

# **Sandvine Corporation**

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

# Sandvine Corporation

## Consolidated Interim Balance Sheets

As at August 31, 2008

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

	August 31 2008 \$	November 30 2007 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	8,716	7,878
Marketable securities	87,374	105,136
Accounts receivable	11,794	10,003
Inventory	15,658	13,874
Future tax asset (note 10)	-	1,075
Other	1,638	1,637
	<u>125,180</u>	<u>139,603</u>
<b>Non current assets</b>		
Property, plant and equipment	12,141	10,137
Intangible assets	6,100	7,300
Goodwill	2,425	2,425
	<u>20,666</u>	<u>19,862</u>
	<u>145,846</u>	<u>159,465</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	5,854	6,094
Current portion of deferred revenue	6,751	4,028
	<u>12,605</u>	<u>10,122</u>
<b>Non current liabilities</b>		
Deferred revenue	36	57
Future tax liability	283	374
Other	335	342
	<u>654</u>	<u>773</u>
	<u>13,259</u>	<u>10,895</u>
<b>Shareholders' equity</b>		
Share capital (note 3)	145,414	146,568
Contributed surplus	4,354	1,532
Accumulated other comprehensive income	27	69
Retained earnings (deficit)	(17,208)	401
	<u>132,587</u>	<u>148,570</u>
	<u>145,846</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 nine month periods ended August 31, 2008

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

	Three months ended		Nine months ended	
	August 31 2008 \$	August 31 2007 \$	August 31 2008 \$	August 31 2007 \$
<b>Revenue</b>				
Product	10,263	19,016	22,977	50,371
Service	2,862	2,160	9,523	6,202
	<u>13,125</u>	<u>21,176</u>	<u>32,500</u>	<u>56,573</u>
<b>Cost of sales</b>				
Product	2,682	5,143	6,221	11,055
Service	629	377	1,667	1,091
	<u>3,311</u>	<u>5,520</u>	<u>7,888</u>	<u>12,146</u>
<b>Gross margin</b>	9,814	15,656	24,612	44,427
<b>Expenses</b>				
Sales and marketing	4,408	4,264	12,580	10,728
Research and development (note 9)	6,283	4,764	18,142	11,230
General and administrative	1,886	1,872	6,386	4,200
Stock based compensation (notes 3 and 4)	1,538	423	3,036	827
Amortization of intangible assets	400	267	1,200	267
Depreciation	1,055	674	2,755	1,836
	<u>15,570</u>	<u>12,264</u>	<u>44,099</u>	<u>29,088</u>
<b>Income (loss) from operations</b>	(5,756)	3,392	(19,487)	15,339
<b>Interest and other income</b>	706	1,244	2,686	2,541
<b>Income (loss) before provision for income taxes</b>	<u>(5,050)</u>	<u>4,636</u>	<u>(16,801)</u>	<u>17,880</u>
<b>Provision for (recovery of) income taxes</b>				
Current	40	(35)	79	135
Future	1,166	1,971	984	(1,147)
	<u>1,206</u>	<u>1,936</u>	<u>1,063</u>	<u>(1,012)</u>
<b>Net income (loss) for the period</b>	<u>(6,256)</u>	<u>2,700</u>	<u>(17,864)</u>	<u>18,892</u>
<b>Earnings (loss) per share (note 8)</b>				
Basic	(0.046)	0.021	(0.131)	0.151
Diluted	(0.046)	0.020	(0.131)	0.143
Basic weighted average number of shares outstanding	<u>136,191,095</u>	<u>130,392,708</u>	<u>136,654,074</u>	<u>125,514,727</u>
Diluted weighted average number of shares outstanding	<u>136,191,095</u>	<u>137,837,689</u>	<u>136,654,074</u>	<u>132,519,583</u>

