

Sandvine Corporation

Unaudited Consolidated Interim Financial Statements
August 31, 2006

Sandvine Corporation
Consolidated Interim Balance Sheets
As at August 31, 2006

	August 31 2006 \$ (unaudited)	November 30 2005 \$ (audited)
Assets		
Current assets		
Cash and cash equivalents	12,811,235	9,755,008
Marketable securities	34,363,763	2,623,030
Accounts receivable	6,298,770	4,827,018
Other receivables	1,067,602	2,219,859
Inventory	5,764,919	5,025,773
Prepaid expenses	409,094	336,627
	<hr/>	<hr/>
	60,715,383	24,787,315
Capital assets	<hr/>	<hr/>
	5,196,256	2,982,948
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	65,911,639	27,770,263
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,012,179	3,000,925
Current portion of deferred revenue	2,426,844	2,476,056
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	6,439,023	5,476,981
Deferred revenue	<hr/>	<hr/>
	58,903	10,807
	<hr/>	<hr/>
	6,497,926	5,487,788
Commitments (note 5 and 7)		
Shareholders' Equity		
Share capital (note 3)	77,753,645	40,316,818
Contributed surplus	258,983	67,037
Deficit	(18,598,915)	(18,101,380)
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	59,413,713	22,282,475
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	65,911,639	27,770,263
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Consolidated Interim Statements of Operations and Deficit For the three and nine month periods ended August 31, 2006

	Three months ended		Nine months ended	
	August 31 2006 \$	August 31 2005 \$	August 31 2006 \$	August 31 2005 \$
Revenue				
Product	7,151,926	3,771,617	19,800,937	8,703,142
Service	923,676	279,490	2,618,189	694,019
	8,075,602	4,051,107	22,419,126	9,397,161
Cost of sales				
Product	1,738,260	1,056,235	5,125,505	2,531,673
Service	338,493	76,867	788,445	173,634
	2,076,753	1,133,102	5,913,950	2,705,307
Gross margin	5,998,849	2,918,005	16,505,176	6,691,854
Expenses				
Sales and marketing	2,319,511	1,772,350	6,187,205	4,786,089
Research and development (note 7)	2,523,507	1,560,219	7,756,497	3,527,427
General and administrative	976,403	834,777	2,918,270	1,448,672
Amortization	440,429	211,340	1,024,118	424,767
	6,259,850	4,378,686	17,886,090	10,186,955
Loss from operations	(261,001)	(1,460,681)	(1,380,914)	(3,495,101)
Interest and other income	495,551	58,769	952,432	141,821
Income (loss) before provision for income taxes	234,550	(1,401,912)	(428,482)	(3,353,280)
Provision for income taxes	51,643	3,689	69,053	2,583
Net income (loss) for the period	182,907	(1,405,601)	(497,535)	(3,355,863)
Deficit – Beginning of period	(18,781,822)	(17,072,381)	(18,101,380)	(15,122,119)
Deficit – End of period	(18,598,915)	(18,477,982)	(18,598,915)	(18,477,982)
Earnings (loss) per share (note 6)				
Basic and diluted	0.002	(0.016)	(0.005)	(0.046)
Basic weighted average number of shares outstanding	114,561,616	86,288,863	103,699,214	73,362,045
Diluted weighted average number of shares outstanding	121,110,016	86,288,863	103,699,214	73,362,045

