

# **Sandvine Corporation**

Consolidated Interim Financial Statements  
**May 31, 2008**  
(unaudited)

# Sandvine Corporation

Consolidated Interim Balance Sheets

As at May 31, 2008

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

	May 31 2008 \$	November 30 2007 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	7,517	7,878
Marketable securities	92,164	105,136
Accounts receivable	11,027	10,003
Inventory	15,896	13,874
Future tax asset (note 10)	1,075	1,075
Other	1,614	1,637
	<u>129,293</u>	<u>139,603</u>
<b>Non current assets</b>		
Property, plant and equipment	11,271	10,137
Intangible assets	6,500	7,300
Goodwill	2,425	2,425
	<u>20,196</u>	<u>19,862</u>
	<u>149,489</u>	<u>159,465</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	5,100	6,094
Current portion of deferred revenue	5,534	4,028
	<u>10,634</u>	<u>10,122</u>
<b>Non current liabilities</b>		
Deferred revenue	66	57
Future tax liability	192	374
Other	311	342
	<u>569</u>	<u>773</u>
	<u>11,203</u>	<u>10,895</u>
<b>Shareholders' equity</b>		
Share capital (note 3)	146,371	146,568
Contributed surplus	2,828	1,532
Accumulated other comprehensive income	7	69
Retained earnings (deficit)	(10,920)	401
	<u>138,286</u>	<u>148,570</u>
	<u>149,489</u>	<u>159,465</u>

See accompanying notes to the consolidated interim financial statements

# Sandvine Corporation

## Consolidated Interim Statements of Operations

For the three and six month periods ended May 31, 2008

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

	Three months ended		Six months ended	
	May 31 2008 \$	May 31 2007 \$	May 31 2008 \$	May 31 2007 \$
<b>Revenue</b>				
Product	7,955	17,797	12,714	31,355
Service	3,132	2,225	6,661	4,042
	<u>11,087</u>	<u>20,022</u>	<u>19,375</u>	<u>35,397</u>
<b>Cost of sales</b>				
Product	2,048	3,338	3,539	5,912
Service	465	367	1,038	714
	<u>2,513</u>	<u>3,705</u>	<u>4,577</u>	<u>6,626</u>
<b>Gross margin</b>	<u>8,574</u>	<u>16,317</u>	<u>14,798</u>	<u>28,771</u>
<b>Expenses</b>				
Sales and marketing	4,233	3,413	8,259	6,464
Research and development (note 9)	5,757	3,823	11,932	6,466
General and administrative	2,176	1,576	4,500	2,328
Stock based compensation (note 4)	715	220	1,338	404
Amortization of intangible assets	400	-	800	-
Depreciation	889	642	1,700	1,162
	<u>14,170</u>	<u>9,674</u>	<u>28,529</u>	<u>16,824</u>
<b>Income (loss) from operations</b>	<u>(5,596)</u>	<u>6,643</u>	<u>(13,731)</u>	<u>11,947</u>
<b>Interest and other income</b>	<u>802</u>	<u>658</u>	<u>1,980</u>	<u>1,297</u>
<b>Income (loss) before provision for income taxes</b>	<u>(4,794)</u>	<u>7,301</u>	<u>(11,751)</u>	<u>13,244</u>
<b>Provision for (recovery of) income taxes</b>				
Current	19	99	39	170
Future	(182)	(3,118)	(182)	(3,118)
	<u>(163)</u>	<u>(3,019)</u>	<u>(143)</u>	<u>(2,948)</u>
<b>Net income (loss) for the period</b>	<u>(4,631)</u>	<u>10,320</u>	<u>(11,608)</u>	<u>16,192</u>
<b>Earnings (loss) per share (note 8)</b>				
Basic	<u>(0.034)</u>	<u>0.084</u>	<u>(0.085)</u>	<u>0.132</u>
Diluted	<u>(0.034)</u>	<u>0.079</u>	<u>(0.085)</u>	<u>0.125</u>
Basic weighted average number of shares outstanding	<u>136,878,515</u>	<u>123,344,744</u>	<u>136,856,170</u>	<u>123,051,037</u>
Diluted weighted average number of shares outstanding	<u>136,878,515</u>	<u>130,521,184</u>	<u>136,856,170</u>	<u>129,885,661</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 six month period ended May 31, 2008

