

Sandvine Corporation

Consolidated Interim Financial Statements

August 31, 2010

(unaudited)

Sandvine Corporation

Consolidated Interim Balance Sheets

As at August 31, 2010

(in Canadian dollars, amounts in thousands) (unaudited)

	August 31 2010 \$	November 30 2009 \$
Assets		
Current assets		
Cash and cash equivalents	5,090	2,341
Marketable securities	84,269	83,423
Accounts receivable	23,849	20,741
Inventory	12,464	9,744
Other	2,629	1,773
	<u>128,301</u>	<u>118,022</u>
Non current assets		
Plant and equipment	13,394	13,026
Intangible assets	3,761	5,221
Other assets	525	-
	<u>17,680</u>	<u>18,247</u>
	<u>145,981</u>	<u>136,269</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	10,994	10,732
Current portion of deferred revenue	10,069	7,513
	<u>21,063</u>	<u>18,245</u>
Non-current liabilities		
Deferred revenue	461	790
	<u>461</u>	<u>790</u>
	<u>21,524</u>	<u>19,035</u>
Shareholders' equity		
Share capital (note 4)	147,425	146,820
Contributed surplus	10,819	9,000
Accumulated other comprehensive loss	(7)	(90)
Deficit	(33,780)	(38,496)
	<u>124,457</u>	<u>117,234</u>
	<u>145,981</u>	<u>136,269</u>

On behalf of the Board:

Roger Maggs
Director

Dave Caputo
Director

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Operations

For the three and nine month periods ended August 31, 2010

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

	Three months ended		Nine months ended	
	August 31 2010 \$	August 31 2009 \$	August 31 2010 \$	August 31 2009 \$
Revenue				
Product	18,527	11,995	54,414	37,045
Service	5,920	4,035	14,300	12,771
	<u>24,447</u>	<u>16,030</u>	<u>68,714</u>	<u>49,816</u>
Cost of sales				
Product	4,864	3,452	13,905	10,211
Service	1,552	872	3,871	2,343
	<u>6,416</u>	<u>4,324</u>	<u>17,776</u>	<u>12,554</u>
Gross margin	<u>18,031</u>	<u>11,706</u>	<u>50,938</u>	<u>37,262</u>
Expenses				
Sales and marketing	4,820	4,682	13,925	15,313
Research and development (note 7)	6,973	6,696	18,809	20,684
General and administrative	1,971	2,228	6,441	6,578
Stock based compensation (notes 4 and 5)	666	823	2,076	2,463
Amortization of intangible assets	328	537	1,272	1,570
Depreciation	1,150	1,210	3,181	3,445
Intangible impairment (note 3)	-	-	669	-
Goodwill impairment	-	-	-	2,425
	<u>15,908</u>	<u>16,176</u>	<u>46,373</u>	<u>52,478</u>
Income (loss) from operations	<u>2,123</u>	<u>(4,470)</u>	<u>4,565</u>	<u>(15,216)</u>
Interest and other income	<u>117</u>	<u>114</u>	<u>252</u>	<u>580</u>
Income (loss) before provision for income taxes	<u>2,240</u>	<u>(4,356)</u>	<u>4,817</u>	<u>(14,636)</u>
Provision for income taxes				
Current (note 12)	40	27	101	95
Future	-	(25)	-	57
	<u>40</u>	<u>2</u>	<u>101</u>	<u>152</u>
Net income (loss) for the period	<u>2,200</u>	<u>(4,358)</u>	<u>4,716</u>	<u>(14,788)</u>
Earnings (loss) per share (note 9)				
Basic	0.016	(0.032)	0.035	(0.109)
Diluted	0.016	(0.032)	0.034	(0.109)
Basic weighted average number of shares outstanding	<u>136,466,457</u>	<u>135,653,593</u>	<u>136,101,292</u>	<u>135,597,816</u>
Diluted weighted average number of shares outstanding	<u>140,729,379</u>	<u>135,653,593</u>	<u>140,557,024</u>	<u>135,597,816</u>