See accompanying notes to the consolidated interim financial statements

# Sandvine Corporation

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

For the nine month period ended August 31, 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	-	-	18,892	-	18,892
Net unrealized (losses) on available for sale financial assets (net of income taxes of \$nil)	-	-	-	20	20
Total comprehensive income					18,912
Stock based compensation	1,369	676	-	-	2,045
Issued for cash	49,579	-	-	-	49,579
Issued as consideration on business acquisition	3,481	-	-	-	3,481
<b>Balance, August 31, 2007</b>	145,676	1,079	331	25	147,111
<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 loss	-	-	(17,864)	-	(17,864)
Net unrealized (losses) on available for sale financial assets (net of income taxes of \$nil)	-	-	-	(42)	(42)
Total comprehensive (loss)					(17,906)
Stock based compensation	295	2,749	-	-	3,044
Shares issued as compensation on business acquisition	234	-	-	-	234
Common shares repurchased	(1,683)	73	(211)	-	(1,821)
<b>Balance, August 31, 2008</b>	145,414	4,354	(17,208)	27	132,587

As at August 31, 2008, the total of retained earnings (deficit) and accumulated other comprehensive income (loss) was \$(17,181) (August 31, 2007 \$356).

See accompanying notes to the consolidated interim financial statements

# Sandvine Corporation

## Consolidated Interim Statements of Cash Flows

For the three and nine month period ended August 31, 2008

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

	Three months ended		Nine months ended	
	August 31 2008 \$	August 31 2007 \$	August 31 2008 \$	August 31 2007 \$
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	(6,256)	2,700	(17,864)	18,892
Items not affecting cash				
Amortization of intangible assets	400	267	1,200	267
Depreciation	1,081	674	2,818	1,836
Foreign exchange (gain) loss	(129)	259	(161)	267
Stock-based compensation (notes 3 and 4)	1,538	423	3,036	827
Future income tax provision (recovery)	1,166	1,971	984	(1,147)
Other	-	1	(328)	52
	(2,200)	6,295	(10,315)	20,994
Changes in non-current balances	(31)	192	(21)	(8)
Changes in non-cash working capital balances	1,573	(392)	(472)	(3,911)
	(658)	6,095	(10,808)	17,075
<b>Investing activities</b>				
Purchase of property, plant and equipment	(1,951)	(1,850)	(4,494)	(5,270)
Business acquisitions, net of cash acquired	-	(5,030)	-	(5,030)
Purchase of marketable securities	(140,179)	(126,673)	(571,185)	(309,327)
Sale of marketable securities	144,990	84,626	588,906	242,956
	2,860	(48,927)	13,227	(76,671)
<b>Financing activities</b>				
Proceeds from the issuance of share capital (note 3)	66	50,005	240	50,825
Common shares repurchased	(1,069)	-	(1,821)	-
	(1,003)	50,005	(1,581)	50,825
<b>Net increase (decrease) in cash during period</b>	<b>1,199</b>	<b>7,173</b>	<b>838</b>	<b>(8,771)</b>
<b>Cash and cash equivalents – Beginning of period</b>	<b>7,517</b>	<b>3,620</b>	<b>7,878</b>	<b>19,564</b>
<b>Cash and cash equivalents – End of period</b>	<b>8,716</b>	<b>10,793</b>	<b>8,716</b>	<b>10,793</b>
<b>Cash and cash equivalents are represented by</b>				
Balances with banks	5,941	713	5,941	713
Cash equivalents	2,775	10,080	2,775	10,080

See accompanying notes to the consolidated interim financial statements

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

August 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.

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that publicly accountable enterprises will be required to use IFRS, as issued by the International Accounting Standards Board, unless modifications or additions to the requirements of IFRS are issued by the AcSB. IFRS must be adopted for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, with restatement for the previous fiscal year. The Company is currently assessing the impact of this announcement.

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

August 31, 2008

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## 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.

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 nine month period ending August 31, 2008, the Company recognized an impairment charge of \$172 and \$712 respectively relating to its inventory balances (2007 - \$142 and \$216). During the three month period ending August 31, 2008 the Company did not reverse any previously recognized impairment charges (nine months ending August 31, 2008 - \$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.