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

	Stated share capital (note 3) \$	Contributed surplus \$	Retained earnings (deficit) \$	Accumulated other comprehensive income (loss) \$	Total \$
<b>Balance, November 30, 2006</b>	91,247	403	(18,483)	-	73,167
Opening balance adjustment for adoption of financial instruments standards	-	-	(78)	5	(73)
<b>Balance, December 1, 2006</b>	91,247	403	(18,561)	5	73,094
Comprehensive income:					
Net income	-	-	16,192	-	16,192
Net unrealized (losses) on available for sale financial assets (net of income taxes of \$nil)	-	-	-	(29)	(29)
Total comprehensive income					16,163
Stock based compensation	894	330	-	-	1,224
<b>Balance, May 31, 2007</b>	92,141	733	(2,369)	(24)	90,481
<b>Balance, November 30, 2007</b>	146,568	1,532	401	69	148,570
Opening balance adjustment for adoption of inventory standard	-	-	466	-	466
<b>Balance, December 1, 2007</b>	146,568	1,532	867	69	149,036
Comprehensive (loss):					
Net income (loss)	-	-	(11,608)	-	(11,608)
Net unrealized (losses) on available for sale financial assets (net of income taxes of \$nil)	-	-	-	(62)	(62)
Total comprehensive (loss)					(11,670)
Stock based compensation	216	1,296	-	-	1,512
Shares issued as compensation on business acquisition	160	-	-	-	160
Common shares repurchased	(573)	-	(179)	-	(752)
<b>Balance, May 31, 2008</b>	146,371	2,828	(10,920)	7	138,286

As at May 31, 2008, the total of retained earnings (deficit) and accumulated other comprehensive income (loss) was \$(10,913) (May 31, 2007 \$(2,393)).

See accompanying notes to the consolidated interim financial statements

# Sandvine Corporation

Consolidated Interim Statements of Cash Flows

For the three and six month periods ended May 31, 2008

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

	Three months ended		Six months ended	
	May 31 2008 \$	May 31 2007 \$	May 31 2008 \$	May 31 2007 \$
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	(4,631)	10,320	(11,608)	16,192
Items not affecting cash				
Amortization of intangible assets	400	-	800	-
Depreciation	916	642	1,737	1,162
Foreign exchange loss	273	333	236	7
Stock-based compensation (note 4)	715	220	1,338	404
Future income tax recovery	(182)	(3,118)	(182)	(3,118)
Other	80	51	(168)	51
	(2,429)	8,448	(7,847)	14,698
Changes in non-current balances	-	(206)	11	(200)
Changes in non-cash working capital balances	(2,631)	(14,206)	(2,314)	(3,517)
	(5,060)	(5,964)	(10,150)	10,981
<b>Investing activities</b>				
Purchase of property, plant and equipment	(1,092)	(1,644)	(2,543)	(3,421)
Purchase of marketable securities	(230,148)	(107,103)	(431,006)	(182,654)
Sale of marketable securities	235,014	108,113	443,916	158,330
	3,774	(634)	10,367	(27,745)
<b>Financing activities</b>				
Proceeds from the issuance of share capital (note 3)	13	633	174	820
Common shares repurchased	(752)	-	(752)	-
	(739)	633	(578)	820
<b>Net (decrease) in cash during period</b>	(2,025)	(5,965)	(361)	(15,944)
<b>Cash and cash equivalents – Beginning of period</b>	9,542	9,585	7,878	19,564
<b>Cash and cash equivalents – End of period</b>	7,517	3,620	7,517	3,620
<b>Cash and cash equivalents are represented by</b>				
Balances with banks	4,167	908	4,167	908
Cash equivalents	3,350	2,712	3,350	2,712

See accompanying notes to the consolidated interim financial statements

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Notes to the Interim Consolidated Financial Statements

May 31, 2008

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

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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, 2007, 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, 2007 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 and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year. In the opinion of management, these consolidated interim financial statements reflect adjustments (which include only normal, recurring adjustments) necessary to state fairly the results for the periods presented.