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

For the nine month period ended August 31, 2010

(in Canadian dollars, amounts in thousands) (unaudited)

	Stated share capital \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income (loss) \$	Total \$
Balance, November 30, 2008	145,103	5,608	(18,979)	46	131,778
Comprehensive loss:					
Net loss	-	-	(14,788)	-	(14,788)
Net unrealized losses on available for sale financial assets	-	-	-	(63)	(63)
Net unrealized loss on derivative financial instruments designated as cash flow hedges	-	-	-	(168)	(168)
Amount transferred to net loss for derivatives designated as cash flow hedges	-	-	-	105	105
Total comprehensive loss					(14,914)
Stock based compensation (notes 4 and 5)	1,379	937	-	-	2,316
Issued as compensation on business acquisition (note 4)	211	-	-	-	211
Balance, August 31, 2009	146,693	6,545	(33,767)	(80)	119,391
Balance, November 30, 2009	146,820	9,000	(38,496)	(90)	117,234
Comprehensive income:					
Net income	-	-	4,716	-	4,716
Net unrealized losses on available for sale financial assets	-	-	-	(24)	(24)
Net unrealized loss on derivative financial instruments designated as cash flow hedges	-	-	-	56	56
Amount transferred to net income for derivatives designated as cash flow hedges	-	-	-	51	51
Total comprehensive income					4,799
Stock based compensation (notes 4 and 5)	588	1,794	-	-	2,382
Employee share purchase plan (note 4)	(97)	25	-	-	(72)
Issued as compensation on business acquisition (note 4)	114	-	-	-	114
Balance, August 31, 2010	147,425	10,819	(33,780)	(7)	124,457

As at August 31, 2010, the total of deficit and accumulated other comprehensive loss was \$(33,787) (August 31, 2009 - \$(33,847)).

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Cash Flows

For the three and nine month periods ended August 31, 2010

(in Canadian dollars, amounts in thousands) (unaudited)

	Three months ended		Nine months ended	
	August 31 2010 \$	August 31 2009 \$	August 31 2010 \$	August 31 2009 \$
Cash provided by (used in)				
Operating activities				
Net income (loss) for the period	2,200	(4,358)	4,716	(14,788)
Items not affecting cash				
Amortization of intangible assets	328	537	1,272	1,570
Depreciation	1,238	1,237	3,419	3,528
Foreign exchange loss (gain)	(107)	155	(100)	279
Stock-based compensation (notes 4 and 5)	666	823	2,076	2,463
Goodwill impairment	-	-	-	2,425
Future income tax provision	-	(25)	-	57
Intangible impairment (note 3)	-	-	669	-
	4,325	(1,631)	12,052	(4,466)
Changes in non-current balances	(272)	127	(329)	337
Changes in non-cash working capital balances	(4,292)	(525)	(3,478)	3,473
	(239)	(2,029)	8,245	(656)
Investing activities				
Purchase of plant, equipment and intangible software assets (note 10)	(2,191)	(589)	(5,071)	(4,435)
Purchase of marketable securities	(22,103)	(85,993)	(82,689)	(470,411)
Sale of marketable securities	21,935	84,921	81,819	474,234
	(2,359)	(1,661)	(5,941)	(612)
Financing activities				
Proceeds from the issuance of share capital (note 4)	212	44	445	64
	212	44	445	64
Net (decrease) increase in cash during period	(2,386)	(3,646)	2,749	(1,204)
Cash and cash equivalents – Beginning of period	7,476	6,314	2,341	3,872
Cash and cash equivalents – End of period	5,090	2,668	5,090	2,668
Cash and cash equivalents are represented by				
Balances with banks	3,487	2,427	3,487	2,427
Cash equivalents	1,603	241	1,603	241

See accompanying notes to the consolidated interim financial statements

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Notes to the Consolidated Interim Financial Statements

August 31, 2010

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1 Basis of presentation

The consolidated interim financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) applicable to interim consolidated financial statements and prepared on a basis consistent with the audited financial statements for the year ended November 30, 2009, except as described in note 2. These consolidated interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements and should be read in conjunction with the November 30, 2009 audited consolidated financial statements.