# Sandvine Corporation

## 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
Issued under the employee stock option plan	104,400	66	-	-	66
Transfer from contributed surplus	-	13	-	-	13
Issued as compensation on business acquisition	-	80	-	-	80
Cancelled from the key employee escrow	(2,798)	(6)	-	-	(6)
Repurchased	(1,037,536)	(1,110)	-	-	(1,110)
<b>Balance, August 31, 2008</b>	135,741,845	145,024	1	390	145,414

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.

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

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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 \$813 of non cash compensation cost (representing 160,605 common shares) related to this contingent consideration should be recorded for the period ended August 31, 2008 (nine months ended August 31, 2008 - \$813). This expense has been included within the "Stock based compensation" line in the consolidated statement of operations. The Company will continue to assess on a regular basis the expected outcome of the performance targets and record compensation costs on a pro-rata basis using the best available estimate of the number of shares expected to be issued.

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. On July 3, 2008, the Company cancelled a further 2,798 shares under the terms of the escrow agreement. A total of 169,105 shares (net of the 54,178 cancelled shares) are issued and allocated to a key employee escrow that is released over time, contingent on the continued employment of certain individuals over a three year period from acquisition. During the three months ended August 31, 2008, the Company released 65,837 shares. The Company will recognize up to a maximum of \$855 as non-cash compensation expense over the period in which the services are rendered. For the three and nine month periods ended August 31, 2008 the Company recognized \$74 and \$234 respectively as compensation expense relating to this key employee escrow.

During the three months ended August 31, 2008, the Company issued 104,400 common shares for cash proceeds of \$66 as a result of option holders exercising their options (386,759 common shares for net proceeds of \$240 for the nine month period ended August 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 August 31, 2008, the Company purchased 1,037,536 common shares at a total cost of \$1,069 (1,573,036 common shares at a total cost of \$1,821 for the nine month period ended August 31, 2008). For share purchases where the amount paid was in excess of the per share paid-in capital of the common shares, the difference of \$211 was charged to retained earnings. For share purchases where the amount paid was less than the per share paid-in capital of the common shares, the difference of \$73 was credited to contributed surplus. All common shares repurchased by the Company have been cancelled. Subsequent to August 31, 2008 the Company has purchased 373,647 shares for a total cost of \$377.

# Sandvine Corporation

Notes to the Interim Consolidated Financial Statements

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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 August 31, 2008, there were 4,204,551 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
Option activity for the period		
Granted	1,810,750	1.03
Forfeited	(251,381)	4.32
Exercised	(104,400)	0.63
<b>Options outstanding, August 31, 2008</b>	9,699,634	2.24

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

August 31, 2008

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

### Stock based compensation

Stock based compensation (related to the Company's stock option plan) recognized for the three and nine month period ended August 31, 2008 was \$651 and \$1,989 (August 31, 2007 – \$365 and \$769) with a corresponding credit to contributed surplus. Previously recognized expense of \$13 and \$55 for the three and nine month period ending August 31, 2008 relating to options exercised during the period has been transferred from contributed surplus to share capital (August 31, 2007 - \$49 and \$123).

	For the three months ended		For the nine months ended	
	August 31 2008	August 31 2007	August 31 2008	August 31 2007
Number of options granted/assumed	1,810,750	1,546,833	2,827,175	2,243,333
Weighted average Black-Scholes value of each option	\$1.05	\$4.28	\$1.63	\$3.60
Assumptions				
Risk free interest rate	3.70%	4.49%	3.80%	4.39%
Expected life in years	10	10	10	10
Expected dividend yield	0%	0%	0%	0%
Volatility	102.19%	59.59%	90.98%	58.88%

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

Range of exercise price \$	Options Outstanding			Options Exercisable	
	Number outstanding at August 31, 2008	Weighted average contractual life (years)	Weighted average exercise price \$	Number outstanding at August 31, 2008	Weighted average exercise price \$
0.40 - 0.63	3,484,702	5.15	0.57	2,731,172	0.55
1.05 - 2.53	3,709,584	9.00	1.65	652,014	2.29
4.11 - 5.50	1,295,814	9.14	4.28	123,009	4.59
6.59 – 6.95	1,209,534	8.89	6.68	114,534	6.93
0.40 - 6.95	9,699,634	7.62	2.24	3,620,729	1.20

