPENSES. Stock-based compensation expenses include the amortization of stock compensation charges resulting from the granting of stock options, including those TTI stock options assumed by Sonus, stock awards to TTI employees under the 2000 Retention Plan, and the sales of restricted common stock to employees and compensation expense associated with the grant of stock options and issuance of restricted stock to non-employees. See Note 4(c) to our unaudited condensed consolidated financial statements. Deferred compensation related to the granting of stock options and sales of restricted common stock to employees, including those TTI stock options assumed by Sonus, are being amortized over the vesting periods of four to five years. The deferred compensation associated with the 2000 Retention Plan awarded to TTI employees will be expensed over the approximate two-year vesting period of the retention shares. These amounts will be adjusted for changes in the fair value of Sonus common stock on the date the related milestone release conditions are earned for accounting purposes. The compensation expense associated with non-employees is recorded at the time services are provided.

Stock-based compensation expenses were $15.4 million in the first quarter of 2001, an increase of $8.4 million from $7.0 million in the first quarter of 2000. This increase is primarily due to the amortization of deferred stock-based compensation resulting from the TTI unvested stock options assumed by Sonus and retention stock awards issued to TTI employees. Based on the grant of stock options, sale of restricted common stock and grant of awards of restricted common stock through March 31, 2001, we expect stock-based compensation expense to impact our results through fiscal 2005.

GOODWILL, PURCHASED INTANGIBLES AND IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSES. In January 2001, Sonus acquired certain intellectual property, in-process research and development and intangible assets in connection of our acquisition of TTI, which resulted in the recording of $457.2 million of goodwill and other intangibles. The goodwill and purchased intangibles are being amortized over a three-year period. Results of operations for the quarter ended March 31, 2001, includes $27.2 million in amortization of goodwill and purchased intangibles and a $40.0 million write-off of purchased in-process research and development.

INTEREST INCOME (EXPENSE), NET. Interest income, net of interest expense increased $1.5 million to $1.7 million for the first three months of 2001, compared to $0.2 million for the same period in fiscal 2000. This increase reflects higher invested balances as a result of our May 2000 initial public offering and private financings, partially offset by interest expense from incurred borrowings through March 2001.

INCOME TAXES. No provision for income taxes has been recorded for the three months ended March 31, 2001 and 2000, due to accumulated net losses. We did not record any tax benefits relating to these losses or other tax benefits due to the uncertainty surrounding the realization of these future tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

Prior to our initial public offering, we financed our operations primarily through private sales of redeemable convertible preferred stock totaling $70.7 million in net proceeds. Upon the closing of our initial public offering on May 31, 2000, the Company received cash proceeds, net of underwriters' discount and offering expenses, totaling $121.6 million, and all of our redeemable convertible preferred stock converted into 96,957,222 shares of common stock. At March 31, 2001, cash and cash equivalents and marketable securities totaled $124.9 million.

Net cash provided by operating activities was $3.8 million for the three months ended March 31, 2001, as compared to cash used in operating activities of $5.7 million for the three months ended March 31, 2000. The cash provided by operating activities in the first quarter of 2001 reflects higher non-cash charges for stock-based compensation, amortization of goodwill and purchased intangibles, in-process research and development and depreciation, and decreases in accounts receivable offset by the net loss.

Net cash used in investing activities was $44.3 million for the three months ended March 31, 2001, as compared to $3.8 million for the three months ended March 31, 2001. Net cash used in investing activities reflects net purchases of marketable securities of $27.1 million, purchases of property and equipment, primarily computers and test equipment for our development and manufacturing activities of $10.9 million and merger expenses associated with our acquisition of TTI of $5.7 million for the quarter ended March 31, 2001. The timing and amount of future capital expenditures will depend primarily on our future growth.

Net cash used in financing activities was $3.9 million for the three months ended March 31, 2001, as compared to cash provided by financing activities of $26.3 million for the three months ended March 31, 2000. The net cash used in the first quarter of 2001 was due to the repayment of $8.0 million in a bank note payable assumed as part of the acquisition of TTI, offset in part by the sale of common stock. The net cash provided in the first quarter of 2000 is primarily the result of the sale of Series D redeemable convertible preferred stock in March of 2000.

