

The Packeteer Q4 2005 Financial Conference Call
January 26, 2006
2:00pm PST

AGENDA

Thank you. Our call today will begin with a summary of Packeteer's financial results for the fourth quarter and full year 2005. 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 a limited opportunity for questions and answers.

By now you should have received a copy of our press release. In the event that you have not, a copy is available on our website at www.packeteer.com. Today's call is being recorded. A replay of this call, along with management's script can be accessed on our 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 revenues and revenue growth as well as gross margin targets, the markets for our products, customer deployments of our products, our ability to continue to innovate and obtain patent protection, operating expense targets, future profits, liquidity, new product development and delivery dates, and macro economic conditions. These statements represent the views and judgment of certain members of management and are 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, 2005, 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 and deferred stock-based compensation, 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 the non-GAAP financial measures is not meant to be considered in isolation or as a substitute for the Company’s financial results prepared in accordance with GAAP.

FOURTH QUARTER AND FULL YEAR 2005 HIGHLIGHTS

STATEMENT OF OPERATIONS

For the fourth quarter 2005, net revenues were \$31.9 million compared with net revenues of \$24.8 million for the third quarter 2005, resulting in a 28% sequential quarterly increase. For the full year 2005, net revenues were \$112.9 million, an increase of 22% from the full year 2004 net revenues of \$92.4 million. For the fourth quarter 2005, the Americas net revenues were 46% of total net revenues, compared with 41% for the full year 2004, while Europe net revenues were 27% for the fourth quarter 2005, compared with 32% for the full year 2004, and Asia-Pacific net revenues were 27% of total net revenues, compared with 27% for the full year 2004.

Our top 10 customers accounted for 64% of total net revenues in the fourth quarter 2005, lower than the 76% reported in the third quarter 2005, but relatively close to the results in the first and second quarters of 2005. Our largest distributor in the U.S., Alternative Technologies, accounted for 18% of total net revenues in the fourth quarter 2005, compared with 26% in the third quarter 2005, and 22% for the full year 2005. Westcon, who is a distribution partner in North America and Europe, accounted for 12% of total net revenues in the fourth quarter 2005, compared with 12% in the third quarter 2005, and 13% for the full year 2005. No other customer accounted for more than 10% of total net revenues in the fourth quarter 2005.

We were very pleased overall with our performance in the fourth quarter, and for the full year of 2005. The effective efforts of our salespeople and channel partners allowed us to achieve much improved channel sell through during the fourth quarter resulting in more modest inventories held by our

channel partners compared with the third quarter. As a result, the \$3.6 million increase in deferred revenues associated with channel inventories that Packeteer had recorded in the third quarter was fully eliminated during the fourth quarter, while at the same time both the Americas and EMEA regions reported record quarterly revenues.

With the strong revenue growth experienced in the most recent quarter, in looking at the first quarter of 2006, we expect revenues to be approximately flat with the fourth quarter 2005. We do expect sequential quarterly growth to resume again in the second quarter, and we plan for additional sequential quarterly revenue growth in the subsequent quarters of 2006. We also plan that non-GAAP operating income in the first quarter and remaining quarters of 2006 will more closely reflect our long-term target range of 16-18%, rather than retain the higher rate experienced in the recently completed quarter.

Gross margins, excluding the amortization of purchased intangible assets were 76% and 75% for the fourth quarter and full year 2005 respectively, roughly the same as gross margins reported in the similar periods of 2004.

Research and Development expenses for the fourth quarter 2005, excluding the amortization of deferred stock-based compensation of \$217,000, were \$5.4 million, or 17% of total net revenues, compared with \$5.3 million, or 21% for the third quarter 2005. For the full year, Research and Development expenses were \$20.9 million, or 19% of total net revenues. We expect that our non-GAAP Research and Development expenses will approximate our long-term business model target of 18% going forward.

Sales and Marketing expenses for the fourth quarter 2005, excluding the amortization of deferred stock-based compensation of \$3,000, were \$10.2 million, or 32% of total net revenues, compared with \$8.9 million, or 36% for the third quarter 2005. For the full year, Sales and Marketing expenses were \$38.3 million, or 34% of total net revenues. We expect that non-GAAP Sales and Marketing expenses will be approximate our long-term business model target of 30-32% going forward.

General and Administrative expenses for the fourth quarter 2005, excluding the amortization of deferred stock-based compensation of \$2,000, were \$2.2 million, or 7% of total net revenues, compared with \$1.8 million, or 7% for the third quarter 2005. For the full year, General and Administrative

expenses were 6% of total net revenues, in line with our long-term target of 6-7%. The sequential increase experienced this quarter was largely a result of recruiting and additional professional fees associated with audit and tax related work.