Sandvine Corporation

Consolidated Interim Statements of Cash Flows

For the three and nine month periods ended August 31, 2006

	Three months ended		Nine months ended	
	August 31 2006 \$	August 31 2005 \$	August 31 2006 \$	August 31 2005 \$
Cash provided by (used in)				
Operating activities				
Net income (loss) for the period	182,907	(1,405,601)	(497,535)	(3,355,863)
Items not affecting cash				
Amortization	440,429	211,340	1,024,118	424,767
Foreign exchange loss (gain)	23,580	253,423	156,952	(192,875)
Stock-based compensation (note 4)	90,280	37,501	191,946	37,501
Loss on disposal of capital assets	-	-	28,149	-
	737,196	(903,337)	903,630	(3,086,470)
Changes in non-current deferred revenue	58,903	(39,747)	48,096	(120,052)
Changes in non-cash working capital balances	(2,633,965)	(530,392)	(326,018)	(2,261,886)
	(1,837,866)	(1,473,476)	625,708	(5,468,408)
Investing activities				
Purchase of capital assets	(1,403,558)	(933,403)	(3,265,575)	(1,964,213)
Government assistant applied against capital assets	-	443,483	-	443,483
Net sale (purchase) of marketable securities	14,853,908	2,176,930	(31,740,733)	(10,101,943)
	13,450,350	1,687,010	(35,006,308)	(11,622,673)
Financing activity				
Proceeds from the issuance of share capital (note 3)	82,853	(39,923)	37,436,827	17,340,596
Net increase in cash during period	11,695,337	173,611	3,056,227	249,515
Cash and cash equivalents – Beginning of period	1,115,898	550,598	9,755,008	474,694
Cash and cash equivalents – End of period	12,811,235	724,209	12,811,235	724,209

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Notes to Unaudited Interim Consolidated Financial Statements

August 31, 2006

1 Basis of presentation

The unaudited interim consolidated financial statements have been prepared 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 August 31, 2006, the Company had 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 1.1304 that matures on or before October 17, 2006. The Company has elected to account for its derivative financial instruments in accordance with EIC-128 issued by the Canadian Institute of Chartered Accountants and has recorded the foreign currency forward at its fair value. 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.

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Notes to Unaudited Interim Consolidated Financial Statements

August 31, 2006

3 Share capital

Authorized

Unlimited number of common shares

	Common Shares		Class A preferred shares		Class B preferred shares		Common share warrant		Total
	#	\$	#	\$	#	\$	#	\$	\$
Balance, November 30, 2005	24,066,408	29,697	34,856,988	21,855,403	28,811,853	18,041,572	1	390,146	40,316,818
Issued under the employee stock option plan	159,000	67,970	-	-	-	-	-	-	67,970
Issued for cash	26,667,367	37,065,865	-	-	-	302,992	-	-	37,368,857
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	18,344,564	-	-	(28,811,853)	(18,344,564)	-	-	-
Balance, August 31, 2006	<u>114,561,616</u>	<u>77,363,499</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1</u>	<u>390,146</u>	<u>77,753,645</u>

The common shares are redeemable at the option of the registered holder at a redemption price equal to the lesser of 90% of the market price of the common shares for the ten trading days immediately prior to the date that the redemption notice has been received and the closing market price on the date that the redemption notice has been received. The redemption feature attached to the common shares limits the amount of cash that can be used for the redemption of common shares to \$50,000 in any calendar month. In accordance with EIC-149, the Company has classified these shares as equity.

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 AIM 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 warrant, in Sandvine Incorporated for common shares, options and warrant, 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 nine month period ended August 31, 2006 the Company collected \$302,992 from these notes and has notes receivable from employees of \$60,651 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

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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
Option activity for the period		
Granted during the period	847,200	2.42
Forfeited and expired	(99,980)	0.63
Exercised	-	-
Options outstanding, August 31, 2006	8,700,121	0.78

Stock based compensation

The Company adopted CICA 3870 during fiscal 2004 and has recognized \$90,280 and \$191,946 for the three and nine month periods ended August 31, 2006 respectively (\$37,501 for the three and nine month periods ended August 31, 2005) as compensation expense for stock-based grants made during the period, with a corresponding credit to contributed surplus.

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The weighted average fair value of stock options granted during the quarter was calculated using the Black-Scholes option-pricing model with the following assumptions:

	For the three months ended		For the nine months ended	
	August 31 2006	August 31 2005	August 31 2006	August 31 2005
Options issued	847,200	398,350	1,527,200	1,553,600
Weighted average Black-Scholes value of each stock option	\$1.82	\$0.21	\$1.27	\$0.21
Assumptions:				
Risk free interest rates	4.10%	4.02%	4.13%	4.02%
Expected life in years	10	10	10	10
Expected dividend yield	0%	0%	0%	0%
Volatility	63.90%	0.00%	41.62%	0.00%