The preparation of these 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. Operating results for the three and nine month periods ended August 31, 2010 are not necessarily indicative of the results that may be expected for the full year ending November 30, 2010. In the opinion of management, all normal recurring adjustments considered necessary for fair presentation have been included in these financial statements.

Recently issued accounting standards

In January 2009, the CICA issued Section 1582, *Business Combinations*, replacing Section 1581, *Business Combinations*. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is evaluating the impact of adopting this new standard in connection with its conversion to International Financial Reporting Standards (“IFRS”).

In January 2009, the CICA issued Section 1601, *Consolidated Financial Statements*, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is evaluating the impact of adopting this new standard in connection with its conversion to IFRS.

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2 Accounting policies

Multiple deliverable revenue arrangements

Effective December 1, 2009, the Company adopted EIC 175, *Multiple Deliverable Revenue Arrangements*, (“New Accounting Standard”) replacing EIC 142, *Revenue Arrangements with Multiple Deliverables* (“Old Accounting Standard”). This abstract was amended to (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the manner in which consideration should be allocated to each deliverable; (2) provide that in situations where a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence of selling price, require that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The Company has elected to early adopt this abstract prospectively to revenue arrangements with multiple deliverables entered into or materially modified on or after December 1, 2009. Arrangements that were entered into prior to December 1, 2009 will continue to be accounted for under the Old Accounting Standard.

Under Old Accounting Standards, the Company was typically unable to establish objective and reliable evidence of fair value for its network equipment, application software and consulting service deliverables. In situations when the Company was not able to establish objective and reliable evidence of fair value for all deliverables of the arrangement, but was able to establish fair value for all undelivered elements, revenue was allocated using the residual method. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. Generally, the only undelivered element in the Company’s arrangements was post contract support (often referred to as support and maintenance services). As the Company had established objective and reliable evidence of fair value for its support and maintenance services, revenue related to the network equipment and application software deliverables would be recognized once they had been delivered and all other revenue recognition criteria had been met. When hardware or software elements were undelivered in a revenue arrangement, all of the revenue was typically deferred until these products or services had been delivered. The entire value of an arrangement which included consulting services were generally deferred until the consulting services were delivered as the Company had concluded that objective and reliable evidence of fair value was not available for its consulting services nor was the company able to reliably estimate effort required.

Under the New Accounting Standard, each deliverable within a multiple deliverable revenue arrangement is accounted as a separate unit of accounting if both of the following criteria are met: (1) the delivered item has value to the customer on a stand-alone basis and (2) if the arrangement includes a general right of return relative to the delivered element, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor. The Company’s customers typically purchase a combination of network equipment and at least one application software license. The combination of network equipment and a single application software license will generally form one unit of accounting when a specific order includes both elements. However, as both the network equipment and application software licenses are typically delivered concurrently, this assessment will generally not impact the timing of revenue recognition. In addition, if consulting services are included in the arrangement and are considered to be critical to the functionality of the delivered product within that arrangement, the particular product revenue and the related consulting services are considered to be one unit of accounting. The Company’s revenue arrangements generally do not include a general right of return relative to delivered products.

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Furthermore, the Company is now required to allocate arrangement consideration to all units of accounting based on their relative selling price. The New Accounting Standard establishes a hierarchy for determining the estimated selling price for a deliverable which includes (1) VSOE, if available, (2) third-party evidence (“TPE”) of selling price, if VSOE is unavailable, and (3) best estimate of the selling price (“BESP”) if neither VSOE nor TPE is available. VSOE is generally limited to the price charged when the same or similar product is sold separately. If a product or service is seldom sold separately, it is unlikely the Company can determine VSOE. TPE is determined based on competitor prices for similar deliverables when sold separately. As the Company is either unable to identify similar competitor products and services, or what the competitors’ selling prices are on a stand-alone basis, the Company did not have sufficient information to substantiate TPE. Since neither VSOE nor TPE can be established for its hardware, application software and consulting services, the Company is required to use its best estimate of the selling price (“BESP”) for those deliverables.