Operating income for the fourth quarter 2005, excluding the amortization of purchased intangible assets of \$400,000 and the amortization of deferred stock-based compensation of \$222,000, was \$6.5 million, or 20% of total net revenues, somewhat above our long-term target of 16-18%. Our plan for non-GAAP operating income in the first quarter 2006 assumes a return to our target range of 16-18%.

Other Income (net) for the fourth quarter 2005 was \$1.0 million, compared with \$776,000 in the third quarter 2005. The increase was primarily due to higher yields on our investments, along with higher cash balances.

The effective tax rate for the year 2005 was 1% and included a substantial tax benefit of \$2.5 million related to the release of a majority of our valuation allowance in the fourth quarter of 2005. Without the release of this valuation allowance, the effective tax rate would have been closer to 13%, which is lower than our earlier estimates for the year primarily due to additional benefits resulting from current year deferred tax assets arising from current year timing differences for which no valuation allowance was deemed necessary. For planning purposes for 2006, we estimate the reported provision to increase to approximately 18-20% on an annual basis.

Non-GAAP net income, which excludes the amortization of purchased intangible assets and the amortization of deferred stock-based compensation, offset by the tax effect of such items, was \$9.7 million and \$21.3 million or \$0.28 and \$0.61 per diluted share for the fourth quarter and full year 2005 respectively.

Total headcount was 304 at December 31, 2005, down slightly from 312 at September 30, 2005, as we fell behind on our hiring goals. Our plans call for modest headcount increases in the first quarter, targeted mainly in the sales and engineering organizations.

BALANCE SHEET

Total cash, comprised of cash, cash equivalents, and investments, was \$122.7 million at December 31, 2005, an increase of approximately \$9.7 million from the balance of \$113.0 million at September 30, 2005, and an increase of \$30.5 million from December 31, 2004.

Trade receivables of \$15.8 million at December 31, 2005 resulted in approximately 46 days sales outstanding, compared with 64 days reported for the September quarter. The decrease in DSO was primarily the result of the reversal in deferred revenue related to channel inventory reserves previously reported in the month of September. Excluding the effect of the reversal of the deferred revenue adjustment, our DSO would have been 51 days.

Our reported inventories, which are primarily comprised of finished goods, were \$5.0 million at December 31, 2005, compared with \$6.4 million at September 30, 2005.

Our deferred revenue balance at December 31, 2005 was \$22.1 million, compared with \$25.2 million at September 30, 2005, with the reduction primarily reflecting the reversal of the \$3.6 million balance reported in the September quarter. The majority of the deferred revenue balance continues to reflect our maintenance billings that are amortized over the lives of the individual contracts, which are generally between 12 months and 36 months.

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:

Thanks David, and thank you everyone for joining us today. Our fourth quarter demonstrated excellent results throughout our operations – 28% growth Q-Q that included 37% product growth over Q305. Our fourth quarter of 2005 delivered strong results in Operating Income and excellent results by geography in revenue.

The Americas continued its strong momentum with a record quarter for revenue. Americas accounted for 46% of revenues and demonstrated 14% Q-Q growth. Europe recovered nicely at 27% of revenues and 9% Q-Q growth. Finally, Asia at 27% of revenue had strong sell-through that enabled us to reverse all of the deferred revenue from channel inventory.

Overall, this is our 16th consecutive quarter of profitability and cash grew \$9.7 million to over \$122 million.

Our efforts in both understanding channel inventory and sales pipeline execution, particularly in Europe, have yielded solid results. The rapid turnaround in our business is a testament to improved execution, but more importantly to the robustness of our solution and our position in the market.

We have seen a positive shift in market and customer demand in the overall WAN optimization market generally and Packeteer specifically, and we expect to benefit from this in 2006 and beyond. As further evidence of the robustness of this market, Cisco made a number of announcements in December describing their “marketecture” for optimizing application performance over networks – a solution we have long been delivering to over 7,000 customers worldwide in an integrated, simple, intelligent overlay to the switched/routed infrastructure. We welcome Cisco’s endorsement of our market, and view our market leadership and proven track record to be a significant advantage over their stated intention to enter our market. Our DNA is about application performance over networks. No one has the wealth of application information or combination of control and acceleration technologies that Packeteer offers to deliver predictable performance and protection of applications across enterprise global networks.

The market attention on application performance comes as corporate networks face increased loads, frequently from non business-critical applications such as iTunes and Skype. In the case of Skype and other P2P and Instant Message applications, enterprise customers are increasingly concerned with possible security, legal and regulatory compliance issues. Packeteer is uniquely positioned to enable our customers to set and manage performance levels for every application at every location.