### *Recently issued accounting standard*

In February 2008, the Canadian Institute of Chartered Accountants (“CICA”) issued Handbook Section 3064, *Goodwill and Intangible Assets* which will replace Handbook Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*. This revision aligns Canadian GAAP with International Financial Reporting Standards and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This section applies to fiscal years beginning on or after October 1, 2008 and will be adopted by the Company effective December 1, 2008. Management is currently in the process of determining the impact of this standard on the Company’s consolidated financial statements.

## 2 Changes in accounting policies

### **Accounting Changes**

Effective December 1, 2007, the Company adopted the CICA Handbook section 1506, *Accounting Changes*. This standard establishes criteria for changes in accounting policies along with the accounting treatment and disclosures required upon adoption of new accounting policies, estimates and corrections of errors. The revised standard did not impact net earnings or financial position.

### **Inventory**

Effective December 1, 2007, the Company adopted the CICA Handbook section 3031, *Inventory*. The adoption of this new inventory standard requires changes for accounting of inventory including the requirement to allocate overhead costs based on normal production levels and changes to the definition of net realizable value. The Company adopted this new accounting standard using permitted transitional provisions. These transitional provisions resulted in the Company applying the impact of adopting the new standard to opening inventory effective December 1, 2007 with an offsetting change to opening retained earnings. The comparative interim consolidated financial statements have not been restated.

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## Notes to the Interim Consolidated Financial Statements

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The new inventory standard clarifies the definition of “cost” to include all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. As a result, companies are required to systematically allocate fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads is based on the normal production capacity of the production facilities. In addition, the standard requires companies to assess the recoverability of inventory costs in comparison to net realizable value. Declines in replacement cost below carrying values for raw material inventories do not require write downs if the finished goods in which they will be incorporated are expected to be sold at or above cost. As a result of this accounting standard change, inventory and opening retained earnings were increased by \$466 on December 1, 2007.

During the three and six month period ending May 31, 2008, the Company recognized an impairment charge of \$104 and \$540 respectively relating to its inventory balances (2007 - \$47 and \$74). During the three month period ending May 31, 2008 the Company reversed a previously recognized impairment charge of \$55.

### **Financial Instrument and Capital Disclosures**

Effective December 1, 2007, the Company adopted CICA Handbook sections 3862, *Financial instruments: disclosure*, section 3863, *Financial instruments: presentation*, and section 1535, *Capital disclosures*. These new standards establish additional presentation and disclosure requirements including the significance of financial instruments to the Company’s position and performance, discussion regarding the nature and extent of risks surrounding the Company’s financial instruments, disclosures regarding the Company’s objectives, policies and process for managing capital and what the Company regards as capital. The adoption of these new standards did not impact net earnings or financial position.

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## Notes to the Interim Consolidated Financial Statements

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### 3 Share capital

Share capital consists of the following:

	Common shares		Common share warrant		Total
	#	\$	#	\$	\$
<b>Balance, November 30, 2007</b>	136,982,300	146,178	1	390	146,568
Issued under the employee stock option plan	260,679	161	-	-	161
Transfer from contributed surplus	-	37	-	-	37
Issued as compensation on business acquisition	-	80	-	-	80
Cancelled due to working capital adjustment on business acquisition	(51,380)	-	-	-	-
<b>Balance, February 29, 2008</b>	137,191,599	146,456	1	390	146,846
Issued under the employee stock option plan	21,680	13	-	-	13
Transfer from contributed surplus	-	5	-	-	5
Issued as compensation on business acquisition	-	80	-	-	80
Repurchased	(535,500)	(573)	-	-	(573)
<b>Balance, May 31, 2008</b>	136,677,779	145,981	1	390	146,371

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 Company determined that the fair value of the warrant was \$390 at the time of issue.

