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RingCentral Makes A Strategic Move Up-Market and Avaya Gets a Lifeline

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In a significant move for both parties, RingCentral (NYSE:RNG), the Belmont, CA based Enterprise Communication provider, and Avaya (NYSE:AVYA), one of the largest cloud and on-premise telephony solutions providers, have announced a strategic partnership in which RingCentral will contribute $500 million to Avaya in the form of a preferred equity investment and an advance on future payments and licensing rights. On an as-converted basis, RingCentral will obtain approximately a 6% stake in Avaya. RingCentral will become the exclusive Unified Communications-as-a-Service ("UCaaS") provider for Avaya's existing customer base, which as of October 2019, stood at greater than 100 million Unified Communications lines and 5 million Contact Center users. Through this unique transaction, RingCentral will gain access to Avaya's vast Enterprise customer base and assist Avaya in moving away from its legacy hardware business in favor of a more Cloud Communications-focused service offering. Avaya was previously rumored to be entertaining merger offers from Mitel and others before ultimately agreeing to the strategic partnership with RingCentral.

The Avaya partnership marks RingCentral's latest effort in its continued campaign to move up-market through acquisitions and investments. RingCentral's previous efforts came by way of acquiring solutions; the Company acquired Dimelo, a French CRM provider, in October 2018 and acquired Connect First, a Colorado Customer Engagement provider, in January 2019. While these acquisitions expanded the Company's solution set, Dimelo and Connect First do not materially increase RingCentral's Average Revenue Per User ("ARPU"), a key metric in the UCaaS market. With this investment, RingCentral jumpstarts its efforts to move up-market and serve larger Enterprise customers. RingCentral, despite impressive revenue growth recently, has historically struggled to win larger Enterprise customers, instead succeeding in the SMB (Small and Medium-sized Businesses) to Mid-Market customer segment. While RingCentral defines Mid-Market as customers generating between $25,000 and $100,000 in Annualized Recurring Revenue ("ARR") and defines Enterprise as customers generating greater than $100,000 in ARR, the Company's ARPU, approximately $400 / month, is significantly lower than that of Avaya. The question still remains if a provider can truly serve the Enterprise segment without a broadband offering and Service Level Agreements (SLAs).

For Avaya, the transaction provides needed capital and a robust cloud solution that has been lacking in its service offering. The question for Avaya is what is the ultimate end game as they now become RingCentral's central white label partner.

Together, the Companies will provide "Avaya Cloud Office by RingCentral" (ACO), adding to an already expansive portfolio of solutions, including Unified Communications-as-a-Service, Communications Platform-as-a-Service, Contact Center, Customer Engagement, as well as other Cloud and managed services. More important than the portfolio additions, the introduction of ACO will give RingCentral access to Avaya's significantly larger Enterprise customer base, a segment of the market that RingCentral has struggled to penetrate in recent years. It also marks a bold move by RingCentral to accelerate its growing white label offering.

Our overall assessment, given other options for both sides, is this deal is hard to rationalize and a jump ball at best. The much-needed cash infusion gives Avaya relief for existing stakeholders and additional runway to try to execute on what has become a clouded strategy. RingCentral is essentially spending $500 million for a hunting license and hope that Avaya's sales team can finally generate meaningful new recurring cloud revenue using a platform that is still a relative newcomer to the enterprise market. Since both organizations will continue to rely heavily on overlapping channel partners, it's unclear how this partnership will be able to effectively manage new channel originated opportunities and the inevitable conflict.