As with previous quarters, large opportunities continued to be a major focus in our sales efforts. In the fourth quarter, there were 53 deals over \$100K, compared to 37 deals greater than \$100K in Q3 2005. This also compares favorably to 46 large deals in Q4 2004. These deals averaged approximately \$210,000 each and represented over \$11 million in revenue during the fourth quarter of 2005.

In Q4, 60% of product revenue came from core units with the balance from edge units and other. The unit split was approximately 60/40 - edge to core

units. Packetshapers with the Xpress software option for compression delivered a contribution at approximately 23% of product revenue and shipped on 35% of all units, the highest percentage mix of Xpress units to date.

We had a number of new customers begin deployments of Packeteer equipment including 7-Eleven, Novartis, Ingram and Mexico's equivalent of the IRS. Others continued global and large-scale deployments including the Department of Homeland Security, Tokyo Mitsubishi Bank, Glaxo Smith Kline and BHP Billiton.

One of our new customers in Q4 was Inergy Automotive Systems. Inergy is a global tier-one supplier of complete fuel systems and energy storage technologies operating in 17 countries with 40 facilities. The benefits they describe in using PacketShapers enterprise-wide echo the key benefits of the Packeteer value proposition.

- Increased application performance, service levels and security delivering rapid payback
- Protection of mission-critical applications
- Improvement of overall security, user satisfaction and capacity planning through enhanced, real-time visibility into traffic patterns
- Advanced compression and rate shaping reducing the need to increase WAN bandwidth – helping conserve operational costs
- Minimization of system and network downtime

During Q4, we introduced a number of new features and capabilities:

- A new version of our management product, PolicyCenter. Key features of this new release include auto-configuration and improved scalability – that enable enterprises to centrally manage and auto-configure large deployments of PacketShaper appliances at remote sites without the need for onsite IT intervention. Auto-configuration can help reduce total cost of ownership dramatically for large customers. Because PacketShapers can now be installed and auto-configured in literally minutes with a single, centrally managed version of PolicyCenter, enterprises from retail, financial, government and manufacturing sectors with hundreds of remote locations can accelerate broad scale deployments of PacketShapers at branch offices.

- Packeteer's New ReportCenter 3.1 provides a single, centralized, enterprise-wide view of an application and its performance running across a WAN by leveraging PacketShaper layer 7 classification, monitoring and reporting capabilities. By understanding how a specific application is performing across the WAN, IT can pinpoint when and where to rate shape traffic to meet policy requirements through PolicyCenter.
- In Q4, the PacketShaper 9500 was named "Best WAN Traffic Manager" by Infoworld magazine in their 2006 Technology of the Year awards
- The PacketShaper 1200 was awarded "Best 50 Business Products of 2005", as reviewed in Business Computing Magazine

As I've mentioned in previous calls, we continued in Q4 to make concerted and deliberate investments in sales and marketing with a number of lead generation campaigns in both North America and EMEA, as well as user meetings and key tradeshows such as Citrix iForum, Educause, and InterOp New York.

During Q4 we also continued our strong focus on knowledge transfer to our partners. We held a promotion that drove hundreds of partner employees to participate in on-demand sales training, with an emphasis on teaching them how to conduct network assessments as part of a professional services offering to their customers. We also continue with our product training Webcasts to make sure our partners understand and can effectively sell key features of Packeteer's solution, including our powerful Adaptive Response features and compression and protocol acceleration capabilities.

A second area of emphasis was on defining and announcing enhancements to the partner program in North America, including assigning additional value to our very successful deal registration program, which rewards channel partners for their commitments to customer satisfaction. The program has also been enhanced to emphasize partner competence and to improve program related processes and communication in support of partner success. Changes were announced in December 2005 and become effective February 1, 2006.

Finally, I am very pleased to announce that Nelu Mihai has joined us as the VP of Engineering. Nelu has over 20 years of senior management experience and was most recently Senior VP of Engineering and Operations at CloudShield Technologies. Prior to CloudShield, he held senior

management positions at CPlane, AT&T and Bell Labs. Nelu has a Ph.D. in Computer Science from CERN in Geneva, Switzerland. We are very excited to have Nelu join our team.

We expect that recent events in our marketplace, overall momentum and our strong close to 2005 will translate into an even stronger 2006. We continue to attract new customers, and existing customers are moving toward global deployments, strategically deploying a Packeteer solution throughout their networks for all-in-one WAN application optimization that improves network visibility, improves application response and performance, and lowers total cost of ownership in bandwidth and management costs.

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 Fourth Quarter 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.