In general, the impact of the New Accounting Standard will be to accelerate recognition of revenue in arrangements with undelivered network equipment, application software and consulting services when the delivered hardware and application software are separate units of accounting.

The following table shows revenues as reported and pro forma revenues that would have been reported during the three and nine month periods ended August 31, 2010, if the transactions entered into or materially modified on or after December 1, 2009 were subject the Old Accounting Standards.

	Three months ended		Nine months ended	
	August 31 2010 \$	August 31 2010 \$	August 31 2010 \$	August 31 2010 \$
	As reported	Pro-forma based on previous accounting standards	As reported	Pro-forma based on previous accounting standards
Revenue				
Product	18,527	18,510	54,414	53,302
Service	5,920	5,498	14,300	13,634
	24,447	24,008	68,714	66,936

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The key elements of the Company's accounting policy for revenue as well as multiple deliverable revenue arrangements is more fully described below.

Revenue recognition

Revenue is derived primarily from the sales of network equipment (including embedded software), application software, consulting services and support and maintenance contracts for its network policy control solutions.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured. Generally, where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met unless the Company can reliably demonstrate its ability to meet the customer specified acceptance criteria. The Company typically does not provide for a right of return to its customers.

Revenue for network equipment is generally recognized when the product is shipped and all other revenue recognition criteria, as described above, have been satisfied. Certain software is licensed to customers on a perpetual or per-use basis. Revenue from perpetually licensed software is recognized at the inception of the license term if all other revenue recognition criteria, as described above, have been satisfied. Revenues for software licenses which are paid for on a per-use basis are recognized at the time a reliable estimate can be made of actual revenues generated from usage. Support and maintenance revenue is deferred and recognized ratably over the period during which the services are to be performed, which is typically one year. Revenue from consulting services is recognized as services are delivered, for time and material contracts, and using the percentage of completion method for fixed price contracts. If there is a significant uncertainty about the project completion, receipt of payment or required effort, revenue is deferred until the uncertainty is resolved. The Company estimates the percentage of completion on contracts with fixed fees using hours incurred as a percentage of total estimated hours to complete the consulting service. When total cost estimates exceed estimated revenues, the Company will accrue for the estimated losses immediately.

Revenue recognition for arrangements with multiple units of accounting

The Company enters into revenue arrangements that may consist of multiple deliverables of network equipment, application software, consulting services and support and maintenance. Typically the Company's network equipment and application software are delivered together with support and maintenance being provided over subsequent reporting periods. In arrangements including consulting services, these services are generally concluded in a subsequent reporting period.

Each deliverable within a multiple deliverable revenue arrangement is accounted as a separate unit of accounting if both of the following criteria are met: (1) the delivered item has value to the customer on a stand-alone basis, and (2) if the arrangement includes a general right of return relative to the delivered element, delivery or performance of the undelivered item is considered probable and substantially in the control of the Company. The Company's customers typically purchase a combination of network equipment and at least one application software license. The combination of network equipment and a single application software license will generally form one unit of accounting when a specific order includes both elements. However, as both the network equipment and application software licenses are typically delivered concurrently, this assessment will generally not impact the timing of revenue recognition. In addition, if consulting services are considered to be critical to the functionality of the delivered product in a specific

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revenue arrangement, the product revenue and the related consulting services are considered to be one unit of accounting.

Arrangement consideration is allocated to all units of accounting based on their relative selling price, except support and maintenance revenues which are recognized based on the customer's stated renewal rate. Since neither VSOE nor TPE can be established for its hardware, application software and consulting services, the Company is required to use BEBP for those deliverables. The Company determines BEBP for a product or service by considering multiple factors including, but not limited to, ongoing pricing strategy and policies, market conditions and historical pricing practices. BEBP will be reassessed annually unless required by changes in business practices or new product introductions.

