

# **Sandvine Corporation**

Unaudited Consolidated Interim Financial Statements  
**February 28, 2007**

# Sandvine Corporation

## Consolidated Interim Balance Sheets

As at February 28, 2007

(in Canadian dollars, amounts in thousands, except share and per share data)

	February 28 2007 \$ (unaudited)	November 30 2006 \$ (audited)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	9,585	19,564
Marketable securities	62,855	37,515
Accounts receivable	6,665	4,421
Other receivables	1,032	1,941
Inventory	12,785	9,625
Prepaid expenses	473	365
	<hr/>	<hr/>
	93,395	73,431
<b>Capital assets</b>	<hr/>	<hr/>
	7,371	6,115
	<hr/>	<hr/>
	100,766	79,546
	<hr/>	<hr/>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	4,841	5,591
Current portion of deferred revenue	16,493	700
	<hr/>	<hr/>
	21,334	6,291
<b>Deferred revenue</b>	<hr/>	<hr/>
	94	88
	<hr/>	<hr/>
	21,428	6,379
	<hr/>	<hr/>
<b>Shareholders' equity</b>		
Share capital (note 3)	91,441	91,247
Contributed surplus	580	403
Accumulated other comprehensive income (note 2)	6	-
Deficit	(12,689)	(18,483)
	<hr/>	<hr/>
	79,338	73,167
	<hr/>	<hr/>
	100,766	79,546
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# Sandvine Corporation

Consolidated Interim Statement of Operations and Deficit

For the three month period ended February 28, 2007

(in Canadian dollars, amounts in thousands, except share and per share data)

	February 28 2007 \$ (unaudited)	February 28 2006 \$ (unaudited)
<b>Revenue</b>		
Product	13,558	6,193
Service	1,817	756
	<u>15,375</u>	<u>6,949</u>
<b>Cost of sales</b>		
Product	2,574	1,621
Service	347	183
	<u>2,921</u>	<u>1,804</u>
<b>Gross margin</b>	<u>12,454</u>	<u>5,145</u>
<b>Expenses</b>		
Sales and marketing	3,051	1,829
Research and development (note 7)	2,643	2,439
General and administrative	752	842
Stock based compensation (note 4)	184	46
Amortization	520	245
	<u>7,150</u>	<u>5,401</u>
<b>Income (loss) from operations</b>	5,304	(256)
<b>Interest and other income</b>	639	82
<b>Income (loss) before provision for income taxes</b>	5,943	(174)
<b>Provision for income taxes</b>	71	1
<b>Net income (loss) for the period</b>	5,872	(175)
<b>Deficit – Beginning of period</b>	(18,483)	(18,101)
Transition adjustment on adoption of financial instruments standards (note 2)	(78)	-
<b>Deficit – End of period</b>	<u>(12,689)</u>	<u>(18,276)</u>
<b>Earnings (loss) per share (note 6)</b>		
Basic	0.048	(0.002)
Diluted	0.045	(0.002)
Basic weighted average number of shares outstanding	122,751,511	87,746,777
Diluted weighted average number of shares outstanding	129,367,292	87,746,777

# Sandvine Corporation

Consolidated Interim Statement of Comprehensive Income

**For the three month period ended February 28, 2007**

( in Canadian dollars, amounts in thousands, except share and per share data)

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**February 28**  
**2007**  
**\$**  
**(unaudited)**

**Net income for the period**

5,872

**Other comprehensive income, net of tax**

Unrealized gains and losses on available for sale financial assets arising  
during the period (net of \$nil tax impact)

1

**Comprehensive income**

5,873

# Sandvine Corporation

Consolidated Interim Statements of Cash Flows

For the three month period ended February 28, 2007

(in Canadian dollars, amounts in thousands, except share and per share data)