As part of the Company's purchase of all the outstanding shares of Simplicita Software, Inc ("Simplicita") in fiscal 2007, additional contingent consideration of up to 555,555 common shares of the Company valued at \$2,811 will be made to specified Simplicita employees on the achievement of certain performance targets and who continue their employment with the Company as of November 30, 2008. The Company has determined based on its best estimate of the outcome of the performance targets and ongoing employment requirements that no compensation cost related to this contingent consideration should be recorded for the period ended May 31, 2008. The Company will continue to assess on a regular basis the expected outcome of the performance targets and record compensation costs based on the best available estimate of the number of shares expected to be issued.

# **Sandvine Corporation**

## Notes to the Interim Consolidated Financial Statements

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On February 14, 2008, the Company cancelled 51,380 shares in conjunction with a working capital adjustment related to the acquisition of Simplicita Software, Inc. A total of 171,903 shares (net of the 51,380 cancelled shares) were issued and allocated to a key employee escrow that will be released over time, contingent on the continued employment of certain individuals over the next three years. The Company will recognize up to a maximum of \$869 as non-cash compensation expense over the period in which the services are rendered. For the three and six month periods ended May 31, 2008 the Company recognized \$80 and \$160 respectively as compensation expense relating to this key employee escrow.

During the three months ended May 31, 2008, the Company issued 21,680 common shares for cash proceeds of \$13 as a result of option holders exercising their options (282,359 common shares for net proceeds of \$174 for the six month period ended May 31, 2008).

On April 9, 2008, the Company obtained the necessary regulatory approvals from the Toronto Stock Exchange (“TSX”) to repurchase up to 10,152,791 shares. This represents approximately 7.4% of the Company’s outstanding shares as of the date of approval. During the three months ended May 31, 2008, the Company purchased 535,500 common shares at a total cost of \$752. The amount paid in excess of the per share paid-in capital of the common shares of \$179 was charged to retained earnings. All common shares repurchased by the Company have been cancelled. Subsequent to May 31, 2008 the Company has purchased 105,000 shares for a total cost of \$125.

# Sandvine Corporation

Notes to the Interim Consolidated Financial Statements

May 31, 2008

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

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## 4 Stock Options

### Stock option plan

The Company has adopted a stock option plan for employees and directors. Options granted prior to March 21, 2006 typically vest over a four year and six month term. Options granted subsequent to this date typically vest over a 5 year term. All options have a contractual life of 10 years and allow for the purchase of one common share per option. The exercise price of the options is the volume weighted average share price of the Company's common shares for the five days prior to the date of grant. As at May 31, 2008, there were 5,754,613 options available for future grants under the stock option plan. A summary of the stock option activity is presented below:

	<b>Options</b>	
	<b>Number</b>	<b>Weighted average price \$</b>
<b>Options outstanding, November 30, 2007</b>	7,839,963	2.32
Option activity for the period		
Granted	833,425	4.05
Forfeited	(99,734)	2.32
Exercised	(260,679)	0.62
<b>Options outstanding, February 29, 2008</b>	8,312,975	2.55
Option activity for the period		
Granted	183,000	1.62
Forfeited	(229,630)	2.00
Exercised	(21,680)	0.65
<b>Options outstanding, May 31, 2008</b>	8,244,665	2.56

# Sandvine Corporation

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### Stock based compensation

Stock based compensation recognized for the three and six month period ended May 31, 2008 was \$715 and \$1,338 (May 31, 2007 – \$220 and \$404) with a corresponding credit to contributed surplus. Previously recognized expense of \$5 and \$42 for the three and six month period ending May 31, 2008 relating to options exercised during the period has been transferred from contributed surplus to share capital (May 31, 2007 - \$67 and \$74).