Investments

Investments in companies where the Company has less than a 20% ownership interest and does not exercise significant influence are accounted for by the cost method. The Company regularly reviews the carrying value of its investments to determine whether a decline other than temporary in nature has occurred. When such declines have occurred, investments are written down to reflect the impairment.

3 Intangible Assets

The Company's capitalized intangible assets include acquired non-patented technology assets, which are amortized over their useful life. Finite life intangible assets are required to be tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Recoverability of a long-lived asset is estimated based on undiscounted future cash flows directly associated with its use and eventual disposition. If the results of the recovery test indicate that the asset is impaired, it is written down to its fair value.

During the three months ended May 31, 2010, certain external factors resulted in changes to cash flow projections associated with a non-patented technology asset. As a result, the Company concluded that an indicator of impairment was present which required the Company to perform a recoverability test. The results of the recoverability test indicated that the non-patented technology asset (the "Impaired Asset") was not fully recoverable. The Company used a present value technique to discount a series of expected future cash flows in order to estimate the fair value of the Impaired Asset. Accordingly the Company recorded a non-cash impairment charge of \$669 during the three months ended May 31, 2010. During the three months ended August 31 2010, the Impaired Asset was sold (see note 13).

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4 Share Capital

Share capital consists of the following:

	Common Shares		Common share warrant		Total \$
	#	\$	#	\$	
Balance, November 30, 2009	135,862,731	146,430	1	390	146,820
Issued under the employee stock option plan	81,358	55	-	-	55
Transfer from contributed surplus	-	22	-	-	22
Issued as compensation on business acquisition	-	49	-	-	49
Unvested shares held by trust	(27,512)	(42)	-	-	(42)
Balance, February 28, 2010	135,916,577	146,514	1	390	146,904
Issued under the employee stock option plan	247,205	178	-	-	178
Transfer from contributed surplus	-	77	-	-	77
Issued as compensation on business acquisition	-	49	-	-	49
Unvested shares held by trust	(13,003)	(26)	-	-	(26)
Balance, May 31, 2010	136,150,779	146,792	1	390	147,182
Issued under the employee stock option plan	442,246	212	-	-	212
Transfer from contributed surplus	-	44	-	-	44
Issued as compensation on business acquisition	-	16	-	-	16
Unvested shares held by trust	(15,605)	(29)	-	-	(29)
Balance, August 31, 2010	136,577,420	147,035	1	390	147,425

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. The issuance of this warrant was a non-cash transaction. The Company determined that the fair value of the warrant was \$390 at the time of issue.

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On June 30, 2007, the Company acquired all of the outstanding shares of Simplicita Software, Inc. (“Simplicita”), a provider of subscriber mediation software for IP networks, for consideration of 643,395 common shares of the Company valued at approximately \$3,423. In addition to the purchase consideration, common shares were issued and allocated to a key employee escrow to be released over time contingent on the continued employment of certain individuals over a three year period. Net of share cancellations, 163,192 shares were issued and allocated to the key employee escrow. During the three and nine month periods ended August 31, 2010, the Company released 4,199 and 29,681 shares respectively. As of August 31, 2010, there are no shares remaining in escrow. During the three and nine month periods ended August 31, 2010 the Company recognized \$16 and \$114 as compensation expense relating to this key employee escrow (August 31, 2009 - \$57 and \$211). The Company recognized a total of \$825 as non-cash compensation expense over the three year period in which the services were rendered. As at August 31, 2010 there is no further non-cash compensation to be recognized.

During the three and nine month period ended August 31, 2010, the Company issued 442,246 and 770,809 common shares for cash proceeds of \$212 and \$445 as a result of option holders exercising their options (August 31, 2009 – nil and \$nil; nil and \$nil).

