BLYTH FUND PROPOSAL | SONS BUY PROPOSAL
By Charles Najda

Date: 10-07-02
Proposal: Proposal: Buy 2000 shares of SONS
Ticker: SONS
Current price: 0.25 (close 10-04-02)
Analyst: Charles Najda
Profile: **Sonus Networks, Inc.** is a provider of voice infrastructure products for the new public network. The Company's suite of voice infrastructure products includes the GSX9000 Open Services Switch, the Insignus Softswitch, and the Sonus Insight Management System. The Company's products, designed for deployment at the core of a service provider's network, reduce the cost to build and operate voice services compared to traditional alternatives. (From *Yahoo! Finance*)

The Numbers:

Shares Outstanding:	205.1 mln	**Market Cap:**	$51.2 mln
Median Target Price 12 months	$1.74	**EPS Growth - 5 years**	25.0%
P/book	0.41	**P/sales**	0.38
Gross Margins	55%	**Net Margins**	N/A
Cash:	$104.7 mln	**Debt/Equity**	0.16
EPS (02)	$-0.29	**EPS (03)**	$-0.26
Dividend	N/A	**Cash Per-share**	$0.51

Reasons to Buy SONS:

- Given the ever changing VoP equipment market, I believe that the fund should alter its strategy with regard to SONS. We originally bought the equity with the intention of holding the stock for 1 to 2 years.
- SONS should be a short term holding now with a three to six month time horizon. In the short term, I believe that there is ample opportunity for Sonus to rise to over a dollar on speculation of a buyout.
- Likewise, there hasn't been an extended market rally since last fall. A strong GDP number or a resolution of the Iraqi conflict would lead to a strong market rally. In that sort of an environment, battered down stocks like Sonus will experience large percentage gains.
- Last Tuesday, Sonus Networks warned of a wider-than-projected third-quarter loss and sales of just one-third of previous expectations due to deterioration in the telecom market.
- The warning is already priced into the equity. However, the company will announce 3rd quarter earnings on October 9th. It's very likely that the company left room for beating their guidance. Moreover, Sonus will be presenting at a Telco conference this week. Even a rumor of an improved outlook would drive the stock up 30+%.
- The company is being priced as if its worth next to nothing. At the current stock price, the cash that the company has is being discounted at a rate of 50%. Moreover, the rest of the firm's assets and intellectual property is being valued at zero.

Valuable Technology:

- Sonus is a pioneer of VoP for cable systems, based on its PacketCable architecture. Thus Sonus' customer base is not limited to the incumbent baby bells and long distance providers, each of the cable companies are also potential Sonus customers.
- The movement to VoP networks for both data and phone service is almost inevitable and a very cost effective move for the large telecommunications companies.
- There is currently hundreds of billions of dollars of circuit-switched equipment, which will need to be replaced in the coming decade (independent of VoIP). In fact, in 2000 alone over $35 billion was spent on circuit-switched equipment.
- Contrary to popular thought Voice-over-IP doesn't cause a delay in conversation. Moreover, voice quality is equal to or better than the PSTN (conventional voice infrastructure).

Strong and Growing Customer Base:

- In July, T-Systems International, a division of Deutsche Telekom, selected Sonus to build out its next-generation voice over IP (VoIP) network. T-Systems will leverage the Sonus-based network to provide multinational corporations services such as global voice VPN and sophisticated call center routing facilities.
- In January, Sonus announced its first customer in China. China Netcom selected Sonus to

provide infrastructure solutions for China Netcom's nationwide packet voice network, which will support both local access and long distance voice services.

