

Sandvine Corporation

Consolidated Financial Statements
May 31, 2006

Sandvine Corporation

Consolidated Balance Sheets

As at May 31, 2006

	May 31 2006 \$ (unaudited)	November 30 2005 \$ (audited)
Assets		
Current assets		
Cash and cash equivalents	1,115,898	9,755,008
Marketable securities	49,217,671	2,623,030
Accounts receivable	2,798,967	4,827,018
Other receivables	1,055,787	2,219,859
Inventory	4,571,044	5,025,773
Prepaid expenses	585,197	336,627
	<hr/> 59,344,564	<hr/> 24,787,315
Capital assets	4,233,127	2,982,948
	<hr/> 63,577,691	<hr/> 27,770,263
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	2,276,619	3,000,925
Current portion of deferred revenue	2,243,399	2,476,056
	<hr/> 4,520,018	<hr/> 5,476,981
Deferred revenue	-	10,807
	<hr/> 4,520,018	<hr/> 5,487,788
Commitments (note 5)		
Shareholders' Equity		
Share capital (note 3)	77,839,495	40,383,855
Deficit	(18,781,822)	(18,101,380)
	<hr/> 59,057,673	<hr/> 22,282,475
	<hr/> 63,577,691	<hr/> 27,770,263

Approved by the Board of Directors

_____ Director

_____ Director

Sandvine Corporation

Consolidated Statements of Operations and Deficit For the six month period ended May 31, 2006

	May 31 2006 \$ (unaudited)	May 31 2005 \$ (unaudited)
Revenue		
Product	12,649,011	4,931,526
Service	1,694,513	414,528
	<u>14,343,524</u>	<u>5,346,054</u>
Cost of sales		
Product	3,387,245	1,373,669
Service	449,952	101,767
	<u>3,837,197</u>	<u>1,475,436</u>
Gross margin	<u>10,506,327</u>	<u>3,870,618</u>
Expenses		
Sales and marketing	3,867,694	3,110,508
Research and development (note 7)	5,232,990	1,967,208
General and administrative	1,941,867	613,895
Amortization	583,689	213,427
	<u>11,626,240</u>	<u>5,905,038</u>
Loss from operations	(1,119,913)	(2,034,420)
Other income	<u>456,881</u>	<u>83,052</u>
Loss before provision for income taxes	(663,032)	(1,951,368)
Provision for income taxes	<u>17,410</u>	<u>1,106</u>
Net loss for the period	(680,442)	(1,950,262)
Deficit – Beginning of period	<u>(18,101,380)</u>	<u>(15,122,119)</u>
Deficit – End of period	<u>(18,781,822)</u>	<u>(17,072,381)</u>
Loss per share (note 6)		
Basic and fully diluted	<u>(0.007)</u>	<u>(0.029)</u>
Basic weighted average number of shares outstanding	<u>100,358,431</u>	<u>68,427,716</u>
Diluted weighted average number of shares outstanding	<u>100,358,431</u>	<u>68,427,716</u>

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Consolidated Statements of Cash Flows
For the six month period ended May 31, 2006

	May 31 2006 \$ (unaudited)	May 31 2005 \$ (unaudited)
Cash provided by (used in)		
Operating activities		
Net loss for the period	(680,442)	(1,950,262)
Items not affecting working capital		
Amortization	583,689	213,427
Foreign exchange loss (gain)	133,372	(446,298)
Stock-based compensation (note 4)	101,666	25,038
Loss on disposal of capital assets	28,149	-
	<u>166,434</u>	<u>(2,158,095)</u>
Changes in non-current deferred revenue	(10,807)	(80,305)
Changes in non-cash working capital balances	<u>2,307,947</u>	<u>(1,864,787)</u>
	<u>2,463,574</u>	<u>(4,103,187)</u>
Investing activities		
Purchase of capital assets	(1,862,017)	(1,030,810)
Net purchase of marketable securities	<u>(46,594,641)</u>	<u>(12,278,873)</u>
	<u>(48,456,658)</u>	<u>(13,309,683)</u>
Financing activity		
Proceeds from the issuance of share capital (note 3)	<u>37,353,974</u>	<u>17,488,774</u>
Net (decrease) increase in cash during period	(8,639,110)	75,904
Cash and cash equivalents – Beginning of period	<u>9,755,008</u>	<u>474,694</u>
Cash and cash equivalents – End of period	<u>1,115,898</u>	<u>550,598</u>

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Notes to Unaudited Interim Consolidated Financial Statements

May 31, 2006

1 Basis of presentation

The unaudited interim consolidated financial statements are in accordance with Canadian generally accepted accounting principles applicable to interim consolidated financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the November 30, 2005 audited consolidated financial statements.

