

The Packeteer Q3 2006 Financial Conference Call
October 19, 2006
2:00pm PDT

AGENDA

Thank you. Our call today will begin with a summary of Packeteer's financial results for the third quarter 2006. Dave Côté, our President and CEO, will follow this summary with an overview of our business. At the conclusion of these presentations, there will be an opportunity for questions.

Today's call is being recorded. A replay of this call, along with management's script can be accessed on Packeteer's website.

FORWARD LOOKING STATEMENT

During the course of this conference call, we will discuss with you some of the factors we currently anticipate may influence our results going forward. These forward-looking statements include express or implied statements regarding future operating results and business developments based on limited information available to us now, which is subject to change. We currently expect to provide guidance regarding our results going forward only during each quarterly financial conference call, and we do not plan to otherwise update that guidance. Actual results may differ materially from those stated or implied by the forward-looking statements we may make today. Such statements are subject to risks and uncertainties, including the risks described in the press release announcing this call and the risks discussed in the Risk Factors section of our 10-K filed with the Securities and Exchange Commission on March 16, 2006, and our 10-Q's and other reports filed with the SEC from time to time.

REGULATION G DISCLOSURE

We will be using non-GAAP financial measures in this conference call, which exclude the amortization of purchased intangible assets, in-process research and development and stock-based compensation from acquisitions, and the expensing of stock options required by FAS 123R, partially offset by the tax effect of these items. For a detailed reconciliation of these financial measures, please see our website at www.packeteer.com under Company – Investors – Conference Calls. In accordance with SEC guidelines, the

presentation of non-GAAP financial measures should not be considered in isolation, or as a substitute for the Company's financial results prepared in accordance with GAAP.

THIRD QUARTER 2006 HIGHLIGHTS

STATEMENT OF OPERATIONS

For the third quarter 2006, net revenues were \$36.0 million compared with net revenues of \$34.2 million for the second quarter 2006, resulting in a 5% sequential quarterly increase. For the third quarter 2006, the Americas net revenues were 48% of total net revenues, compared with 46% for the full year 2005, while Europe net revenues were 27% for the third quarter 2006, compared with 29% for the full year 2005, and Asia-Pacific net revenues were 25% of total net revenues, compared with 25% for the full year 2005.

Our top 10 customers accounted for 76% of total net revenues in the third quarter 2006, compared with 77% in second quarter 2006. Our largest distributor in the U.S., Alternative Technology, accounted for 26% of total net revenues in the third quarter 2006, compared with 25% in the second quarter 2006. Westcon, a distribution partner in North America and Europe, accounted for 15% of total net revenues in the third quarter 2006, compared with 22% in the second quarter 2006. No other customer accounted for more than 10% of total net revenues in the third quarter 2006.

We are very pleased to again be reporting record quarterly revenues. Although revenues for the new iShared product line of approximately \$2.4 million were less than our guidance of \$3-\$4 million for the third quarter, we have been pleased by the market opportunities we are now seeing for this new product line. For the fourth quarter, we expect modestly higher sequential revenues in our base business, and substantially higher revenue of approximately \$4-\$5 million from the iShared product line.

As we mentioned when we acquired Tacit in the middle of the second quarter 2006, our expectation was that the iShared revenues would grow sequentially, but the effect of higher operating expenses and slightly lower gross margins resulting from this acquisition would be dilutive in the short term. Three months ago, we estimated that our operating income as a percent of revenue would be 8-9% of revenues in the third quarter, and increase to 11-12% of revenues in the fourth quarter of 2006. We are very

pleased to report that through tight expense controls, we were able to achieve 10% operating income as a percent of revenue in the third quarter. In addition, our plans still target operating income of 11-12% of revenues in the fourth quarter. Our plans now suggest that our operating income will reach 13-14% of revenues in the first quarter 2007, before approaching our long term operating income targets of 16-18% in the second quarter 2007.

Gross margins of \$27.0 million and \$26.3 million, excluding the amortization of purchased intangible assets and the expensing of stock options of \$951,000 and \$733,000, in the third quarter and second quarter respectively, were 75% in the third quarter and 77% in the second quarter 2006.