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<b>May 31 2008</b>	<b>May 31 2007</b>	<b>May 31 2008</b>	<b>May 31 2007</b>
Number of options issued	183,000	170,500	1,016,425	696,500
Weighted average Black-Scholes value of each option	\$1.34	\$3.04	\$2.68	\$2.07
Assumptions				
Risk free interest rate	3.68%	4.18%	3.98%	4.17%
Expected life in years	10	10	10	10
Expected dividend yield	0%	0%	0%	0%
Volatility	86.80%	62.80%	71.00%	57.29%

The following table summarizes information regarding stock options outstanding at May 31, 2008:

<u>Options Outstanding</u>				<u>Options Exercisable</u>	
<b>Range of exercise price \$</b>	<b>Number outstanding at May 31, 2008</b>	<b>Weighted average contractual life (years)</b>	<b>Weighted average exercise price \$</b>	<b>Number outstanding at May 31, 2008</b>	<b>Weighted average exercise price \$</b>
0.40 - 0.63	3,599,502	5.41	0.57	2,649,242	0.55
1.52 - 2.53	2,003,473	8.30	2.26	614,811	2.29
4.11 - 5.50	1,312,239	9.39	4.27	39,021	4.00
6.59 - 6.95	1,329,451	9.14	6.67	5,224	6.95
0.40 - 6.95	8, 244,665	7.34	2.56	3,308,298	0.94

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

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### 5 Financial Instruments

Under Canadian generally accepted accounting principles, financial instruments are classified into one of the following categories: held for trading, held-to-maturity, available-for-sale, loans and receivables and other financial liabilities. The following table summarizes information regarding the carrying values of the Company's financial instruments:

	<b>May 31 2008</b>	<b>November 30 2007</b>
	\$	\$
Held for trading (1)	7,499	7,716
Available-for-sale (2)	92,164	105,136
Loans and receivables (3)	11,770	11,030
Other financial liabilities (4)	5,100	6,094

(1) Includes cash and cash equivalents and foreign exchange derivatives

(2) Includes marketable securities

(3) Includes accounts receivable and other current assets

(4) Includes accounts payable and accrued liabilities

#### *Fair value*

Cash and cash equivalents are valued at fair value. Accounts receivable, other current assets and accounts payable and accrued liabilities are short term financial instruments whose fair value approximates the carrying amount given that they will mature shortly. The fair value of marketable securities is based on quoted market prices. The fair values of currency forward contracts (note 13) and embedded derivatives have been estimated using a discounted cash flow model using observable market inputs including but not limited to quoted currency spot rates and interest rates, and have been included in other current assets or accounts payable and accrued liabilities on the Company's consolidated balance sheet. As at May 31, 2008, the fair value of the Company's marketable securities was \$92,164 resulting in net unrealized cumulative gains of \$7 being recorded in accumulated other comprehensive income. These unrealized gains were related to interest rate decreases in the marketplace. During the current period, no material realized gains or losses have been recognized on the Company's marketable securities.

#### *Interest rate risk*

Marketable securities with fixed interest rates are invested in separate investments with varying maturities exposing the Company to interest rate risk on these financial instruments. All marketable securities have remaining maturities of less than one year. The Company does not use financial instruments to mitigate this interest rate risk. Recognized interest income for the Company's marketable securities for the three and six month period ended May 31, 2008 was \$754 and 1,843 respectively.

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## Notes to the Interim Consolidated Financial Statements

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At May 31, 2008, if interest rates at that date had been 25 basis points lower with all other variables held constant, after tax net income for the six month period ending May 31, 2008 would remain the same and other comprehensive income would have been \$22 higher arising mainly as a result of increasing fair values for fixed rate financial assets classified as available for sale. If interest rates at that date had been 25 basis points higher with all other variables held constant, after tax net income for the six month period ending May 31, 2008 would remain the same and other comprehensive income would have been \$22 lower arising mainly as a result of decreasing fair values for fixed rate financial assets classified as available for sale.