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

Range of Exercise price \$	Number outstanding at August 31 2006	Options Outstanding		Number outstanding at August 31 2006	Options Exercisable	
		Weighted average contractual life (years)	Weighted average exercise price \$		Weighted average exercise price \$	
0.40 – 0.63	7,643,321	6.74	0.57	4,926,849	0.53	
1.52 – 2.43	1,056,800	9.82	2.35	-	-	
0.40 – 2.43	8,700,121	7.11	0.78	4,926,849	0.53	

5 Lease commitments

Future minimum operating lease payments for premises over the next five fiscal years, including the balance of 2006, and thereafter are as follows:

2006	\$ 109,350
2007	437,400
2008	437,400
2009	437,400
2010	437,400
2011	437,400
Thereafter	218,700
	<u>2,515,050</u>

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6 Earnings (loss) per share

	For the three months ended		For the nine months ended	
	August 31 2006 \$	August 31 2005 \$	August 31 2006 \$	August 31 2005 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	182,907	(1,405,601)	(497,535)	(3,355,863)
Denominator for basic earnings (loss) per share, weighted average number of shares outstanding	114,561,616	86,288,863	103,699,214	73,362,045
Denominator for diluted earnings (loss) per share, weighted average number of shares and assumed conversions	121,110,016	86,288,863	103,699,214	73,362,045
Earnings (loss) per share:				
Basic	0.002	(0.016)	(0.005)	(0.046)
Diluted	0.002	(0.016)	(0.005)	(0.046)

In periods where the Company incurred 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 \$224,191 has been accrued in the nine month period ended August 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:

	For the three months ended		For the nine months ended	
	August 31 2006 \$	August 31 2005 \$	August 31 2006 \$	August 31 2005 \$
Research and development	2,442,752	2,247,930	7,532,306	5,678,004
Government repayments/(assistance)	80,755	(687,711)	224,191	(2,150,577)
	2,523,507	1,560,219	7,756,497	3,527,427

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:

	For the three months ended		For the nine months ended	
	August 31 2006 \$	August 31 2005 \$	August 31 2006 \$	August 31 2005 \$
Sales				
Canada	126,360	30,913	285,828	316,919
United States	7,510,790	2,740,398	20,853,158	6,455,215
Caribbean and Latin America	12,020	1,791	111,768	56,807
Europe, Middle East and Africa	406,810	354,764	872,169	1,590,757
Asia Pacific	19,622	923,241	296,203	977,463
	8,075,602	4,051,107	22,419,126	9,397,161
	%	%	%	%
Sales				
Canada	1.6	0.8	1.3	3.4
United States	93.0	67.6	93.0	68.7
Caribbean and Latin America	0.1	0.0	0.5	0.6
Europe, Middle East and Africa	5.0	8.8	3.9	16.9
Asia Pacific	0.3	22.8	1.3	10.4
	100.0	100.0	100.0	100.0

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For the three and nine month periods ended August 31, 2006 one customer represented 74% and 73% of total revenue respectively (three month ended August 31, 2005 – two customers represented 40%; nine months ended August 31, 2005 – two customers represented 51%).

	August 31 2006	November 30 2005
	\$	\$
Capital and intangible assets		
Canada	5,196,256	2,982,948
Total assets		
Canada	65,852,135	27,410,300
United States	8,544	130,355
Europe, Middle East and Africa	50,960	229,608
	<u>65,911,639</u>	<u>27,770,263</u>

9 Supplemental cash flow information

The Company paid \$33,170 for income tax in cash and did not pay any interest in cash for the nine month period ended August 31, 2006 (August 31, 2005 - \$44,084).

10 Credit facility

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 facility.

As at August 31, 2006, the Company has drawn upon US\$83,565 (Cdn.\$92,450) under the letter of credit line and US\$1,000,000 of the forward contract line.

11 Subsequent event

On October 26, 2006, the Company issued 7,895,000 common shares for net proceeds of \$13.2 million in connection with an initial public offering of the Company's shares on the Toronto Stock Exchange. Following closing of this offering, the Company filed Articles of Amendment to remove the redemption feature on the common share as described in note 3.