Research and Development expenses, excluding stock-based compensation from acquisitions and the expensing of stock options of \$1,259,000 and \$929,000 in the third and second quarters respectively, resulted in total expenses of \$7.1 million and \$6.3 million for the third and second quarters of 2006, or 20% and 19% of revenues respectively. We expect that our non-GAAP Research and Development expenses will approximate our long-term business model target of 18% of revenues again, beginning in the second quarter 2007.

Sales and Marketing expenses, excluding stock-based compensation from acquisitions, the expensing of stock options, and the amortization of purchased intangible assets of \$1,907,000 and \$1,288,000 in the third and second quarters respectively, resulted in total expenses of \$13.4 million and \$12.4 million for the third and second quarters of 2006, or 37% and 36% of revenues respectively. We expect that non-GAAP Sales and Marketing expenses will approximate our long-term business model target of 30-32% of revenues again, beginning in the second quarter 2007.

General and Administrative expenses, excluding stock-based compensation from acquisitions and the expensing of stock options, of \$756,000 and \$649,000 in the third and second quarters respectively, resulted in total expenses of \$3.0 million and \$2.5 million for the third and second quarters of 2006, or 8% and 7% of revenues respectively. The large increase is primarily a result of incremental professional services, and headcount related expenses including the first full quarter of the additional Tacit employees. Our long-term target for non-GAAP General and Administrative expenses remains at 6-7% of revenues.

Operating income excluding stock-based compensation from acquisitions, the expensing of stock options, the amortization of purchased intangible assets and in process research and development of \$4,872,000 and \$5,399,000 in the third and second quarters respectively, resulted in total non-GAAP operating income of \$3,515,000 and \$5,013,000 for the third and second quarters of 2006, or 10% and 15% of revenues respectively. Our plan for non-GAAP operating income assumes that we should approach our target range of 16-18% beginning in the second quarter 2007.

Other Income (net) for the third quarter 2006 was \$807,000, compared with \$1.0 million in the second quarter 2006. The decrease was primarily due to the significantly lower cash balances as a result of the Tacit acquisition.

During the third quarter of 2006, we recorded a tax benefit of \$851,000, primarily as a result of the annual reconciliation of the prior year tax provision to the related tax return along with other adjustments, partially offset by additional tax reserves. We would estimate a tax provision of 5-10% for the fourth quarter 2006.

Non-GAAP net income, which excludes the amortization of purchased intangible assets, in-process research and development, stock-based compensation from acquisitions and the effect of expensing stock options, offset by the tax effect of such items, was \$5.0 million and \$4.3 million, or \$0.14 and \$0.12 per diluted share for the third and second quarters respectively.

Total headcount was 422 at both September 30 and June 30, 2006. Our plans call for selected headcount increases during the remainder of the year, targeted mainly in the sales, engineering and operations organizations.

BALANCE SHEET

Total cash, comprised of cash, cash equivalents and investments, was \$72.6 million at September 30, 2006, substantially unchanged from \$72.4 million at June 30.

Trade receivables of \$22.3 million at September 30, 2006 resulted in approximately 57 days sales outstanding, compared to \$19.2 million or 51

days reported at June 30, 2006. The higher receivable balance at September 30, 2006 was primarily due to slightly less linear quarterly revenues.

Our reported inventories, which are primarily comprised of finished goods, were \$5.8 million at September 30, 2006, compared to \$3.8 million at June 30, 2006. The increase in inventory balances at September 30 was primarily associated with the introduction of our new RoHS-compatible hardware platforms. Over the next couple of quarters, we would expect more normal inventory levels of \$4-\$5 million.

I'll now turn the call over to our CEO, Dave Côté, for some specific comments on the state of our business. Dave.

Dave Côté:

Thank you David, and thanks to all of you for joining us today. We achieved record revenues in our third quarter and exceeded our guidance for operating margin of 8-9% by delivering 10% operating margin. While we grew our iShared business to \$2.4 million in the third quarter, it did not meet our target of \$3 to \$4 million, primarily do to a shortfall in our Americas iShared revenue.

