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Unified Communications

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Reason for Report: Topical Update

Still 80% of the Ocean to Boil

Key Points:

We recently attended the Cloud Communications Summit in Leesburg, VA where we had the opportunity to speak with a number of private and public company representatives as well as listen to thought leaders discuss the market trends across the UCaaS, CCaaS, and CPaaS landscape. Below are a number of themes we took away from the conference. We reiterate our Buy ratings on 8x8 Inc. (EGHT, PT \$28), RingCentral (RNG, PT \$85), and Vonage (VG, PT \$16).

Additional Details:

Market Opportunity is Now... At long last, cloud-based business communications have come full circle where enterprises believe the infrastructure is ready and support mechanisms are in place. A sign that the market has matured is Cavell Group's estimation that the US market is roughly 18% to 20% penetrated and Netherlands is the only country with over 20% of the market on cloud-based communications systems. Consequently, European carriers are seeing their fixed line revenue decline, as KPN dropped 18% Y/Y, Swisscom declined 11% Y/Y, and Proximus was down 8% Y/Y. Cavell Group also indicated their research suggests only 5 to 10% of the large enterprise market has migrated over to cloud-based communications.

Edgewater Networks shared their SME Research Study (September 2017) which indicated 61% of their 1,250 SMBs interviewed switched to IP from TDM and 44% of the organizations purchased their UCaaS solution from the channel. Auto attendant, portal, mobile integration, and call center features were the primary reasons to move to IP and the most important features to their businesses now are mobile integration, call center features, portal, call recording, and auto attendant. Please refer to Page 3 where we captured several key charts from the study.

With the maturation of demand and industry research suggesting 20% - 30% of the 10 - 100 seat market penetrated, several macro trends have evolved as it relates to where the respective UCaaS providers are focusing: (1) upmarket, with deeper penetration and global deployments as larger projects canvas the globe, which require integration into existing workflows, (2) richer platform sets with API integration, contact center, collaboration, analytics, CPaaS, and SD-WAN requirements, (3) international customers, (4) industry verticals, (5) channel strategy, (6) channel operations, and (7) customer service.

In particular, UCaaS companies are now expanding in various directions to make their claim on a piece of the UCaaS land grab, such as expanding internationally and focusing on industry market segments. Those investing internationally include Vonage branching out its offices for CPaaS, 8x8 adding key partners internationally, RingCentral with its Google partnerships, and both Evolve IP and Star2Star acquiring companies outside the US. In terms of industry expansion, 8x8 has a partnership with Bullhorn for HR recruiting and RingCentral is HITRUST certified to meet requirements in the healthcare industry. We view the next step for these providers after the international land grab will be to drill down into micro segmentation, such as BlueIP's hyper focus on the hospitality market or NetFortris' focal point centered on healthcare.

Several presenters see SD-WAN as a large opportunity as 33% of service providers indicate they plan to add SD-WAN services in the next 12 months. We see those suppliers who own their SD-WAN capabilities at a slight advantage at this time, as this provides a window into customers' cloud behavior and allows the supplier to position future services based on analytics collected. In Q1, Vonage cited their SD-WAN services grew 100% Y/Y. Both 8x8 and RingCentral have SD-WAN partners. We view this segment as another opportunity for consolidation as there are currently over 64 SD-WAN providers.

Channel Strategy, Operations, and Customer Service... Once again, presenters and providers discussed the importance of the channel and leverage it has in reaching mid-market to large enterprise customers. Conversations with resellers indicated RingCentral has really defined what it means to support your channel partners, as they typically have their channel managers co-locating within the partners office. Also becoming more important in sustaining a long term customer relationship are post sales support, implementation, deployments, billing, and training. If the customers are not trained on all the bells and whistles, one reseller noted, you typically see decline in attach rates.

This current period of rapid adoption is a natural tailwind to many of the cloud-based communications providers at this juncture of the market. Resellers we met with indicated over 80% of the deal flow is for cloud-based communications systems. The players that are doing well today are benefiting from the natural tailwind of the rapid adoption but also understand their customer segmentation and can execute very well. We believe those firms with strong broad-based portfolios (API Integration, CCaaS, CPaaS, analytics, and SD-WAN), channels, and customer engagement

strategies are positioned to take advantage of the accelerated migration to cloud-based communication systems. We believe those providers who are content with just selling the voice component of UCaaS will most likely be marginalized in the mid term.