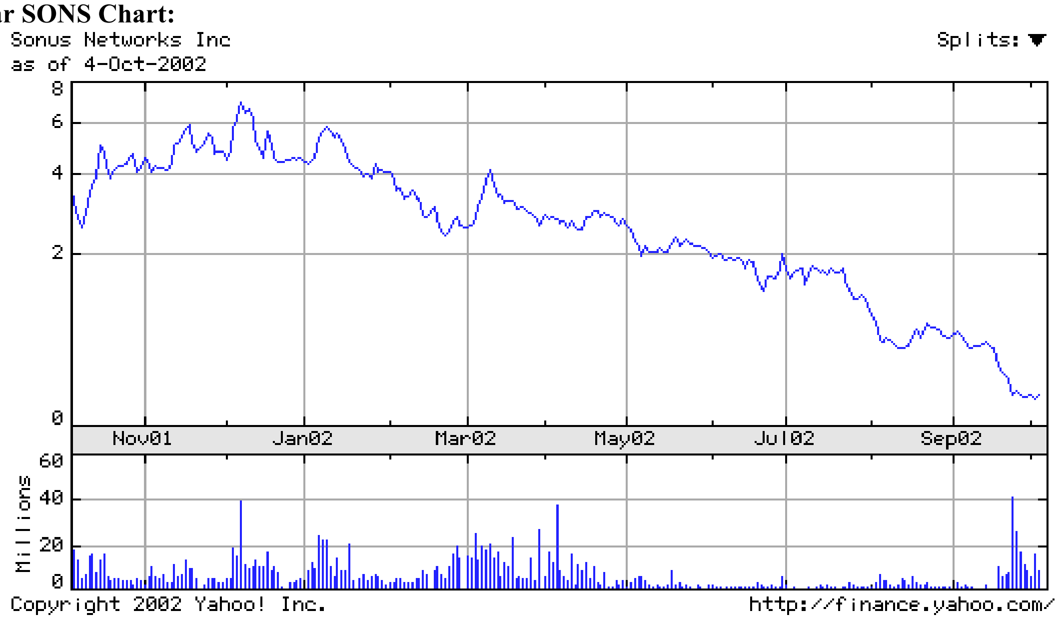
Takeover Target:

- Sonus is still the market leader in VoP equipment. They have a real technological lead over their larger competitors. Currently Sonus has over half of the market for VoP solutions. In an improved economic environment, the ability to control over half of the market is certainly worth more than Sonus' current market capitalization.
- Lucent recently withdrew from the softswitch market, in which it competed with SONS. Lucent is laying off over 1000 employees, while SONS has only 593 employees.
- Lucent's withdrawal may be a harbinger of a possible buyout of Sonus. Instead of spending its own valuable capital to develop a product, LU can write off the softswitch group and purchase SONS. Lucent ends up spending less money and earns a tax write-off for any future earnings from the Sonus unit.
- Lucent's withdrawal also means that Sonus can increase its market share by wining over former Lucent customers. Lucent is the second largest player in the softswitch segment of the VoP market.
- If Lucent were to purchase SONS for 200 mln, the real cost of the purchase would only be half that, because of the 100 mln in cash Sonus has.
- In recent months there have also been rumors that CSCO was interested in purchasing Sonus.

Closing Thoughts:

- Selling Corvis and purchasing Sonus will reduce the overall risk level of the fund, by consolidating our holdings into the investment with greater upside potential.
- This proposal is a speculative play that assumes that the market will rally during the 4th quarter on macroeconomic and improving earnings news. SONS has a very high beta of 4.60. If the S&P 500 rallies 20% during the last quarter of the year, SONS is likely to move up 80 to 100 percent.
- On a pure valuation basis, SONS is a much "cheaper" stock than CORV. Sonus' price sales ratio is close to ten times lower than Corvis' P/Sales ratio.
- Sonus' VoP technology has a larger potential market than Corvis' optical switches.
- Sonus is not in danger of bankruptcy in the immediate future. At the time of our purchase, seven months ago, the company had $125 million in cash. That means that Sonus is burning through about 10-15 million dollars each quarter.

1 Year SONS Chart:



Global Deployments:

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Sonus Networks' Open Services Architecture™ (OSA) is one of the most globally deployed packet voice solutions on the market today. Homologated in over 30 countries, the OSA has been designed for rapid deployment in worldwide networks.