The Americas accounted for 48% of revenues and grew 10% quarter on quarter, partly due to the first full quarter of iShared revenues. Europe at 27% of revenues was down approximately 5% reflecting typical seasonal patterns. And, Asia at 25% of revenue was up about 8% led by Japan. Cash at \$72.6 million was approximately flat with the balance at June 30.

Even though we were disappointed by the revenue performance of the iShared business for Q3, we continue to be very encouraged by the overall market opportunity, as well as the deals and activities we are seeing in this business.

In a recent Wave of the InfoPro Storage Study, a quarterly research report for the storage market, Fortune 1000 enterprises reaffirmed both the underlying drivers for WAFS technology, as well as the importance of WAFS products to their upcoming plans. Among Top Storage Initiatives, server/storage consolidation was ranked as the number 2 priority. And, in ranking the Top 10 Storage Networking

Technologies, WAFS was ranked #2 for those in pilot stages, #5 for those in Near Term Plans, and #2 for those in Long Term Plans. WAFS continues to be hot, ranked #4, on the “Heat Index”, which is a measure of the interest in storage technologies by the InfoPro study. Conversely, it is ranked very low in the adoption index. This implies an important technology at the very beginning of its adoption curve – further evidence that this is an exciting emerging opportunity.

Through the iShared products, technology, and partnerships we have added important complementary technology to our overall WAN Optimization Solution, giving us the most complete vision for providing guaranteed application delivery to our customers, for all of their applications, at all of their locations.

The integration and training of our sales teams and channel partners, as well as building the pipeline took more of Q3 than we had expected. While there continue to be opportunities for improving our performance, Q3 marked an important period in which the traditional PacketShaper sales force, with the WAFS specialty team, began to identify and develop a broad range of WAFS and acceleration opportunities. The iShared products have definitely opened up new opportunities to our sales organization that will begin to pay-off in the fourth quarter and into 2007. In fact, we believe that iShared revenue will be between \$4 and \$5 million for the fourth quarter, approximately doubling over Q306.

Our partnership with Microsoft also represents an important leverage point for our plans going forward.

Microsoft is a key force in the move to server consolidation. Our ability to seamlessly fit into the Microsoft environment, in fact delivering Microsoft branch office services on iShared, makes our platform the only true server consolidation solution. This enables our customers to remove all of their servers from branch locations.

We are also working with Microsoft at the field level by aligning our sales people with the Microsoft enterprise sales teams worldwide. Microsoft has been instrumental in bringing us in to several large opportunities. We will also partner with them in telling the branch

office story. The iShared team presented with Microsoft on the R2 rollout at 30 cities in the US during Q2 of this year. There will be other programs and joint marketing that will occur in the coming months. To insure our focus on this important partnership we have hired a new Director of our Microsoft Alliance located in the Seattle area to maximize our contact and focus with Microsoft.

We continue to drive the integration efforts strongly and continue to target Q1 as our goal for making this transaction accretive; however, given the slightly slower ramp in our revenues, we think it is prudent to suggest that it may be the 2nd quarter before we are able to deliver a fully accretive quarter.

In addition to the integration efforts of the iShared business that occurred throughout the organization in Q3, we had a number of other activities that were accomplished.

We began shipping iShared version 3.2, which is the first release to begin to deliver the “branch office in a box” solution. This offering combines WAFS including CIFS acceleration, file differencing, storage caching, and a distributed file system with WAN Optimization, as well as advanced Microsoft branch office services.

We launched new versions of our SkyX gateways, the SkyX 250 and the SkyX 750, which are both higher performing units and met RoHS standards for shipments to the European Union and other countries.

In September we announced and began shipping the PacketShaper 1400, delivering an aggressive price/performance benchmark specifically designed for branch office and network edge deployments. The PacketShaper 1400 meets the WAN application optimization needs of distributed branch office enterprises by combining a high capacity appliance with built-in scalability that fits a branch office budget and resources.