The Company was incorporated in February 2006. In March 2006, the Company acquired all of the issued and outstanding shares of Sandvine Incorporated (note 3). As both the Company and Sandvine Incorporated were related through common share ownership, the business combination has been recorded using the continuity of interest's method, whereby the financial statements have been prepared on the basis that the Company had always been the sole shareholder of Sandvine Incorporated. Certain comparative information included in these financial statements relates to the financial information of Sandvine Incorporated.

The preparation of these unaudited consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from these estimates and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year. In the opinion of management, these unaudited consolidated financial statements reflect adjustments necessary to state fairly the results for the periods presented.

These unaudited consolidated financial statements have been prepared on a basis consistent with the audited financial statements for the year ended November 30, 2005.

2 Financial instruments

As at May 31, 2006, the Company has one foreign currency forward contract that has the effect of fixing the conversion of \$1 million of the Company's net US dollar asset position to Canadian dollars at a rate of 1.1116. The Company is carrying this contract that matures on or before July 14, 2006 at its fair value of approximately \$1.1 million. Changes in the value of these contracts are recorded as an element of general and administrative expense, which is consistent with the Company's treatment of foreign currency gains and losses.

Sandvine Corporation

Notes to Unaudited Interim Consolidated Financial Statements

May 31, 2006

3 Share capital

Authorized

Unlimited number of common shares

	Common Shares		Class A preferred shares		Class B preferred shares		Common share warrants		Contributed surplus	Total
	#	\$	#	\$	#	\$	#	\$	\$	\$
Balance, November 30, 2005	24,066,408	29,697	34,856,988	21,855,403	28,811,853	18,041,572	619,280	390,146	67,037	40,383,855
Issued under the employee stock purchase price	159,000	67,970	-	-	-	-	-	-	-	67,970
Issued for cash	26,667,367	37,065,865	-	-	-	220,139	-	-	-	37,286,004
Issued on exchange to Class A preferred shareholders	34,856,988	21,855,403	(34,856,988)	(21,855,403)	-	-	-	-	-	-
Issued on exchange to Class B preferred shareholders	28,811,853	18,261,711	-	-	(28,811,853)	(18,261,711)	-	-	-	-
Stock option expense	-	-	-	-	-	-	-	-	101,666	101,666
Balance, May 31, 2006	114,561,616	77,280,646	-	-	-	-	619,280	390,146	168,703	77,839,495

The common shares are redeemable at the option of the registered holder upon receipt of a redemption notice at a redemption price determined in accordance with the attributes of the common shares.

On March 21st, 2006 the Company issued 26,667,367 shares for net proceeds of \$37,065,865 as part of listing its entire share capital on the Alternative Investment Market of the London Stock Exchange. In connection with the listing, the Company executed a corporate reorganization that included, among other steps, shareholders exchanging the then current common shares, Class A shares and Class B shares, as well as existing options and warrants, in Sandvine Incorporated for common shares, options and warrants, in Sandvine Corporation the listed entity.

In connection with a Class B share issuance in November 2005, the Company provided interest free loans to certain employees to finance the share purchase. During the period ended May 31, 2006 the Company collected \$220,139 from these notes and has notes receivable from employees of \$143,504 which it has offset against share capital since the terms of the loan do not meet the criteria for separate disclosure as outlined in EIC 132.

The Company also issued during the period 159,000 common shares on the exercise of stock options for total consideration of \$67,970.

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Notes to Unaudited Interim Consolidated Financial Statements
May 31, 2006

4 Stock options

Stock option plan

The Company has a stock option plan for key employees and directors. Such options typically vest over a five year term, have a contractual life of 10 years and allow for the purchase of one common share per option. The exercise price of the options is the fair market value of the Company's common shares at the date of grant. A summary of the stock option activity is presented below:

	Number	Options Weighted average price \$
Options outstanding, November 30, 2004	5,989,551	0.54
Options activity for the year		
Granted during the year	2,069,200	0.63
Forfeited and expired	(464,452)	0.63
Exercised	(6,348)	0.63
Options outstanding, November 30, 2005	7,587,951	0.56
Option activity for the period		
Granted during the period	680,000	1.06
Forfeited and expired	(156,050)	0.63
Exercised	(159,000)	0.43
Options outstanding, May 31, 2006	7,952,901	0.61

Stock based compensation

The Company adopted CICA 3870 during fiscal 2004 and has recognized \$101,666 as compensation expense for stock-based grants made during the period, with a corresponding credit to contributed surplus.