The Company has a trust vehicle to facilitate its employee share purchase plan and hold shares of the Company allocated to individual employees. This trust is considered to be a variable interest entity and has been consolidated by the Company. Excluded from the outstanding common shares of the Company as of August 31, 2010 are 56,120 unvested common shares which are held by the trust (August 31, 2009 – nil).

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5 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 prior to the date of grant. As at August 31, 2010, there were 3,034,382 options available for future grants under the stock option plan. A summary of the stock option activity is presented below:

	Options	
	Number	Weighted average exercise price \$
Options outstanding, November 30, 2009	10,398,100	1.69
Option activity for the period		
Forfeited	(183,097)	3.02
Exercised	(81,358)	0.67
Options outstanding, February 28, 2010	10,133,645	1.68
Option activity for the period		
Granted	1,277,000	1.51
Forfeited	(231,547)	2.42
Exercised	(247,205)	0.72
Options outstanding, May 31, 2010	10,931,893	1.66
Option activity for the period		
Granted	916,600	1.82
Forfeited	(469,883)	3.43
Exercised	(442,246)	0.48
Options outstanding, August 31, 2010	10,936,364	1.65

Stock based compensation

Stock based compensation (related to the Company's stock option plan) recognized for the three and nine month periods ended August 31, 2010 was \$639 and \$1,937 respectively with a corresponding credit to contributed surplus (August 31, 2009 - \$766 and \$2,252). Previously recognized compensation expense of \$44 and \$143 relating to options exercised during the three and nine month periods ended August 31, 2010 has been transferred from contributed surplus to share capital (August 31, 2009 - \$12 and \$17).

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	Three months ended		Nine months ended	
	August 31 2010	August 31 2009	August 31 2010	August 31 2009
Number of options issued	916,600	1,309,300	2,193,600	2,315,250
Weighted average Black-Scholes value of each option	\$1.39	\$0.92	\$1.63	\$0.83
Assumptions				
Risk free interest rate	2.76%	2.83%	3.03%	2.81%
Expected life in years	7.44	7.37	7.44	8.51
Expected dividend yield	0%	0%	0%	0%
Volatility	89.31%	98.17%	90.25%	99.85%

The following table summarizes information regarding stock options outstanding at August 31, 2010:

Options Outstanding				Options Exercisable	
Range of exercise price \$	Number outstanding	Weighted average contractual life (years)	Weighted average exercise price \$	Number outstanding	Weighted average exercise price \$
0.40 - 0.82	3,267,866	4.53	0.64	2,665,966	0.60
1.05 - 2.53	6,460,559	8.25	1.53	1,688,489	1.88
4.11 - 5.50	869,822	7.07	4.37	505,054	4.39
6.59 - 6.95	338,117	6.94	6.70	203,993	6.70
0.40 - 6.95	10,936,364	7.00	1.65	5,063,502	1.65

6 Lease commitments

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

	\$
2010	195
2011	633
2012	288
2013	22
Thereafter	-
	<u>1,138</u>

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7 Government assistance

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

	Three months ended		Nine months ended	
	August 31 2010	August 31 2009	August 31 2010	August 31 2009
	\$	\$	\$	\$
Research and development	6,682	6,689	20,287	21,516
Government repayments	664	401	1,912	1,246
Government assistance / investment tax credits	(373)	(394)	(3,390)	(2,078)
	6,973	6,696	18,809	20,684

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 \$9,500 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 \$16,000. Royalties are charged at 2.5% of the Company’s gross revenues. The obligation to pay royalties expires on November 30, 2013. During the three and nine month periods ended August 31, 2010, the Company recognized \$612 and \$1,720 respectively (August 31, 2009 - \$401 and \$1,246) as royalty expense which has been recorded as an increase to research and development expenses. Cumulatively, the Company has accrued or paid total royalties of \$6,078 under the agreement.