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

August 31, 2008

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

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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>August 31</b>	<b>November 30</b>
	<b>2008</b>	<b>2007</b>
	\$	\$
Held for trading (1)	8,585	7,716
Available-for-sale (2)	87,374	105,136
Loans and receivables (3)	12,313	11,030
Other financial liabilities (4)	5,854	6,094

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

(2) Includes marketable securities

(3) Includes trade and other accounts receivable

(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 August 31, 2008, the fair value of the Company's marketable securities was \$87,374 resulting in net unrealized cumulative gains of \$27 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 nine month period ended August 31, 2008 was \$676 and \$2,519 respectively.

# Sandvine Corporation

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At August 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 nine month period ending August 31, 2008 would remain the same and other comprehensive income would have been \$63 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 nine month period ending August 31, 2008 would remain the same and other comprehensive income would have been \$63 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 August 31, 2008 no one issuer represented more than 34.5% 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 August 31, 2008, 5 companies, with greater than ten percent concentration in accounts receivable, accounted for 70.4% of the Company's total accounts receivable (August 31, 2007 – 3; 78.1%). The Company's allowance for doubtful accounts is not significant. Of the Company's accounts receivable, \$4,826 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 August 31, 2008, \$4,397 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	94.7	-	5.3	100.0
Marketable securities	100.0	-	-	100.0
Accounts receivable and other current assets	10.5	40.2	49.3	100.0
Derivative financial instruments	100.0	-	-	100.0

# Sandvine Corporation

## Notes to the Interim Consolidated Financial Statements

August 31, 2008

(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 August 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 \$61 for the nine month period ending August 31, 2008. If the Canadian dollar had appreciated 5 percent against the US dollar at August 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 \$61 for the nine month period ending August 31, 2008.

For the three and nine month periods ended August 31, 2008, general and administrative expenses included a foreign exchange (gain )loss of \$(274) and \$251 respectively (2007 - \$259 and \$267).

### *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 August 31, 2008 the Company's accounts payable and accrued liabilities were \$5,854, 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.

# 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)

## 7 Lease commitments

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

	\$
2008	222
2009	613
2010	543
2011	482
2012	219
Thereafter	-
	<u>2,079</u>

## 8 Earnings (loss) per share

	For the three month ended		For the nine month ended	
	August 31 2008 \$	August 31 2007 \$	August 31 2008 \$	August 31 2007 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	(6,256)	\$2,700	(17,864)	\$18,892
Denominator for earnings (loss) per share, weighted average number of shares outstanding				
Basic	136,191,095	130,392,708	136,654,074	125,514,727
Effect of warrant outstanding	-	619,280	-	619,280
Effect of stock options issued	-	6,675,228	-	6,335,052
Effect of contingently returnable shares	-	150,473	-	50,524
Diluted	<u>136,191,095</u>	<u>137,837,689</u>	<u>136,654,074</u>	<u>132,519,583</u>
Earnings (loss) per share:				
Basic	\$(0.046)	\$0.021	\$(0.131)	\$0.151
Diluted	\$(0.046)	\$0.020	\$(0.131)	\$0.143

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

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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 nine months ended August 31, 2008, the Company recognized \$328 and \$812 (2007 - \$260 and \$614) 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 \$2,171 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 nine months ended August 31, 2008, the subsidiary received funding of \$394 USD (\$401 CDN) under these programs. As of August 31, 2008 the subsidiary has received cumulative grants of \$853 USD (\$851 CDN).

Non repayable government assistance recorded during the three and nine month periods ending August 31, 2008 of \$160 and \$625 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 recorded all amounts currently approved under this 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 nine months ended</u>	
	<u>August 31</u>	<u>August 31</u>	<u>August 31</u>	<u>August 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	6,115	4,504	18,356	10,849
Government repayments	328	260	812	614
Investment tax credits / government assistance	(160)	-	(1,026)	(233)
	<u>6,283</u>	<u>4,764</u>	<u>18,142</u>	<u>11,230</u>

# Sandvine Corporation

Notes to the Interim Consolidated Financial Statements

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## 10 Income taxes

At each balance sheet date, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The Company records a valuation allowance to reduce future income tax assets to the amount that is more likely than not to be realized. In this regard, the Company regularly assesses all negative and positive evidence to evaluate the recoverability of its future tax assets, including an evaluation of the amount and nature of significant tax assets and their carryforward period, the Company's recent earnings history, the Company's cumulative profit or losses in recent years and the Company's ability to reasonably forecast sufficient future earnings.