	February 28 2007 \$ (unaudited)	February 28 2006 \$ (unaudited)
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income (loss) for the period	5,872	(175)
Items not affecting cash		
Amortization	520	245
Foreign exchange (gain) loss	(326)	88
Stock-based compensation (note 4)	184	46
	<u>6,250</u>	<u>204</u>
Changes in non-current balances	6	(154)
Changes in non-cash working capital balances	10,695	2,352
	<u>16,951</u>	<u>2,402</u>
<b>Investing activities</b>		
Purchase of capital assets	(1,777)	(700)
Net (purchase) of marketable securities	(25,340)	(8,466)
	<u>(27,117)</u>	<u>(9,166)</u>
<b>Financing activity</b>		
Proceeds from the issuance of share capital (note 3)	187	126
<b>Net (decrease) in cash during period</b>	(9,979)	(6,638)
<b>Cash and cash equivalents – Beginning of period</b>	19,564	9,755
<b>Cash and cash equivalents – End of period</b>	<u>9,585</u>	<u>3,117</u>
<b>Cash and cash equivalents are represented by</b>		
Balances with banks	1,500	3,117
Cash equivalents	8,085	-

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 1 Basis of presentation

The unaudited consolidated interim financial statements are in accordance with Canadian generally accepted accounting principles applicable to interim consolidated financial statements. These unaudited consolidated interim financial statements should be read in conjunction with the November 30, 2006 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. 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 interim financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated interim 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 interim financial statements reflect adjustments necessary to state fairly the results for the periods presented.

These unaudited consolidated interim financial statements have been prepared on a basis consistent with the audited financial statements for the year ended November 30, 2006, except as described in note 2.

## 2 Changes in accounting policies

### Financial instruments

The Company adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3855, *Financial Instruments – Recognition and Measurement*; Section 1530, *Comprehensive Income*, Section 3861, *Financial Instruments – Disclosure and Presentation* and Section 3865, *Hedges* on December 1, 2006. The adoption of these new financial instruments standards resulted in changes in the accounting for financial instruments as well as the recognition of certain transition adjustments that have been recorded in opening accumulated other comprehensive income as described below. The comparative interim consolidated financial statements have not been restated. The principal changes in the accounting for financial instruments due to the adoption of these accounting standards are described below.

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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## **(a) Financial assets and financial liabilities**

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

### *Held for trading*

Financial assets that are purchased and incurred with the intention of generating profits in the near term are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net income during the period. Cash and cash equivalents totalling \$10.7 million and foreign currency derivatives of \$11 were classified as held for trading on December 1, 2006.

### *Available-for-sale*

Financial assets classified as available-for-sale are carried at fair value with the changes in fair value recorded in other comprehensive income. When a decline in fair value is determined to be other-than-temporary, the cumulative loss included in accumulated other comprehensive income is removed and recognized in net income. Gains and losses realized on disposal of available-for-sale securities are recognized in other income. Investments totalling \$46.3 million were classified as available-for-sale on December 1, 2006.

### *Held-to-maturity*

Securities that have a fixed maturity date and which the Company has positive intention and the ability to hold to maturity are classified as held-to-maturity and accounted for at amortized cost using the effective interest rate method. No investments were classified as held-to-maturity on December 1, 2006.

### *Receivables*

Receivables are accounted for at amortized cost. This classification is consistent with the classification under the prior accounting standards.

## **(b) Embedded derivatives**

Derivatives may be embedded in other financial and non-financial instruments (the "host instrument"). Prior to the adoption of the new standards, embedded derivatives were not accounted for separately from the host instrument except in certain circumstances which were not applicable to the Company. Under the new standards, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with subsequent changes recognized in the Statement of Operations and Deficit as an element of general and administrative expenses.

# **Sandvine Corporation**

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

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The Company enters into certain non-financial instrument contracts which contain embedded foreign currency derivatives. In cases where the contract is not leveraged, does not contain an option feature and is denominated in a currency that is commonly used in the economic environment where the transaction takes place, the embedded derivative is not accounted for separately from the host contract.

The change in accounting policy related to embedded derivatives resulted in an increase of \$78 to the opening deficit at the date of adoption. As of 28 February 2007, the fair value of the embedded derivative liability is \$94. During the period, the Company recognized a loss of \$87 on its embedded derivatives.

## **(c) Determination of fair value**

The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, fair value is determined by using valuation techniques which refer to observable market data.