We had an excellent quarter for larger opportunities, closing a record number of large deals. In the third quarter, there were over 50 deals of \$100K or more. This was up from 44 deals greater than \$100K in the prior quarter – Q2 2006, as well as significantly higher than the

37 deals that occurred in the year ago quarter, Q3 2005. The average deal size in the third quarter was over \$215,000.

In Q3, 65% of product revenue came from core units with the balance from edge units and other. The unit split was approximately 70/30 - edge to core units. PacketShapers with the Compression Module delivered a contribution of approximately 20% of product revenue and shipped on approximately 25% of all units, which has become typical for most quarters. Q3 represented our first complete quarter of shipping the new release 8, which includes our acceleration module. Acceleration shipped on 8% of units during the third quarter, which we view as a very positive start for this major new feature.

Q3 saw a number of large existing customers continuing their worldwide or nationwide rollouts. These included Bank of Tokyo-Mitsubishi, Clifford Chance, the world's largest law firm, Nomura Securities, Toyota, FMC Corporation, the US Navy, Glaxo Smith Kline, Autodesk, ACE Insurance and DHL to name a few.

In addition we had large deals with a number of new customers including Coherent, Conde Nast, eBay, the Ministry of Education for Kuwait, Netversant, SFR Vodafone, and Welsh Water, several of which were iShared wins.

We also had several announcements of iShared customer stories which are available in more detail on our website. These included stories on the Avid Group, a civil engineering firm, ERO, an architecture and structural engineering firm, and Enterasys, the Secure Networks Company. All of these firms use iShared solutions to improve the performance of their applications at branch office locations.

We are also very pleased that two of our customers have won industry awards based on their Packeteer installations. Inergy Automotive Systems was selected as a 2006 Network World "Enterprise All-Star" award winner for deploying PacketShapers to Alleviate Converged Network Congestion and Optimize Strategic Application Performance. The Network World Enterprise All-Star

Award program recognizes exceptional use of network technology to further enterprise business objectives.

Separately, Info Security Products Guide named Arch Coal winner of the 2006 Best Deployment Scenario Award in the WAN Optimization Category for their PacketShaper deployment at mining complexes throughout North America.

We are well on our way in integrating the iShared business into Packeteer.

As I shared last quarter, this process includes a complete integration of the Packeteer and Tacit Networks channels and full cross training of sales personnel. We are making good progress by targeting key “Go-to” partners in all of our regions. The six-month corporate strategy calls for full integration of each organization’s support operations and a fully integrated sales organization, which will continue to have WAFS technical and sales specialists.

In the coming weeks we will be out on the road talking to industry analysts and press regarding our roadmap for delivering integration and interoperability between PacketShaper and iShared technology. It will involve several phases over the next 3-12 months – more on this in a few weeks.

There has been a great deal of attention by industry analysts and the financial community on the market for WAN optimization. Current excitement centers on acceleration technologies. As the market leader, we believe that this is a very narrow view of a much larger opportunity for Application Delivery. We continue to assert that our vision for guaranteed application delivery that includes, visibility and monitoring, QoS, acceleration, and WAFS is the complete solution that our customers require.

Finally we just recently announced the appointment of our new vice president for Asia Pacific, Alan Leong. Alan comes to us most recently from Computer Associates, where he ran their China operation. He has also held senior sales management positions in Asia for Sun Microsystems and EMC. He will be responsible for all

of Asia except Japan where we have been very successful under the long-term leadership of our vice president for Japan, Mori Kinjo.

Once again, thank you for your time. Now I'm going to turn the call back to David Yntema for Q&A.

INTRODUCTION OF Q&A (David) This concludes Packeteer's financial and business presentations, and the call will now be open for Q&A. Our moderator will now review the Q&A process.

(Operator)

CONCLUSION OF CONFERENCE CALL This concludes the Packeteer Third Quarter 2006 Financial Conference call. Thank you for joining us today. If you have additional questions, please feel free to call our Investor Relations line at 408-873-4422.