### *Credit risk*

The Company is exposed to credit risk in its cash and cash equivalents, marketable securities, accounts receivable, other current assets and to the credit risk of its derivative financial instrument counterparties if they do not meet their obligations. As the Company does not utilize credit derivatives or similar instruments, the maximum exposure to credit risk is the full carrying value of the financial instrument or face value of open derivative financial instruments. The Company minimizes the credit risk of cash and cash equivalents by depositing with only reputable financial institutions and minimizes the credit risk of marketable securities by investing in securities that meet minimum credit ratings as stipulated by the Company's investment policy and limiting exposure to any one issuing entity. As at May 31, 2008 no one issuer represented more than 25.1% of the total marketable securities. The Company minimizes the credit risk of its derivative financial instruments by dealing only with reputable financial institutions and monitoring the credit risk of these financial institutions. The Company minimizes its credit risk of its accounts receivable and other receivables by performing credit reviews for each of its customers. As at May 31, 2008, 5 companies, with greater than ten percent concentration in accounts receivable, accounted for 75.5% of the Company's total accounts receivable (May 31, 2007 – 2; 76.6%). The Company's allowance for doubtful accounts is not significant. Of the Company's accounts receivable, \$3,410 are past due. The definition of items that are past due is determined by reference to terms agreed with individual customers. Of the overdue balances at May 31, 2008, \$2,866 has been subsequently collected. Of the remaining overdue balances, none are in excess of three months overdue. None of the amounts outstanding have been challenged by the respective customer(s) and the Company continues to conduct business with them on an ongoing basis. Accordingly, management has no reason to believe that this balance is not fully collectible in the future.

The Company's financial instruments could be sensitive to changing conditions in particular geographic regions.

	<b>Canada</b>	<b>United States</b>	<b>Other</b>	<b>Total</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Cash and cash equivalents	90.9	1.2	7.9	100.0
Marketable securities	100.0	-	-	100.0
Accounts receivable and other current assets	21.9	56.2	21.9	100.0
Derivative financial instruments	100.0	-	-	100.0

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

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

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### *Foreign currency risk*

There is a risk to the Company's earnings that arises from fluctuations in foreign exchange rates and the degree of volatility of these rates. The Company's financial results are reported in Canadian dollars. The Company's exposure to foreign currency risk is primarily related to fluctuations in the value of the Canadian dollar relative to that of the United States dollar as the Company's transactions with customers and directly associated costs generally occur in United States dollars. The Company may enter into forward contracts to reduce its exposure to fluctuations in foreign exchange rates. As the Company does not account for these forward contracts using hedge accounting, these instruments are measured at fair value with changes recognized in earnings.

If the Canadian dollar had depreciated 5 percent against the US dollar at May 31, 2008, with all other variables held constant, the impact of the foreign currency change on our US dollar denominated financial instruments would lead to an additional after tax net income of \$250 for the six month period ending May 31, 2008. If the Canadian dollar had appreciated 5 percent against the US dollar at May 31, 2008, with all other variables held constant, the impact of the foreign currency change on our US dollar denominated financial instruments would lead to a decrease of after tax net income of \$250 for the six month period ending May 31, 2008.

For the three and six month periods ended May 31, 2008, general and administrative expenses included a foreign exchange loss of \$115 and \$525 respectively (2007 - \$333 and \$7).

### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company currently settles its financial obligations out of cash and cash equivalents and marketable securities. The ability to do this relies on the Company collecting its accounts receivables in a timely manner and by maintaining sufficient cash and cash equivalents and marketable securities in excess of anticipated needs. At May 31, 2008 the Company's accounts payable and accrued liabilities were \$5,100, all of which fall due for payment within twelve months of the balance sheet date.