During the third quarter of fiscal 2008, the Company determined that it was no longer able to conclude, based on the assessment of available negative and positive evidence, that it was more likely than not that its future tax assets associated with temporary differences and unused loss carryforwards will be realized. As a result, an increase in the Company's valuation allowance has been provided against its future tax assets resulting in the recognition of a future tax expense of \$1,075 on the Consolidated Statement of Operations in this fiscal quarter. In addition, the Company has not recognized the benefit associated with its non-refundable investment tax credits.

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.

# Sandvine Corporation

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### 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 nine months ended</u>	
	<u>August 31</u>	<u>August 31</u>	<u>August 31</u>	<u>August 31</u>
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	\$	\$	\$	\$
Sales				
Canada	56	26	1,919	202
United States	6,097	18,838	19,533	51,483
Caribbean and Latin America	1,463	81	1,583	181
Europe, Middle East and Africa	4,938	1,851	8,232	3,814
Asia Pacific	571	380	1,233	893
	<u>13,125</u>	<u>21,176</u>	<u>32,500</u>	<u>56,573</u>
	%	%	%	%
Sales				
Canada	0.4	0.1	5.9	0.4
United States	46.5	89.0	60.1	91.0
Caribbean and Latin America	11.1	0.4	4.9	0.3
Europe, Middle East and Africa	37.6	8.7	25.3	6.7
Asia Pacific	4.4	1.8	3.8	1.6
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

For the three and nine month periods ended August 31, 2008 major customers, being those that represent more than 10% of total revenues for an individual period, represented 50.5% and 13.7% respectively of total revenue (2007 – 77.5 % and 67.9%). The breakdown of major customers is as follows:

	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<u>August</u>	<u>August</u>	<u>August</u>	<u>August</u>
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	%	%	%	%
Customer A	8.8	54.4	13.7	54.2
Customer B	14.2	23.1	6.6	9.1
Customer C	11.0	-	6.5	-
Customer D	11.1	-	4.7	-
Customer E	14.2	-	5.7	-

# Sandvine Corporation

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	August 31 2008 \$	November 30 2007 \$
Property, plant and equipment, intangibles and goodwill		
Canada	11,377	9,538
United States	4,197	4,828
Europe, Middle East and Africa	5,092	5,496
	<hr/> 20,666	<hr/> 19,862
Total assets		
Canada	135,879	148,780
United States	4,229	4,933
Europe, Middle East and Africa	5,738	5,752
	<hr/> 145,846	<hr/> 159,465

## 12 Supplemental cash flow information

For the three and nine month periods ending August 31, 2008 the Company paid \$162 and \$220 respectively for income tax in cash (2007 - \$21 and \$81). The Company did not pay any interest in cash during the three and nine month period ended August 31, 2008 (2007 - \$nil and \$nil).

## 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 August 31, 2008 the Company has issued four letters of credit under its operating line for US\$84 (CDN\$89) expiring October 31, 2008, US\$64 (CDN\$68) expiring December 31, 2008, US\$203 (CDN\$216) expiring February 11, 2010 and US\$79 (CDN\$85) expiring August 31, 2011.

# **Sandvine Corporation**

## Notes to the Interim Consolidated Financial Statements

**August 31, 2008**

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

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As of August 31, 2008 the Company has two foreign currency forward contracts that have the effect of fixing the conversion of \$5,000 of the Company's net US dollar asset position to Canadian dollars at a rate of 1.0381. These contracts mature on or before October 31, 2008 and have a fair value of \$131 at August 31, 2008. The Company recognized a loss of \$94 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.