

The Packeteer Q4 2006 Financial Conference Call
January 25, 2007
2:00pm PDT

AGENDA

Thank you. Our call today will begin with a summary of Packeteer's financial results for the fourth 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.

FOURTH QUARTER 2006 HIGHLIGHTS

STATEMENT OF OPERATIONS

For the fourth quarter 2006, net revenues were \$43.2 million compared with net revenues of \$36.0 million for the third quarter 2006, resulting in a 20% sequential quarterly increase. For the full year 2006, net revenues were \$145.6 million, an increase of 29% from the full year 2005 net revenues of \$112.9 million. The Americas net revenues were 45% of total net revenues for the fourth quarter, and 47% for the full year 2006. Europe net revenues were 34% of total net revenues for the fourth quarter, and 29% for the full year 2006. Asia-Pacific net revenues were 21% of total net revenues for the fourth quarter, and 24% for the full year 2006.

Our top 10 customers accounted for 73% of total net revenues in the fourth quarter 2006, compared with 75% in third quarter 2006. Our largest distributor in the U.S., Alternative Technology, accounted for 21% of total net revenues in the fourth quarter compared with 23% in the full year 2006. Westcon, a distribution partner in North America and Europe, accounted for 20% of total net revenues in the fourth quarter 2006, compared with 18% in the full year 2006. No other customer accounted for more than 10% of total net revenues in the fourth quarter 2006.

We are very pleased to again be reporting record quarterly revenues, which exceeded our target. In addition to the substantial growth in our PacketShaper product revenues, our new iShared products accounted for revenues of \$4.4 million, a sequential increase of 83%. As a result of the large 20% sequential revenue growth in our fourth quarter, we plan for flat to modestly higher sequential revenues in the first quarter, 2007. More importantly, we currently are planning for revenue growth in calendar year 2007 that should meet or exceed the revenue growth we reported in calendar year 2006.

All remaining commentary in this script regarding income statement margins, costs, and absolute profits will refer to non-GAAP results. These non-GAAP results exclude the effects of stock-based compensation from

acquisitions, the expensing of stock options, the amortization of purchased intangible assets, and the one time write off of in-process R&D associated with acquisitions.

As we disclosed 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. During the earnings call for the third quarter, we reported operating income of 10% of revenues. Results for the fourth quarter have demonstrated an improvement in operating income to 11% as a percent of revenue. Our plans now suggest that our operating income as a percent of revenue should continue to improve over the next couple of quarters as we start to approach the lower end of our long term targeted operating income.

Gross margins of \$31.4 million and \$27.0 million were 73% in the fourth quarter and 75% in the third quarter 2006.

Research and Development expenses of \$7.2 million and \$7.1 million in the fourth and third quarters of 2006 were 17% and 20% of revenues respectively. We expect that our Research and Development expenses should again approximate our long-term business model target of 18% of revenues beginning in 2007.

Sales and Marketing expenses of \$16.1 million and \$13.4 million in the fourth and third quarters of 2006 were 37% of revenues in each quarter. We expect that Sales and Marketing expenses should approximate our long-term business model target of 30-32% of revenues again, beginning in mid-2007.

General and Administrative expenses were \$3.2 million and \$3 million in the fourth and third quarters of 2006, or 7% and 8% of revenues respectively. Our long-term target for General and Administrative expenses remains at 6-7% of revenues.

Operating income was \$4.9 million and \$3.5 million in the fourth and third quarters of 2006, or 11% and 10% of revenues respectively. Operating income for the full year 2006 was \$20.8 million, or 14% of revenues. Our plan for future operating income assumes that we should approach the lower end of our target range of 16-18% beginning in mid-2007.

Other Income (net) for the fourth quarter 2006 was \$838,000, compared with \$807,000 in the third quarter 2006.

As stated in our earnings press release, the effective tax rate for the year 2006 was 15%. Our best estimate for 2007 is 17-20%.

Net income was \$5.1 million and \$5.0 million, or \$0.14 per diluted share for both quarters. For the full year 2006, net income was \$21.6 million, or \$0.60 per diluted share compared with net income of \$21.3 million, or \$0.61 per diluted share for 2005.

Total headcount was 421 and 422 at December 31 and September 30, 2006. While this might imply little change in our employee base, we have been actively upgrading our organization during the entire year. For the year, we have hired 217 new employees (including the 104 Tacit employees) and had 100 terminations which accounts for the total increase of 117 heads this past year. Our plans call for continued headcount increases during 2007, targeted mainly in the sales, engineering and operations organizations. And in fact, during the first 3 weeks of 2007, we have already added 18 new employees.