A subsidiary of the Company participates in programs sponsored by a foreign government for the support of research and development activities. The subsidiary is obligated to pay royalties, amounting to 3% - 3.5% on sales and other related revenues generated from the subsidiary’s products up to the amount granted plus interest. The subsidiary’s obligation to pay these royalties is contingent on actual sales of its products, and in the absence of such sales, no payment is required. During the three and nine month periods ended August 31, 2010, the subsidiary received additional funding of \$nil and \$750 USD (\$nil and \$792 CAD) under these programs (August 31, 2009 - \$nil and \$723 USD). As of August 31, 2010, the subsidiary has received cumulative grants of \$2,326 USD (\$2,527 CAD). During the three and nine month periods ended August 31, 2010, the Company recognized \$52 and \$192 respectively (August 31, 2009 - \$nil and \$nil) as royalty expense which has been recorded as an increase to research and development expenses. Cumulatively, the Company has accrued or paid total royalties of \$503 USD (\$544 CAD) under the agreement.

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The Company has entered into an agreement with the Province of Ontario relating to the Next Generation of Jobs Fund, which will provide funding relating to one of the Company's projects. Under the agreement, the Company will be eligible to receive funding equal to 11% of eligible project expenditures from February 24, 2009 to February 24, 2014 to a maximum of \$18,700 (the "Initial Grant"). Payments made in respect of the Initial Grant can become conditionally repayable if certain cumulative job targets are not met. In addition, at the end of the agreement, the Company may be entitled to receive up to an additional 4% of eligible project expenditures (to a maximum of \$6,800) if certain Ontario-based job targets have been met. During the three and nine month periods ended August 31, 2010, the Company recorded \$659 and \$4,420 of funding eligible from the program. The amount of funding received in respect of eligible expenses is as follows:

	Three months ended		Nine months ended	
	August 31 2010	August 31 2009	August 31 2010	August 31 2009
	\$	\$	\$	\$
Sales and marketing	45	-	351	-
Research and development	373	-	2,588	-
General and administrative	180	-	847	-
	598		3,786	
Purchase of plant, equipment and intangible software assets	61	-	634	-
	659		4,420	

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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 management equipment and solutions for broadband service providers. Selected financial information is as follows:

	Three months ended		Nine months ended	
	August 31 2010 \$	August 31 2009 \$	August 31 2010 \$	August 31 2009 \$
Sales				
Canada	249	351	978	2,970
United States	9,023	8,499	31,071	24,344
Caribbean and Latin America	2,102	806	5,471	3,455
Europe, Middle East and Africa	6,715	3,234	16,883	13,052
Asia Pacific	6,358	3,140	14,311	5,995
	<u>24,447</u>	<u>16,030</u>	<u>68,714</u>	<u>49,816</u>
	%	%	%	%
Sales				
Canada	1.0	2.2	1.4	6.0
United States	36.9	53.0	45.2	48.9
Caribbean and Latin America	8.6	5.0	8.0	6.9
Europe, Middle East and Africa	27.5	20.2	24.6	26.2
Asia Pacific	26.0	19.6	20.8	12.0
	<u>100.00</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

In situations where a sale is made through a reseller, revenue associated with that sale is attributed to the geographic location of the end customer. Revenue from individually significant countries contained within these geographic regions included Malaysia, which represented 12.6% and 4.5% of revenue for the three and nine month periods ended August 31, 2010 (August 31 2009 – nil% and nil%).

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Major customers are customers which represent more than 10% of total revenues for a given period. For the three and nine month periods ended August 31, 2010 major customers represented 51.0% and 45.9% of total revenue respectively (August 31, 2009 – 45.0% and 13.4%). The breakdown of major customers for the three months ended August 31, 2010 is as follows:

	Three months ended		Nine months ended	
	August 31 2010 %	August 31 2009 %	August 31 2010 %	August 31 2009 %
Customer A	21.6	11.5	17.0	13.4
Customer B	14.9	0.4	5.5	1.8
Customer C	14.5	5.3	18.2	4.8

	August 31 2010 \$	November 30 2009 \$
Plant and equipment, intangibles and goodwill		
Canada	15,131	13,535
United States	92	2,232
Europe, Middle East and Africa	1,932	2,480
	17,155	18,247
Total assets		
Canada	143,153	130,728
United States	260	2,377
Europe, Middle East and Africa	2,568	3,164
	145,981	136,269