M&A Update... We see several different rollup strategies that may play out over the next 12 to 24 months.

We view the UCaaS providers that are potential targets are those that have at least one, if not all, of the following characteristics: (1) strong understanding of their customer base, supported by strong customer engagement and service, (2) micro segmentation in a particular vertical market such as hospitality, government, healthcare, retail, etc. and (3) a history of strong execution.

We believe the European market is ripe for consolidation as in the UK alone, there are over 94 UCaaS providers, and another 25-plus providers in Holland with estimated annual revenues ranging from \$5M to \$10M. Not all the providers will be able to scale and, as a result, will seek out another partner in the US or Europe. We are starting to see US-based cloud providers expand internationally, acquiring UCaaS providers in Europe (i.e. Evolve IP has acquired MoTol and Star2Star merged with Blueface).

Disintermediation by Google, Microsoft, Facebook and/or Amazon could come into play once one of the cloud-based communications players achieves greater than 20% market share with an established brand. There is the potential for Amazon, the disrupter, to swoop in and establish their dominance in the sector, similar to their acquisition of Wholefoods with its established brand for selling organic food products without artificial additive products.

We also believe the traditional service providers and cable operators may look to the OTT providers once they have established 20% market share.

Valuations...

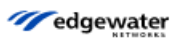
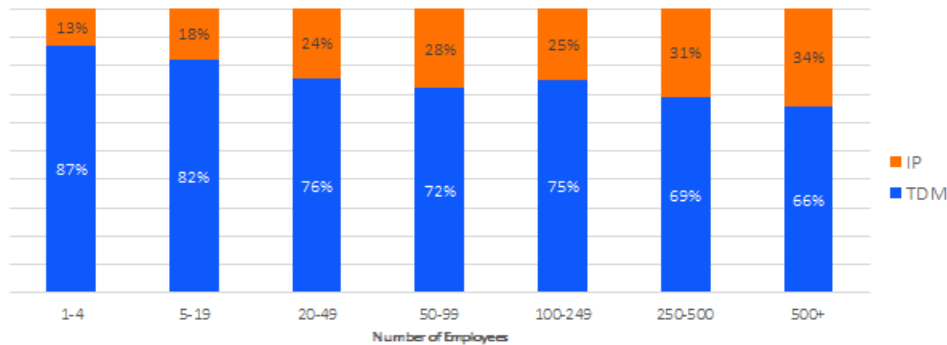
8x8: We are maintaining our Buy rating and Price Target of \$28. We continue to believe 8x8 has significant opportunity to gain market share in the fiscal year, particularly through the introduction of X Series and a more aggressive channel strategy. Our PT is based on 6.1x EV/CY'19 Sales using our revenue estimate of \$403.3M. This compares to UCaaS peers with similar growth who trade at an average EV/Sales of 5.8x using CY'19 consensus estimates.

RingCentral: We are maintaining our Buy rating and Price Target of \$85. Our Price Target values RingCentral at 8.7x EV/Sales using our CY'19 forecast of \$798.0M (+24% Y/Y). We believe this is a fair multiple as it is roughly in-line with a blended group (UCaaS and SaaS companies) showing similar revenue growth (+24% Y/Y), which trades at an average of 8.6x using consensus CY'19 estimates. It also remains below a group of SaaS comps growing >25% Y/Y who trade at 9.1x CY'19 EV/Sales following recent market weakness. We believe the company's valuation profile should mirror high-growth leading SaaS organizations, particularly as we see more upside in RingCentral's projected FY'19 growth.

Vonage: We are maintaining our Buy rating and Price Target of \$16. Our Price Target is based on a sum of parts calculation using a 4.0x sales multiple on UCaaS, 5.5x sales multiple on Nexmo, and 3.5x on consumer OIBDA. Based on these multiples and subtracting out net debt of \$210M, we derive an equity value of \$4.0B or ~\$16 a share. This compares to the UCaaS peer group, which trades at 5.1x on CY'19 consensus revenue and Twilio at 7.2x. We believe this is an appropriate model as Vonage shares remain attractive at a 2.9x sales multiple on CY'19 consensus estimates.