BALANCE SHEET

Total cash, comprised of cash, cash equivalents and investments, was \$76.6 million at December 31, 2006 compared with \$72.6 million at September 30. Free cash flow for 2006 was \$16.6 million, and was negatively impacted primarily by the substantial growth in our fourth quarter receivables. For 2007, we expect a significant improvement in free cash flows from operations.

Trade receivables of \$31.7 million at December 31, 2006 resulted in approximately 68 days sales outstanding, compared to \$22.3 million or 57 days reported at September 30, 2006. The higher receivable balance and days sales outstanding at December 31 was a result of the substantially higher revenues recorded in the quarter, and which were more back end loaded than previous quarters. We would expect that days sales outstanding should return to our target range of 55-60 days in the first quarter 2007.

Our reported inventories, which are primarily comprised of finished goods, were \$4 million at December 31, 2006, compared to \$5.8 million at September 30, 2006. As you'll recall, we suggested that our inventory

balances at September 30 were higher than normal. Over the next couple of quarters, we would expect more normal inventory levels of approximately \$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 had a tremendous quarter, achieving record revenues of \$43.2 million and delivering \$4.9M of operating income capping a very successful year in which we grew revenues 29% over revenues in 2005. Overall, revenue grew 20% over the third quarter of 2006, led by our iShared revenue which grew 83% quarter over quarter to \$4.4M. PacketShaper and SkyX combined revenue grew 15% Q4 over Q3. And our operating income at 11% reflected a strong improvement from the 10% reported in the third quarter.

The Americas accounted for 45% of revenues and grew 15% quarter over quarter. Europe had a very strong result and was up 50% over the third quarter, representing 34% of revenues. And, Asia at 21% of revenue was about flat after a very strong third quarter posted by Japan. Cash, at \$76.6 million was up approximately \$4M over the balance at September 30.

Our iShared business was up sharply in the fourth quarter, growing at over 80%, as I said. The key factors related to our growing success with iShared are superior CIFS acceleration, our virtual file system, native Microsoft operation and delivering Microsoft branch services on the same appliance. Additionally, with the introduction of our FlexInstall software option this past summer, we are the only vendor to enable our customers to fully consolidate all of their servers, not just file servers, and preserve their hardware investments if they so choose.

Not only was our iShared revenue up significantly, but all of our acceleration products experienced strong growth. Q306 marked the first full quarter of iShared revenue and the first full quarter of version 8 shipments. Combined with SkyX accelerators, these

products represent our overall acceleration portfolio. In the fourth quarter, acceleration revenue from these products grew more than 80% over Q3 and represented approximately 20% of our overall Q406 revenues.

In Q4, we launched our “Intelligent Acceleration” initiative. Intelligent Acceleration starts with our industry-leading visibility and monitoring to understand the state of our customers networked applications. Based on this information, Packeteer customers can apply the right tool for the job. For WAFS that is iShared, but for many acceleration applications, our customers found that PacketShaper was the tool of choice, as they enabled both policy management and our new acceleration techniques in version 8 to guarantee the performance of their key applications.

We are so confident of the power of Intelligent Acceleration, that we announced the offering of a free network assessment to any prospective customer. This consists of putting a PacketShaper on a customer’s network or offline on a mirror port, assessing traffic for a few days to a week, and then providing them with a report outlining the specific applications, users, and statistics for their network. They can then choose to go further with us to implement the right solution for their applications and their network.

We believe that this assessment is the quickest and easiest way to see what’s on your network and pinpoint where problems may lie. Armed with that, you can choose the right Packeteer technology to solve all of your application needs, not just point problems.

As we enter 2007, the market for intelligent acceleration is heating up. Server consolidation, MPLS implementations, voice and video convergence projects and even data center replication, all mean customers are trying to manage an increasingly complex set of applications over their networks. Our ability to deliver the right solution for every application at every location is driving our success.

In the fourth quarter, the number and size of large opportunities increased. We delivered over 60 deals of \$100K or higher worldwide, and the average deal size was \$336K, a substantial

increase over Q3. This growth was anchored by a significant number of deals over \$500 thousand and several over \$1 million. This compares to just over 50 deals in Q3 of '06 and just over 50 deals in the year ago Q4 '05.

During Q4, 60% of PacketShaper product revenue came from core units with the balance from edge units. The unit split was approximately 75/25 - edge to core units. The shift to a higher percentage of edge units was led by our newly introduced model 1400. The model 1400 created a price/performance breakthrough starting at just \$1500 U.S. Manufacturer's Suggested List Price. In Q4, the Model 1400 represented just over 20% of PacketShaper Units shipped in the quarter, the fastest start for any Packeteer product ever introduced.