## **6 Capital management**

In the management of capital, the Company includes shareholders equity, excluding accumulated other comprehensive income and the balance of purchase price or earn out obligations of its acquisitions (note 3). The Company manages its capital to ensure that financial flexibility is present to increase shareholder value through organic growth and selective acquisitions as well as allow the Company to respond to changes in economic and/or marketplace conditions. In order to maintain or adjust its capital structure the Company may issue new shares, purchase shares for cancellation or raise debt. At this time the Company has not utilized debt facilities as part of its capital management program nor paid dividends to its shareholders. The Company is not subject to any externally imposed capital requirements. There were no changes in the Company's approach to capital management during the period.

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## 7 Lease commitments

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

	\$
2008	410
2009	575
2010	517
2011	466
2012	219
Thereafter	-
	<u>2,187</u>

## 8 Earnings (loss) per share

	For the three month ended		For the six month ended	
	May 31 2008 \$	May 31 2007 \$	May 31 2008 \$	May 31 2007 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	\$(4,631)	\$10,320	\$(11,608)	\$16,192
Denominator for earnings (loss) per share, weighted average number of shares outstanding				
Basic	136,878,515	123,344,744	136,856,170	123,051,037
Effect of warrant outstanding	-	619,280	-	619,280
Effect of stock options issued	-	6,557,160	-	6,215,344
Effect of contingently returnable shares	-	-	-	-
Diluted	<u>136,878,515</u>	<u>130,521,184</u>	<u>136,856,170</u>	<u>129,885,661</u>
Earnings (loss) per share:				
Basic	\$(0.034)	\$0.084	\$(0.085)	\$0.132
Diluted	\$(0.034)	\$0.079	\$(0.085)	\$0.125

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

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

May 31, 2008

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

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### 9 Government assistance

The Company has an agreement with Technology Partnership Canada (“TPC”) who provided partial funding towards one of the Company’s research and development projects. The Company received \$9,500 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 million on gross revenues of the Company. From December 1, 2005 to November 30, 2007, the Company was required to pay royalties at a rate of 1% of gross revenues until the earlier of December 1, 2007 or the date the Company’s cumulative gross revenues exceeds \$85 million, at which time the royalty rate will be increased to 2.5%. During the year ended November 30, 2007 the royalty rate increased to 2.5% of gross revenues as the Company’s cumulative gross revenues surpassed the \$85 million threshold. The obligation to pay royalties expires on November 30, 2013. During the three and six months ended May 31, 2008, the Company recognized \$277 and \$484 (2007 - \$200 and \$354) 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 \$1,843 under the agreement.

A subsidiary of the Company participated in programs sponsored by a foreign government body for the support of research and development activities. The subsidiary is obligated to pay royalties, amounting to 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. The estimated fair value of the contingent obligation at the time of acquisition of the subsidiary was recognized in conjunction with the purchase price allocation, and is included within “Other” non-current liabilities on the balance sheet. During the three months ended May 31, 2008, the subsidiary received funding of \$394 USD (\$401 CDN) under these programs. As of May 31, 2008 the subsidiary has received cumulative grants of \$853 USD (\$851 CDN).

Non repayable government assistance recorded during the three and six month periods ending May 31, 2008 of \$339 and \$465 respectively relates to funding received through a Canadian government program in respect of certain research and development activities undertaken by the Company. The Company has been approved to receive up to \$625 (in total) under the program.

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

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<u>May 31</u>	<u>May 31</u>	<u>May 31</u>	<u>May 31</u>
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Research and development	6,220	3,623	12,314	6,345
Government repayments	277	200	484	354
Investment tax credits / government assistance	(740)	-	(866)	(233)
	<u>5,757</u>	<u>3,823</u>	<u>11,932</u>	<u>6,466</u>

# Sandvine Corporation

Notes to the Interim Consolidated Financial Statements

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## 10 Income taxes

As at May 31, 2008 future tax assets associated with temporary differences and reserves with a value totalling \$1,075 are more likely than not to be realized given the Company's expectations of future profitability. A valuation allowance has been applied against the Company's remaining future tax assets associated with non-capital losses, temporary differences and reserves. In addition, the Company has not recorded the benefit associated with its non-refundable investment tax credits.