A PERFECT STORM – PART 1

IP Communications Adoption Rates are Low: Lots of Available Market

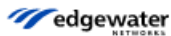
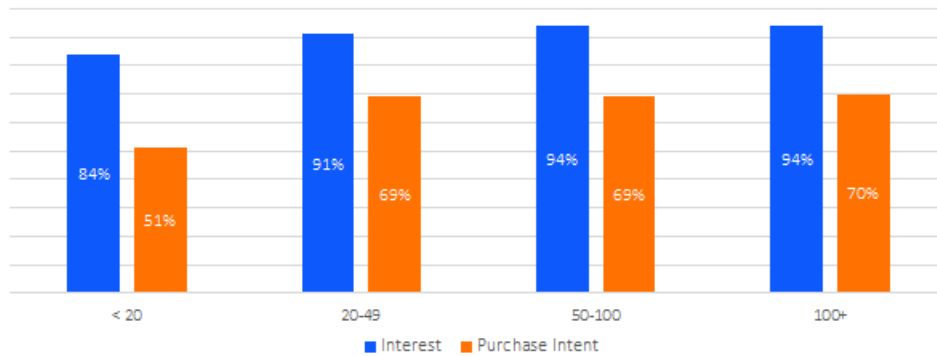


SOURCE: Edgewater Networks SME Research Study, September 2017

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A PERFECT STORM - PART 2

Interest and Purchase Intent are Strong

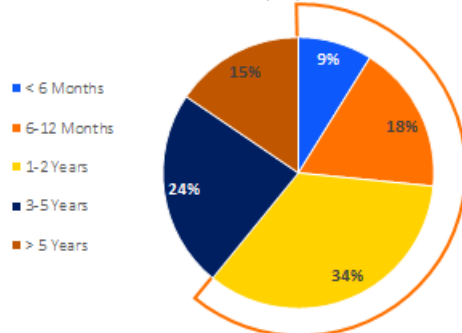


SOURCE: Edgewater Networks SME Research Study, September 2017

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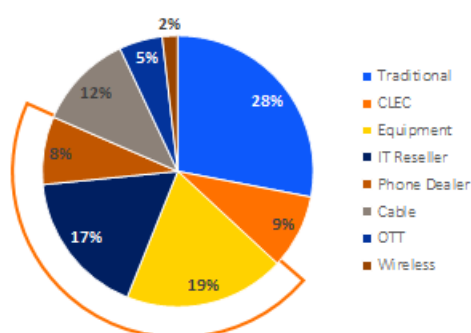
When and Whom?

When Did Your Company Switch?

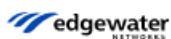


61% Bought in the Last 2 Years

From What Type of Provider?



44% Bought Through the Channel



SOURCE: Edgewater Networks SME Research Study, September 2017

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IMPORTANT DISCLOSURES

Companies Mentioned

8x8, Inc: Buy, \$28.00

RingCentral, Inc.: Buy, \$85.00

Vonage Holdings Corp.: Buy, \$16.00

I, Catharine Trebnick, certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers.

Dougherty & Company LLC makes a market in these securities: EGHT, RNG and VG .

The ratings used in Dougherty & Company LLC research reports are defined as followed:

