

May 28, 2008

RESEARCH NOTE:

SANGOMA TECHNOLOGIES CORPORATION – (TSXV : STC)

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- *Sangoma reported its Q3-08 results, revenue was \$3.21 million up 4.7% sequentially or up 43.6% year-over-year and slightly lower than our estimate of \$3.5 million, while net earnings were \$0.03 versus \$0.02 last year and slightly below our forecast of \$0.04.*
- *Gross margins were below our expectations, though remain well above the telecom equipment average range of 35% - 40%*
- *Sangoma's cash position remains strong, generating over \$1.3 million in the quarter, bringing the cash balance to \$5.2 million or \$0.18 per share.*
- *Sangoma remains a solid investment due to its above average gross margins, strong cash generation and revenue growth. We are maintaining our STRONG BUY recommendation and lowering our 12-month target price to \$3.40 from \$3.60.*

SANGOMA TECHNOLOGIES CORPORATION

Equity Research | Technology

Ticker

Recommendation

12-month Target

Please see important disclosures at the end of this document

TSXV: STC
\$1.34

STRONG BUY
(unchanged)

\$3.40
(was \$3.60)

Sangoma Reports Lower than Expected Q3-08 Results, However Remains a STRONG BUY May 28, 2008

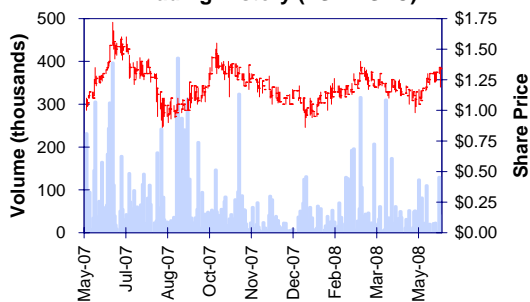
Market Data

52-week High-Low	\$1.72-\$0.86
Shares Outstanding	
– Basic	28.1 million
– Fully diluted	28.9 million
Market Capitalization	\$38.7 million
Cash	\$5.2 million
Enterprise Value	\$33.5 million
Total Debt	Nil
Fiscal Year End	June 30
Major Shareholders	Insiders: 23%

Financial Data

(millions, except EPS)	FY06A	FY07E	FY08E	FY09E
Revenue	\$4,776	\$8,223	\$12,803	\$17,626
Net Earnings	\$1,008	\$1,988	\$3,403	\$5,066
EPS FD	\$0.04	\$0.07	\$0.12	\$0.18
P/S	7.5x	4.4x	2.8x	2.0x
P/E	33.6x	17.9x	10.5x	7.1x

Trading History (TSXV:STC)



Company Description

Sangoma Technologies Corporation provides connectivity hardware and software products for PBX and LAN/WAN infrastructure. The Company's products, in combination with open source software products, can enable industry standard PCs and servers to perform routing and PBX functions. Sangoma's products are distributed globally through its network of regional distribution partners and integrators that service local businesses.

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Event

Yesterday (May 27) after market close, Sangoma reported its Q3-08 results.

Highlights

Sangoma reported its Q3-08 results (quarter ended March 30) on Tuesday evening after market close. Total revenue was \$3.21 million, up 4.7% sequentially or up 43.6% year-over-year and slightly lower than our estimate of \$3.5 million.

Q3-08 gross margin was 67.8% versus 72.0% last quarter and 68.2% last year, and below our forecast of 72.0%. Gross margins were negatively impacted by several larger OEM sales that have become a larger portion of the Company's sales. OEM sales are generally done at a lower gross margin percentage due to their high volume.

Total operating expenses were \$0.6 million, down 31.9% sequentially or flat year-over-year. The large sequential decline in the quarter was primarily due to a large foreign exchange gain of \$228,012 due to a favorable change in the US\$-C\$ exchange rate.

Adjusted EPS was \$0.03 versus \$0.03 last quarter and \$0.02 last year, and slightly below our forecast of \$0.04.

Overall, the quarter was slightly below expectations and, as a result, we are lowering our forecast accordingly. However, even at the reduced forecast, Sangoma remains a solid company with strong growth potential for both revenue and earnings. Also, Sangoma continues to generate strong cash flows, with over \$1.3 million cash added in the quarter, as total cash and equivalents now exceeding \$5.1 million or \$0.18 per share.

Investment Conclusion

We are maintaining our STRONG BUY recommendation and lowering our 12-month target price to \$3.40 from \$3.60, based on an P/E multiple of 15x our earnings per share forecast of \$0.23 for the 12 months ending March 31, 2010.

Financial Results

Revenue: Sangoma reported Q3-08 revenue of \$3.2 million, up 4.7% sequentially or up 43.6% year-over-year and slightly lower than our estimate of \$3.5 million.

Gross Margin: Gross margin was weaker in the quarter at 67.8% versus 72% last quarter and 75% last year, and slightly below our forecast of 72.0%.

Expenses: General and Admin expenses were \$0.22 million, up 5.5% sequentially or up 3.8% y/y and slightly below our estimate of \$0.26 million. Selling and marketing expenses were \$0.46 million, up 14.2% sequentially or up 84.9% y/y, and above our estimate of \$0.4 million.