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

CAUTIONARY STATEMENTS

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

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

To date, we have shipped our products to a limited number of customers and only during the first quarter of fiscal 2000 did we begin to recognize revenues. We expect that in the foreseeable future, substantially all of our revenues will depend on sales of our products to a limited number of customers. For example, for the quarter ended March 31, 2001, four customers each contributed more than 10% of our revenues. The customers to whom we have shipped products are currently using our products in laboratory testing or internal trials or have deployed our products in their commercial networks. Our customers may not, or may not continue to, deploy our products in their commercial networks on a timely basis, or at all, and any delay or failure by our customers to introduce commercial services based on our products, or a downturn in their business, would seriously harm our ability to sell products and generate revenues.

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

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

- customer unwillingness to implement our new voice infrastructure products;

- any delays or difficulties that we may incur in completing the development and introduction of our planned products or product enhancements;

- our customers inability to raise capital to finance their business plans;

- new product introductions by our competitors;

- any failure of our products to perform as expected; or

- any difficulty we may incur in meeting customers' delivery requirements.

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

THE MARKET FOR VOICE INFRASTRUCTURE PRODUCTS FOR THE NEW PUBLIC NETWORK IS NEW AND EVOLVING AND OUR BUSINESS WILL SUFFER IF IT DOES NOT DEVELOP AS WE EXPECT.

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

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

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

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

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

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

- loss of, or delay in, revenues;

- loss of customers and market share;

- a failure to attract new customers or achieve market acceptance for our products;

- increased service, support and warranty costs and a diversion of development resources; and

- costly and time-consuming legal actions by our customers.

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

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

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

We rely on a small number of contract manufacturers to manufacture our products according to our specifications and to fill orders on a timely basis. Our contract manufacturers provide comprehensive manufacturing services, including assembly of our products and procurement of materials. Each of our contract manufacturers also builds products for other companies and may not always have sufficient quantities of inventory available to fill our orders or may not allocate their internal resources to fill these orders on a timely basis. We do not have long-term supply contracts with our manufacturers and they are not required to manufacture products for any specified period. We do not have internal manufacturing capabilities to meet our customers' demands. Qualifying a new contract manufacturer and commencing commercial-scale production is expensive and time consuming and could result in a significant interruption in the supply of our products. If a change in contract manufacturers results in delays in our fulfillment of customer orders or if a contract manufacturer fails to make timely delivery of orders, we may lose revenues and suffer damage to our customer relationships.

WE HAVE BEEN IN BUSINESS FOR A SHORT PERIOD OF TIME AND YOUR BASIS FOR EVALUATING US IS LIMITED.

We were founded in August 1997, and only during the first quarter of fiscal 2000 did we begin to recognize any revenues. We have a limited meaningful operating history upon which you may evaluate us and our prospects. Moreover, we cannot be sure that we have accurately identified all of the risks to our business. Also, our assessment of the prospects for our success may prove inaccurate.

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

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

- fluctuation in demand for our voice infrastructure products and the timing and size of customer orders;

- the length and variability of the sales cycle for our products and the corresponding timing of recognizing or deferring revenues;

- new product introductions and enhancements by our competitors and us;

- changes in our pricing policies, the pricing policies of our competitors and the prices of the components of our products;

- our ability to develop, introduce and ship new products and product enhancements that meet customer requirements in a timely manner;

- the mix of product configurations sold;

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

- our ability to attain and maintain production volumes and quality levels for our products;

- costs related to acquisitions of complementary products, technologies or businesses; and

- general economic conditions, as well as those specific to the telecommunications, networking and related industries and other factors.

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

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

WE MAY NOT BECOME PROFITABLE.

We have incurred significant losses since inception and expect to continue to incur losses in the future. As of March 31, 2001, we had an accumulated deficit of $166.4 million and had only recognized cumulative revenues since inception of $93.3 million through March 31, 2001. We have not achieved profitability on a quarterly or annual basis. As a result of our acquisition of TTI, we expect to incur significant expenses for stock-based compensation and amortization of goodwill and purchased intangibles, which will make achieving profitability more difficult in the near to mid-term.