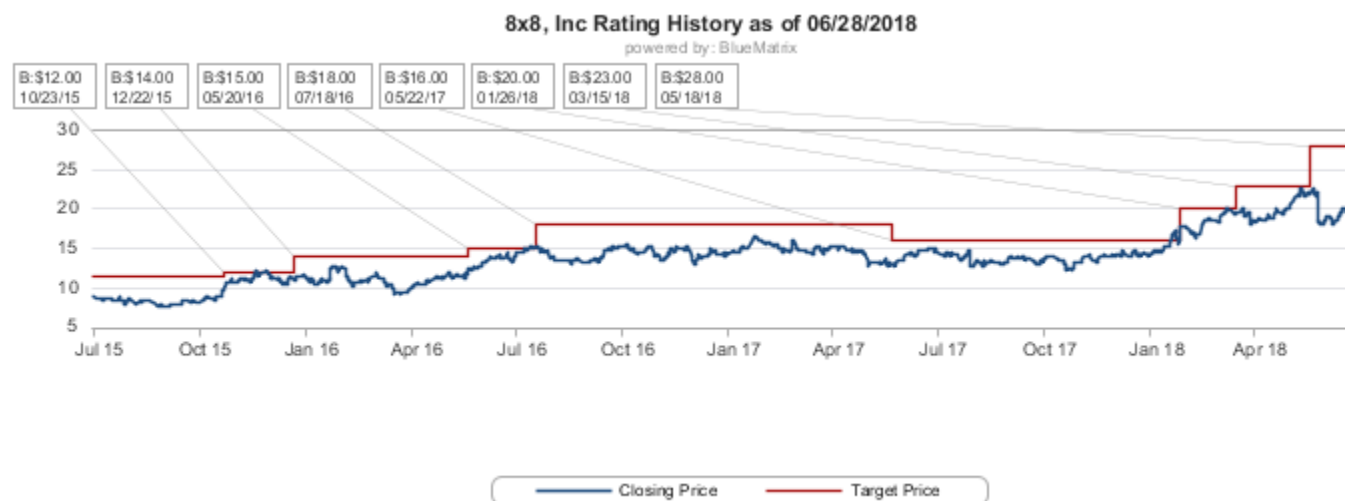
Buy: *Expected to outperform the broader market and/or its sector over the next six to twelve months.*

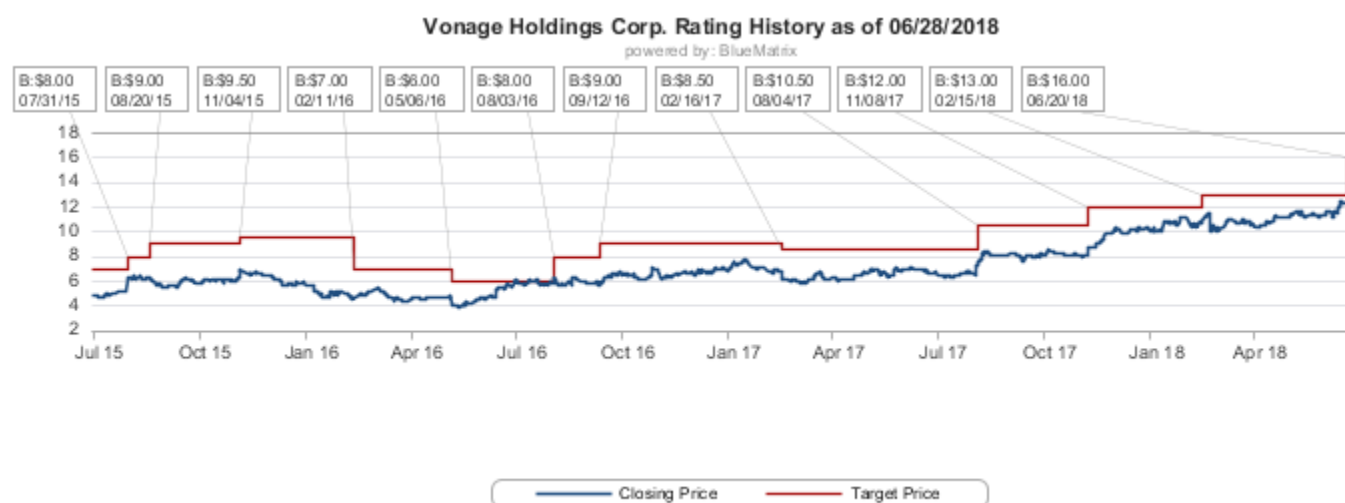
Neutral: *Expected to perform generally in-line to moderately below the broader market and/or its sector over the next six to twelve months.*

Sell: *Expected to materially underperform the broader market and/or its sector over the next six to twelve months.*

RATINGS DISPERSION AND BANKING RELATIONSHIPS AS OF (June 29, 2018)

| Rating | % | IB % |
|----------------|------|------|
| Buy | 70.1 | 6.1 |
| Neutral | 28.2 | 0.0 |
| Sell | 1.7 | 0.0 |





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