## **(d) Comprehensive income**

Comprehensive income is composed of the Company's net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available-for-sale securities, net of income taxes. The components of comprehensive income are disclosed in the Consolidated Interim Statement of Comprehensive Income. The change in accounting policy resulted in the recognition of a \$5 unrealized gain on available-for-sale securities in accumulated other comprehensive income on the date of adoption.

## **(e) Hedge accounting**

There was no impact on the Company as a result of adopting Section 3865.

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 3 Share capital

Share capital consists of the following:

	Common Shares		Common share warrant		Total
	#	\$	#	\$	\$
<b>Balance, November 30, 2006</b>	122,668,416	90,857	1	390	91,247
Issued under the employee stock option plan	313,115	187	-	-	187
Transfer from contributed surplus	-	7	-	-	7
<b>Balance, February 28, 2007</b>	122,981,531	91,051	1	390	91,441

The Company has authorized an unlimited number of common shares.

The Company has one outstanding and authorized common share purchase warrant which entitles the holder to acquire 619,280 common shares for \$0.00001 at any time prior to March 31, 2023. This transaction was a non-cash transaction. The Company determined that the fair value of the warrant was \$390 at the time of issue.

During the period, the Company issued 313,115 common shares for net proceeds of \$187 as a result of option holders exercising their options.

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

For the period ended February 28, 2007

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 4 Stock options

### Stock option plan

The Company has adopted a stock option plan for employees and directors. Options granted prior to March 21, 2006 typically vest over a four year and six month term. Options granted subsequent to this date typically vest over a 5 year term. All options 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 volume weighted average share price of the Company's common shares for the five days following the date of grant. As at February 28, 2007, there were 3,155,347 available for future grants under the stock option plan. A summary of the stock option activity is presented below:

	<b>Options</b>	
	<b>Number</b>	<b>Weighted average price \$</b>
<b>Options outstanding, November 30, 2005</b>	<b>7,587,951</b>	<b>0.562</b>
Option activity for the period		
Granted during the period	2,143,600	1.884
Forfeited and expired	(406,830)	0.686
Exercised	(370,800)	0.537
<b>Options outstanding, November 30, 2006</b>	<b>8,953,921</b>	<b>0.875</b>
Option activity for the period		
Granted during the period	526,000	2.530
Forfeited and expired	(24,000)	2.288
Exercised	(313,115)	0.596
<b>Options outstanding, February 28, 2007</b>	<b>9,142,806</b>	<b>0.976</b>

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

## Stock based compensation

During the period, the Company recognized \$184 (2006 – 46) as compensation expense for stock-based grants, with a corresponding credit to contributed surplus. Previously recognised expense of \$7 (2006 - \$nil) relating to options exercised during the period has been transferred from contributed surplus to share capital.

	<b>February 28 2007</b>	<b>February 28 2006</b>
Number of options issued	526,000	470,400
Weighted average Black-Scholes value of each option	\$1.76	\$0.21
Assumptions		
Risk free interest rate	4.17%	4.10%
Expected life in years	10	10
Expected dividend yield	0%	0%
Volatility	55.50%	0%

The following table summarizes information regarding stock options outstanding at February 28, 2007:

Range of exercise price \$	Options Outstanding			Options Exercisable	
	Number outstanding at February 28 2007	Weighted average contractual life (years)	Weighted average exercise price \$	Number outstanding at February 28 2007	Weighted average exercise price \$
0.40 - 0.63	6,979,706	6.28	0.56	4,809,476	0.53
1.52 - 2.53	2,163,100	9.57	2.31	-	-
0.40 - 2.53	9,142,806	7.06	0.98	4,809,476	0.53

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 5 Lease commitments

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

	\$
2007	380
2008	437
2009	437
2010	437
2011	437
Thereafter	219
	<hr/>
	2,347
	<hr/>

## 6 Earnings (loss) per share

	February 28 2007 \$	February 28 2006 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	5,872	(175)
Denominator for basic earnings (loss) per share, weighted average number of shares outstanding	122,751,511	87,746,777
Denominator for diluted earnings (loss) per share, weighted average number of shares and assumed conversions	129,367,292	87,746,777
Earnings (loss) per share:		
Basic	0.048	(0.002)
Diluted	0.045	(0.002)

In periods where the Company incurred losses applicable to common shares, the common share purchase warrant 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.