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9 Earnings (loss) per share

	Three months ended		Nine months ended	
	August 31 2010 \$	August 31 2009 \$	August 31 2010 \$	August 31 2009 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	2,200	(4,358)	4,716	(14,788)
Denominator for earnings (loss) per share, weighted average number of shares outstanding				
Basic	136,466,457	135,653,593	136,101,292	135,597,816
Effect of warrant outstanding	619,280	-	619,280	-
Effect of stock options issued	3,642,304	-	3,823,438	-
Effect of contingently returnable shares	1,338	-	13,014	-
Diluted	140,729,379	135,653,593	140,557,024	135,597,816
Earnings (loss) per share:				
Basic	0.016	(0.032)	0.035	(0.109)
Diluted	0.016	(0.032)	0.034	(0.109)

In periods where the Company incurred losses attributable to common shares, options granted under the Company's stock option plan, contingently returnable shares and the common share purchase warrant have been excluded in the diluted loss per share calculation as their inclusion would have been anti-dilutive.

10 Supplemental cash flow information

For the three and nine month periods ended August 31, 2010 the Company paid \$48 and \$171 for income tax in cash (August 31, 2009 - \$4 recovery and \$29 paid). The Company did not pay any interest in cash during the three and nine month periods ended August 31, 2010 and August 31, 2009.

During the three and nine month periods ended August 31, 2010, the Company recorded \$61 and \$634 of government assistance relating to plant, equipment and intangible software asset acquisitions. This government assistance has been netted against plant, equipment and intangible software asset purchases as disclosed in the Statement of Cash Flows. Exclusive of government assistance, purchases of plant, equipment and intangible software were \$2,252 and \$5,705 for the three and nine month periods ended August 31, 2010.

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11 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 \$1,000 operating line to provide letters of credit and a \$2,500 contingency 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 plus 0.5%. Marketable securities with a carrying value and fair value of \$3,500 are pledged as security for the credit facility. The assets pledged as security can be called by the lender upon default of the facility or insolvency of the Company. The facility and the related security will remain in effect until the facility, which has no term, is terminated.

As of August 31, 2010 the Company had issued three letters of credit under its operating line. The individual letters of credit were; US\$292 (CDN\$307) expiring July 15, 2011, US\$16 (CDN\$17) expiring July 24, 2011 and US\$79 (CDN\$84) expiring August 31, 2011.

12 Income taxes

The income tax expense recorded during the three and nine months ended August 31, 2010 differs from the expected tax expense that would be calculated by applying the statutory Canadian tax rate primarily as a result of the use of temporary differences and tax loss carryforwards against which a valuation allowance has previously been recorded. The Company continues to evaluate and examine its future tax assets and valuation allowance on a regular basis. As at August 31, 2010, the Company determined that it was still not able to satisfy the "more likely than not" standard, and continued to take a full valuation allowance in respect of its net future income tax assets..

13 Disposal of intangible asset

Effective July 1, 2010, the Company entered into an asset purchase agreement to sell a non-patented technology asset (the "Disposed Asset") that had a carrying value of \$1,105 (see note 3). Under the terms of the agreement, the Company received the following non-cash consideration: preferred shares of the acquirer, the right to ongoing royalties associated with future revenues of the acquirer, and a perpetual license allowing the restricted use of the intellectual property associated with the Disposed Asset. The Company has determined that the fair value of the assets received is approximately equal to the carrying amount of the Disposed Asset, and accordingly no material gain or loss on disposal was recognized during the third quarter of fiscal 2010.

14 Acquisition of intangible software asset

During the three months ended August 31, 2010, the Company capitalized \$1,187 relating to the ongoing implementation of a new Enterprise Resource Planning ("ERP") system. As at August 31, 2010, no amortization had been recorded relating to the ERP asset as it remained under development.