The Company will continue to evaluate and examine the valuation allowance on a regular basis and as future events unfold, the valuation allowance may be adjusted.

The Company has not provided for Canadian future income taxes or foreign withholding taxes that would apply on the distribution of the earnings of its non-Canadian subsidiaries, since these earnings are intended to be reinvested indefinitely.

## 11 Segment disclosures

The Company has one reportable segment. The Company's operations are substantially all related to the research, design, manufacturing and sales of network equipment for the computer communications equipment industry. Selected financial information is as follows:

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<u>May 31</u>	<u>May 31</u>	<u>May 31</u>	<u>May 31</u>
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Sales				
Canada	1,833	56	1,863	176
United States	6,298	19,420	13,436	32,645
Caribbean and Latin America	31	43	120	100
Europe, Middle East and Africa	2,719	362	3,294	1,963
Asia Pacific	206	141	662	513
	<u>11,087</u>	<u>20,022</u>	<u>19,375</u>	<u>35,397</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
Sales				
Canada	16.5	0.3	9.6	0.5
United States	56.8	97.0	69.4	92.2
Caribbean and Latin America	0.3	0.2	0.6	0.3
Europe, Middle East and Africa	24.5	1.8	17.0	5.6
Asia Pacific	1.9	0.7	3.4	1.4
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

May 31, 2008

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For the three and six month period ended May 31, 2008 major customers, being those that represent more than 10% of total revenues for an individual period, represented 62.3% and 44.5% respectively of total revenue (2007 – 83.9 % and 74.8%). The breakdown of major customers is as follows

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<b>May 31 2008</b> %	<b>May 31 2007</b> %	<b>May 31 2008</b> %	<b>May 31 2007</b> %
Customer A	11.3	47.3	17.1	54.1
Customer B	20.8	-	11.9	-
Customer C	15.8	-	9.1	-
Customer D	14.4	-	8.3	-
Customer E	1.9	0.5	15.5	1.9

	<b>May 31 2008</b> \$	<b>November 30 2007</b> \$
Property, plant and equipment, intangibles and goodwill		
Canada	10,691	9,538
United States	4,406	4,828
Europe, Middle East and Africa	5,099	5,496
	<u>20,196</u>	<u>19,862</u>
Total assets		
Canada	139,189	148,780
United States	4,539	4,933
Europe, Middle East and Africa	5,761	5,752
	<u>149,489</u>	<u>159,465</u>

## 12 Supplemental cash flow information

For the three and six month periods ending May 31, 2008 the Company paid \$29 and \$50 for income tax in cash (2007 - \$7 and \$60). The Company did not pay any interest in cash during the three and six month period ended May 31, 2008 (2007 - \$nil and \$nil).

# **Sandvine Corporation**

Notes to the Interim Consolidated Financial Statements

**May 31, 2008**

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## **13 Credit facility**

The Company has a demand credit facility with a major Canadian chartered bank. Under the terms of the facility, the Company has available to it a \$500 operating line to provide letters of credit and a US\$15 million forward contract line to permit the Company to enter into foreign currency forward contracts. Borrowings made from the facility attract interest at the bank's prime rate of interest. Cash equivalents with a carrying value and fair value of \$2,500 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 on the Company. The facility and the related security will remain in effect until the facility, which has no term, is terminated.

As of May 31, 2008 the Company has issued two letters of credit under its operating line for US\$84 (CDN\$84) expiring July 31, 2008 and US\$64 (CDN\$64) expiring December 31, 2008.

As of May 31, 2008 the Company has two foreign currency forward contracts that have the effect of fixing the conversion of \$3,000 of the Company's net US dollar asset position to Canadian dollars at a rate of 0.9828. These contracts mature on or before July 31, 2008 and have a fair value of \$18 at May 31, 2008. The Company recognized a loss of \$48 relating to the change in fair value of foreign currency forward contracts which settled during the period.

## **14 Comparative figures**

Certain of the comparative figures have been reclassified to conform to the current period's presentation.