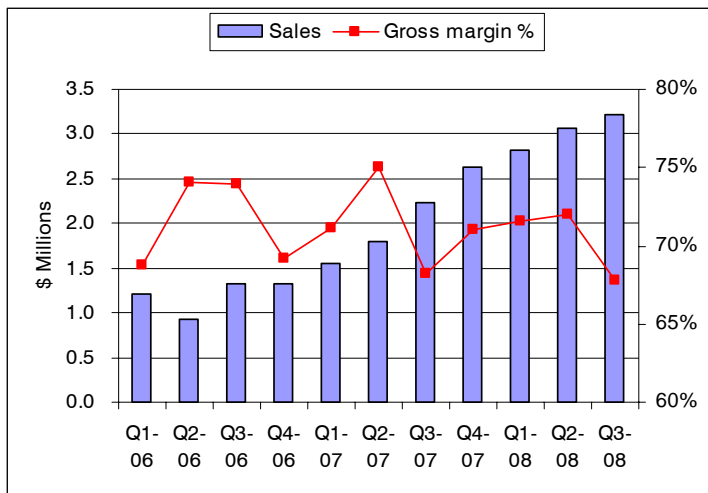
Net Income: Adjusted net income was \$0.96 million or \$0.03, up from \$0.86 million or \$0.03 last quarter and slightly below our estimate of \$1.0 million or \$0.04.

Analysis

Revenue was below our expectations, but still exhibited strong year-over-year growth of 43.7%. Management indicated that much of the increase in sales was the result of growth in offshore markets (non-North American) where sales were up 84% year-over-year. Sales to the US also grew by 22%, while Canadian sales declined 12% year-over-year, though on a relatively small base. The US is currently the largest single country market for Sangoma products at just over 40%, while offshore markets, at over 52%, are the fastest growing for the Company at this time.

Sangoma has several large OEM customers in the US including Fidelity, which resells its hardware through Dell. OEM relationships tend to drive stronger sales though with slightly lower margins, as was demonstrated in Q3-08, as gross margins declined from 72% last quarter to 68%. We expect margins to fluctuate somewhat based on changes in order patterns; however, it is important to note that despite the sequential decline in gross margins, the margins overall remain very healthy in comparison to others in the telecom industry, particularly large telecom equipment providers, including Nortel (41.5%), Nokia (35.7%), and Ericsson (38.1%). The following chart illustrates the Company's quarterly sales and margin history.

Sangoma Quarterly Sales and Gross Margin



Source: Company Reports, NSI

Sangoma generated just over \$1.3 million in cash in Q3 with just under \$1.6 million in cash coming from operations. The Company's cash balance now stands at \$5.2 million or \$0.18 per share. We do not believe the Company is actively looking at any acquisitions at this time, as management has stated to us on several occasions that it believes most acquisitions fail to become successful. However, at some point, as the cash position becomes significant, the Company will have to do something with it, which could include a dividend, stock buyback or acquisition. Sangoma also has significant inventory holdings of \$1.8 million or \$0.06 per share, as management believes in making larger

purchases of raw material in order to achieve a lower cost for parts. Management also maintains large stocks of finished goods as the order patterns can be lumpy at times.

Conclusion

We are making minor changes to our forecast as illustrated in the following table:

NSI Sangoma Forecast Changes

	Q3-08A	Q3-08 E	F2008 New	F2008 Old	F2009 New	F2009 Old
Revenue	3,213,999	3,531,047	12,802,762	13,484,416	17,625,901	18,800,321
G.M.	67.8%	72.0%	69.6%	71.9%	67.3%	71.5%
Net Income	960,462	1,014,224	3,403,489	3,675,326	5,066,157	5,845,824
EPS F.D.	\$0.03	\$0.04	\$0.12	\$0.13	\$0.18	\$0.21

Source: Company Reports, NSI

Overall, the Q3-08 results were slightly below our expectations, though the Company continues to demonstrate strong revenue growth and solid margins. As a result, we are lowering our revenue and EPS forecast accordingly as indicated in the above table.

In our opinion, despite the less than expected results, Sangoma remains a solid investment due to its above average gross margins, strong cash generation and revenue growth. The Company's revenues are well geographically diversified, which should help the Company weather a slowdown in any one region. Therefore, **we are maintaining our STRONG BUY recommendation and lowering our 12-month target price to \$3.40 from \$3.60**, based on a P/E multiple of 15x our earnings per share forecast of \$0.23 for the 12 months ending March 31, 2010.

IMPORTANT DISCLOSURES

May 28, 2008

Company	Ticker	Ex	Rating	Price Target	Last Price	Market Cap (millions)	Shares o/s (millions)	Previous Volume	52 Week		Applicable Disclosures
									High	Low	
Sangoma Technologies Corporation	STC	V	StrB	\$3.40	\$1.34	\$37	27.9	40,000	\$1.72	\$0.86	8

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Investment Opinion Definition

- STRONG BUY:** NSI expects the share price to appreciate 30% or more over the next 12 months.
BUY: NSI expects the share price to appreciate 10% to 30% over the next 12 months.
HOLD: NSI expects the share price to appreciate 10% or less over the next 12 months.
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