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Notes to Unaudited Interim Consolidated Financial Statements May 31, 2006

For the three month period ended May 31, 2006, options were granted to employees with a fair value per option of \$1.45 (three months ended February 28, 2006 - \$0.21, May 31, 2005 - \$0.21). The fair market value of these options has been determined using the Black Scholes model based on the fair value of the common shares on the date of grant and the following assumptions: ten year expected life, 0% expected dividend rate, interest rate of 4.35% (February 28, 2006 – 4.10%, May 31, 2005 – 4.02%), volatility of 45% (February 28, 2006 – 0%, May 31, 2005 – 0%).

The following table summarizes information regarding stock options outstanding at May 31, 2006:

Range of Exercise price \$	Number outstanding at May 31 2006	Options Outstanding		Options Exercisable	
		Weighted average contractual life (years)	Weighted average exercise price \$	Number outstanding at May 31 2006	Weighted average exercise price \$
0.40 - 0.63	7,743,301	7.02	0.57	4,683,259	0.52
1.52 - 2.34	209,600	9.90	2.03	-	-
0.40 - 2.34	7,952,901	7.10	0.61	4,683,259	0.52

5 Lease commitments

Future minimum operating lease payments for premises over the next five years and thereafter are as follows:

	\$
2006	218,700
2007	437,400
2008	437,400
2009	437,400
2010	437,400
Thereafter	656,100
	<u>2,624,400</u>

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May 31, 2006

6 Loss per share

	May 31 2006	May 31 2005
	\$	\$
Numerator for basic and diluted loss per share available to common shareholders	(680,442)	(1,950,262)
Denominator for basic loss per share, weighted average number of shares outstanding	100,358,431	68,427,716
Denominator for diluted loss per share, weighted average number of shares and assumed conversions	100,358,431	68,427,716
Loss per share:		
Basic	(0.007)	(0.029)
Diluted	(0.007)	(0.029)

As a result of the losses applicable to common shares, the common share purchase warrants and the options granted under the Company's stock option plan have been excluded in the diluted loss per share calculation as their inclusion would have been anti-dilutive.

7 Government assistance

In 2003, an agreement was entered into with Technology Partnership Canada ("TPC"), which provided partial funding towards the Company's research and development. The agreement relates to a twenty-two month research and development project under which TPC contributed a maximum \$9,500,000. The agreement requires the contribution to be repaid in the form of royalties to a maximum of \$16,000,000 on gross revenues of the Company. During 2005, an amendment to the agreement was signed such that the period in which the Company is required to pay such royalties was changed to the period from December 1, 2005 to November 30, 2013. From December 1, 2005 to November 30, 2007, royalties will be paid at a rate of 1% and as such an amount of \$143,436 has been accrued in the six month period ended May 31, 2006. On the earlier of December 1, 2007 or the date the Company's cumulative gross revenues exceeds \$85,000,000, the royalty rate will increase to 2.5%. The obligation to pay royalties will continue until November 30, 2013.

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Government assistance and repayments, together with investment tax credits, have been applied to research and development expense as follows:

	May 31 2006	May 31 2005
	\$	\$
Research and development	5,089,554	3,430,075
Government repayments/(assistance)	143,436	(1,462,867)
	<u>5,232,990</u>	<u>1,967,208</u>

8 Segment disclosures

The Company has one reportable segment. The Company's operations are substantially all related to the research, design, manufacturing and sales of network equipment for the computer communications equipment industry. Selected financial information is as follows:

	May 31 2006	May 31 2005
	\$	\$
Sales		
Canada	159,468	286,005
United States	13,342,367	3,714,817
Foreign countries	841,689	1,345,232
	<u>14,343,524</u>	<u>5,346,054</u>
	2006	2005
	%	%
Sales		
Canada	1.11	5.35
United States	93.02	69.49
Foreign countries	5.87	25.16
	<u>100.00</u>	<u>100.00</u>

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May 31, 2006

For the period ended May 31, 2006 two customers represented 80% of total revenue (2005 – two customers represented 77%).

	May 31 2006	November 30 2005
	\$	\$
Capital and intangible assets		
Canada	4,233,127	2,982,948
Total assets		
Canada	63,523,659	27,410,300
United States	18,016	130,355
Foreign countries	16,016	229,608
	<u>63,577,691</u>	<u>27,770,263</u>

9 Supplemental cash flow information

The Company paid \$9,207 for income tax in cash and did not pay any interest in cash for the period ended May 31, 2006 (2005 – \$10,577).

10 Credit facilities

The Company has available to it a credit facility from a major Canadian chartered bank. Under the terms of the facility, the Company has available to it a \$500,000 operating line to provide letters of credit and a US\$15,000,000 forward contract line to permit the Company to enter into foreign currency forward contracts. Borrowings made from the facility attract interest at the bank's prime rate of interest. Marketable securities in the amount of \$2,500,000 are pledged as security for the credit facilities.