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 7 Government assistance

The Company has an agreement with Technology Partnership Canada (“TPC”) who provided partial funding towards one of the Company’s research and development projects. The Company received \$9.5 million over a twenty-two month period which ended during fiscal 2005. The agreement requires the contribution to be repaid in the form of royalties to a maximum of \$16 million on gross revenues of the Company. From December 1, 2005 to November 30, 2007, royalties will be paid at a rate of 1%. On the earlier of December 1, 2007 or the date the Company’s cumulative gross revenues exceeds \$85 million, the royalty rate will increase to 2.5%. The obligation to pay royalties will continue until November 30, 2013. During the period, the Company recognized \$154 (2006 - \$69) as royalty expense which has been recorded as an increase to research and development expenses. Cumulatively, the Company has recognized total royalties of \$470 under the agreement.

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

	<b>February 28 2007</b>	<b>February 28 2006</b>
	\$	\$
Research and development	2,722	2,370
Government repayments	154	69
Investment tax credits	(233)	-
	<hr/>	<hr/>
	2,643	2,439
	<hr/>	<hr/>

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

For the period ended February 28, 2007

(in Canadian dollars, amounts in thousands, except share and per share data)

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## 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:

	<b>February 28 2007</b>	<b>February 28 2006</b>
	\$	\$
Sales		
Canada	120	77
United States	13,224	6,510
Caribbean and Latin America	57	86
Europe, Middle East and Africa	1,601	127
Asia Pacific	373	149
	<hr/>	<hr/>
	15,375	6,949
	<hr/>	<hr/>
	<b>2007</b>	<b>2006</b>
	%	%
Sales		
Canada	0.8	1.1
United States	86.0	93.8
Caribbean and Latin America	0.4	1.2
Europe, Middle East and Africa	10.4	1.8
Asia Pacific	2.4	2.1
	<hr/>	<hr/>
	100.0	100.0
	<hr/>	<hr/>

For the period ended February 28, 2007 major customers represented 74.8% (2006 - 81.7%) of total revenue. One customer represented 63.0% of revenue during the period (2006 – 70.8%). A second customer represented 11.8% of revenue during the period (2006 – nil). A third major customer accounted for no revenue during the period (2006 – 10.9%).

# Sandvine Corporation

Notes to the Unaudited Interim Consolidated Financial Statements

**For the period ended February 28, 2007**

(in Canadian dollars, amounts in thousands, except share and per share data)

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	<b>February 28 2007</b>	<b>November 30 2006</b>
	\$	\$
Capital assets		
Canada	7,371	6,115
Total assets		
Canada	100,635	79,419
United States	21	15
Europe, Middle East and Africa	110	112
	<u>100,766</u>	<u>79,546</u>

## 9 Supplemental cash flow information

The Company paid \$53 (2006 - \$7) for income tax in cash and did not pay any interest in cash for the period ended February 28, 2007 (2006 - \$nil).

## 10 Credit facility

The Company has a demand credit facility with a major Canadian chartered bank. Under the terms of the facility, the Company has available to it a \$500 operating line to provide letters of credit and a US\$15 million 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 \$2.5 million are pledged as security for the credit facility.

As of February 28, 2007 the Company has issued letters of credit under its operating line for US\$84 (CDN\$97) expiring July 31, 2007 and US\$64 (CDN\$74) expiring December 29, 2007.

As of February 28, 2007 the Company has three foreign currency forward contracts that have the effect of fixing the conversion of \$4 million of the Company's net US dollar asset position to Canadian dollars at a weighted average rate of 1.1605. These contracts mature on or before April 30, 2007 and have fair value of \$11 at period end. The Company recognized an expense of \$82 relating to the change in fair value of foreign currency forward contracts which settled during the period.