PacketShapers with the Compression Module delivered a contribution of approximately 20% of product revenue and shipped on just over 30% of all units. Acceleration which began shipping in Q3 was shipped on 15% of units during the fourth quarter, which is nearly triple the number of units shipped with acceleration in Q306.

Q4 saw a number of large existing customers continuing their worldwide or nationwide rollouts. These included Clifford Chance, Glaxo Smith Kline, Japan Post Office, Nomura Securities, Ogilvy and Mather, the US Navy and Universal Music Group to name a few. Additionally a number of deals were led by large systems integrators and service providers such as General Dynamics, Lockheed Martin, France Telecom, and Atos Origin in EMEA.

In addition we had large deals with a number of new customers including the American Bureau of Shipping, Crown Prosecution Services in the UK, HUD (US Department of Housing and Urban Development), and Blue Dart Express in Asia.

There were also several large deals at existing customers for both iShared and PacketShapers, demonstrating the value our customers see in our complete solution for managing applications over wide area networks.

These included Watson Wyatt, Cap Gemini and California Employee Development

There are also a number of new customer stories on our website describing our customers' use of Packeteer technology to optimize their applications over the WAN. Please take a look at www.packeteer.com for the latest information about our customers and products.

We made great progress last quarter in our integration of the former Tacit Networks products and organization.

As we enter 2007, we have added to our sales teams worldwide, including the overlay WAFS team throughout the world. We still have positions to fill throughout the first half, but have over 50% more sales people than we did one year ago.

In December, we began a series of roadshows to our partners and customers that will include 40 cities over the next two quarters. The focus will be on intelligent acceleration and the breadth and depth of the Packeteer solution.

Our Microsoft partnership will continue to be a key focus for us in 2007.

An example of this is a joint promotion Microsoft announced yesterday for their branch office products and our iShared WAFS solution. They have extended their existing promotion for a year and we have added our FlexInstall, software version of iShared to that promotion.

Quoting from Microsoft's release, "As an additional benefit to any customer that purchases this Microsoft promotional SKU, Packeteer is offering a 30% discount on its iShared FlexInstall Wide Area File Services (WAFS) software product. Packeteer is one of Microsoft's key partners in the Branch Office market. iShared FlexInstall is a WAFS software application that easily installs on to any Windows Server 2003 platform, leveraging an existing Microsoft

infrastructure and integrating easily with other Microsoft branch office solutions.” End quote

We have worked with Microsoft to align our sales resources and have already worked with them on a number of opportunities where Microsoft has a strong presence. Our respective engineering teams are finalizing the joint product roadmap for the next twelve to eighteen months and we are implementing additional joint marketing programs worldwide with their branch office team.

Brocade continues to be a very strategic OEM partner for WAFS technology and their pipeline for opportunities continues to grow. They also announced the availability of a software-only version of Brocade WAFS which is based on our software-only iShared version called FlexInstall. This software-only version enables customers to protect their investments in hardware, even as they consolidate their server resources.

Our product pipeline is being readied for the first half of the year. Our focus is on integration for the branch, acceleration and file management solutions for mobile users, core performance and scale, as well as central management for all Packeteer products. 2007 will be a very active year for Packeteer products.

In December, we took another important step forward with our classification technology. We are the only provider to deliver automatic discovery of highly granular application layer data using our patented deep packet inspection technology. We announced that we now automatically discover and classify over 600 different applications and protocols, continuing our dramatic lead over any competitor.

The latest applications are a group of video plug-ins for common video players and websites. This represents an important new set of applications for our customers. Video uses lots of bandwidth and varies in its importance and application within our customers. It can be critical to the business – like video teleconferencing, or important, such as a webinar, and some video is purely recreational or even problematic. Our goal is to give our customers an ability to manage video the way they want to - simply and thoroughly – and

that starts with a granular understanding of what video is on their network.

Q4 was an exceptional quarter for Packeteer and caps a strong year of growth and change both for our company and the industry. As we look forward to 2007, Packeteer is in a very strong position to grow even faster than in 2006. We have a larger and more effective sales organization. Our solution is the broadest and most effective in the industry, and our product pipeline is the strongest it has been in the history of the company. We have integrated the iShared products and people into Packeteer. We are taking advantage of the growing awareness in this market. In short, we are the leader in the WAN Optimization market and intend to strengthen that leadership position throughout 2007

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 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.