Our revenues may not grow and we may never generate sufficient revenues to achieve or sustain profitability. We expect to continue to incur significant and increasing sales and marketing, product development, administrative and other expenses. As a result, we will need to generate significant revenues to achieve and maintain profitability.

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

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

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

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

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

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

To compete effectively, we must deliver innovative products that:

- provide extremely high reliability and voice quality;

- scale easily and efficiently;

- interoperate with existing network designs and other vendors' equipment;

- provide effective network management;

- are accompanied by comprehensive customer support and professional services; and

- provide a cost-effective and space-efficient solution for service providers.

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

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

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

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

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

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

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

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

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

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

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

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be harmed.

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

- stop selling, incorporating or using our products that use the challenged intellectual property;

- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or

- redesign those products that use any allegedly infringing technology.

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

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

Although we have no current agreements to do so, we intend to consider investing in, or acquiring, complementary products, technologies or businesses. In the event of future investments or acquisitions, we could, and in connection with our recent acquisition of TTI, we did:

- issue stock that would dilute our current stockholders' percentage ownership;

- incur debt or assume liabilities;

- incur significant amortization expenses related to goodwill and other intangible assets; or

- incur large and immediate write-offs for in-process research and development and stock-based compensation.

Our integration of any acquired products, technologies or businesses, including those associated with our acquisition of TTI, will also involve numerous risks, including:

- problems and unanticipated costs associated with combining the purchased products, technologies or businesses;

- diversion of management's attention from our core business;

- adverse effects on existing business relationships with suppliers and customers;

- risks associated with entering markets in which we have limited or no prior experience; and

- potential loss of key employees, particularly those of the acquired organizations.

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

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

Our expansion into international markets will require significant management attention and financial resources to successfully develop direct and indirect international sales and support channels. In addition, we may not be able to develop international market demand for our products, which could impair our ability to grow our revenues.

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

- greater difficulty collecting accounts receivable and longer collection periods;

- difficulties and costs of staffing and managing international operations;

- the impact of differing technical standards outside the United States;

- the impact of recessions in economies outside the United States;

- unexpected changes in regulatory requirements and currency exchange rates;

- certification requirements;

- reduced protection for intellectual property rights in some countries; and

- potentially adverse tax consequences.

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

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

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

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

- fund ongoing operations;

- take advantage of opportunities, including more rapid expansion or acquisition of complementary products, technologies or businesses;

- develop new products; or

- respond to competitive pressures.

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

OUR STOCK PRICE MAY BE VOLATILE.

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

- loss of any of our major customers;

- the addition or departure of key personnel;

- variations in our quarterly operating results;

- announcements by us or our competitors of significant contracts, new products or product enhancements, acquisitions, distribution partnerships, joint ventures or capital commitments;

- changes in financial estimates by securities analysts;

- sales of common stock or other securities by us or by our stockholders in the future;

- any acquisitions, distribution partnerships, joint ventures or capital commitments;

- the impact of recessions in economies outside the United States;

- unexpected changes in regulatory requirements and currency exchange rates;

- certification requirements;

- reduced protection for intellectual property rights in some countries; and

- potentially adverse tax consequences.

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

Some stockholders who acquired shares prior to our initial public offering hold a substantial number of shares of our common stock that have not yet been sold in the public market. Sales of a substantial number of shares of our common stock within a short period of time in the future could cause our stock price to fall. In addition, the sale of these shares could impair our ability to raise capital through the sale of debt or additional stock.

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

As of February 15, 2001, our executive officers, directors and entities affiliated with them beneficially own, in the aggregate, approximately 24.9% of our outstanding common stock. These stockholders, if acting together, would be able to influence significantly all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

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

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

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

PART II--OTHER INFORMATION

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: None

(b) Reports on Form 8-K: The Company filed a Current Report on Form 8-K on February 2, 2001 in connection with our acquisition of telecom technologies, inc.

SIGNATURE

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

Dated: May 14, 2001

SONUS NETWORKS, INC.

By: /s/ STEPHEN J. NILL

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