

# **Sandvine Corporation**

Consolidated Financial Statements  
**November 30, 2009**

January 13, 2010

**Auditors' Report**

**To the Shareholders of Sandvine Corporation**

We have audited the consolidated balance sheets of **Sandvine Corporation** as at November 30, 2009 and November 30, 2008 and the consolidated statement of operations, changes in shareholders' equity and comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at November 30, 2009 and November 30, 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

**Chartered Accountants, Licensed Public Accountants**

# Sandvine Corporation

## Consolidated Balance Sheets

As at November 30, 2009

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

	2009	2008
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	2,341	3,872
Marketable securities (note 5)	83,423	88,676
Accounts receivable	20,741	19,202
Inventory (note 6)	9,744	14,960
Other	1,773	1,513
	<u>118,022</u>	<u>128,223</u>
<b>Non current assets</b>		
Plant and equipment (note 7)	13,026	12,595
Intangible assets (note 8)	5,221	6,809
Goodwill (note 4)	-	2,425
	<u>18,247</u>	<u>21,829</u>
	<u>136,269</u>	<u>150,052</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	10,732	8,941
Current portion of deferred revenue	7,513	8,951
	<u>18,245</u>	<u>17,892</u>
<b>Non current liabilities</b>		
Deferred revenue	790	186
Future tax liability (note 11)	-	196
	<u>790</u>	<u>382</u>
	<u>19,035</u>	<u>18,274</u>
<b>Shareholders' equity</b>		
<b>Share capital</b> (note 12)	146,820	145,103
<b>Contributed surplus</b>	9,000	5,608
<b>Accumulated other comprehensive income</b> (note 16)	(90)	46
<b>Deficit</b>	<u>(38,496)</u>	<u>(18,979)</u>
	<u>117,234</u>	<u>131,778</u>
	<u>136,269</u>	<u>150,052</u>

On behalf of the Board:

**Roger Maggs**  
Director

**Dave Caputo**  
Director

*See accompanying notes to the consolidated financial statements*

# Sandvine Corporation

## Consolidated Statements of Operations

For the year ended November 30, 2009

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

	2009	2008
	\$	\$
<b>Revenue</b>		
Product	51,958	38,459
Service	16,890	12,625
	<u>68,848</u>	<u>51,084</u>
<b>Cost of sales</b>		
Product	14,375	8,741
Service	3,362	2,412
	<u>17,737</u>	<u>11,153</u>
<b>Gross margin</b>	<u>51,111</u>	<u>39,931</u>
<b>Expenses</b>		
Sales and marketing	20,584	18,052
Research and development (note 17)	27,681	26,172
General and administrative	8,828	7,702
Stock based compensation (notes 12 and 13)	4,982	4,356
Amortization of intangible assets	2,130	2,188
Depreciation	4,691	3,473
Goodwill impairment (note 4)	2,425	-
	<u>71,321</u>	<u>61,943</u>
<b>Loss from operations</b>	<u>(20,210)</u>	<u>(22,012)</u>
<b>Interest and other income</b>	662	3,373
<b>Loss before provision for income taxes</b>	<u>(19,548)</u>	<u>(18,639)</u>
<b>Provision for (recovery of) income taxes (note 11)</b>		
Current	165	100
Future	(196)	896
	<u>(31)</u>	<u>996</u>
<b>Net loss for the year</b>	<u>(19,517)</u>	<u>(19,635)</u>
<b>Loss per share</b>		
Basic and diluted	(0.144)	(0.144)
Basic and diluted weighted average number of shares outstanding	<u>135,636,736</u>	<u>136,336,109</u>

See accompanying notes to the consolidated financial statements

# Sandvine Corporation

## Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Loss

For the year ended November 30, 2009

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

	Stated share capital \$	Contributed surplus \$	Retained earnings (deficit) \$	Accumulated other comprehensive income (loss) \$	Total \$
<b>Balance, November 30, 2007</b>	146,568	1,532	401	69	148,570
Opening balance adjustment for adoption of inventory standard (note 3)	-	-	466	-	466
<b>Balance, December 1, 2007</b>	146,568	1,532	867	69	149,036
Comprehensive loss:					
Net loss	-	-	(19,635)	-	(19,635)
Net unrealized losses on available for sale financial assets	-	-	-	(23)	(23)
Total comprehensive loss					(19,658)
Stock based compensation (notes 12 and 13) Issued as compensation on business	306	3,988	-	-	4,294
acquisition (note 12)	312	-	-	-	312
Common shares repurchased	(2,083)	88	(211)	-	(2,206)
<b>Balance, November 30, 2008</b>	145,103	5,608	(18,979)	46	131,778
Comprehensive loss:					
Net loss	-	-	(19,517)	-	(19,517)
Net unrealized losses on available for sale financial assets	-	-	-	(17)	(17)
Net unrealized loss on derivative financial instruments designated as cash flow hedges	-	-	-	(266)	(266)
Amount transferred to net loss for derivatives designated as cash flow hedges	-	-	-	147	147
Total comprehensive loss					(19,653)
Stock based compensation (notes 12 and 13) Issued as compensation on business	1,457	3,392	-	-	4,849
acquisition (note 12)	260	-	-	-	260
<b>Balance, November 30, 2009</b>	146,820	9,000	(38,496)	(90)	117,234

As at November 30, 2009, the total of deficit and accumulated other comprehensive loss was \$(38,586) (November 30, 2008 \$(18,933)).

See accompanying notes to the consolidated financial statements

# Sandvine Corporation

## Consolidated Statements of Cash Flows

For the year ended November 30, 2009

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

	2009 \$	2008 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the year	(19,517)	(19,635)
Items not affecting cash		
Amortization of intangible assets	2,130	2,188
Depreciation	4,818	3,587
Foreign exchange loss (gain)	127	(1,497)
Stock-based compensation (notes 12 and 13)	4,982	4,356
Goodwill impairment (note 4)	2,425	-
Future income tax provision (recovery) (note 11)	(196)	896
Other	-	(293)
	(5,231)	(10,398)
Changes in non-current balances	605	128
Changes in non-cash working capital balances	3,521	(768)
	(1,105)	(11,038)
<b>Investing activities</b>		
Purchase of plant, equipment and intangible software assets	(5,789)	(7,450)
Purchase of marketable securities	(470,411)	(578,341)
Sale of marketable securities	475,647	594,779
	(553)	8,988
<b>Financing activities</b>		
Proceeds from the issuance of share capital (note 12)	127	250
Common shares repurchased	-	(2,206)
	127	(1,956)
<b>Net decrease in cash during year</b>	(1,531)	(4,006)
<b>Cash and cash equivalents – Beginning of year</b>	3,872	7,878
<b>Cash and cash equivalents – End of year</b>	2,341	3,872
<b>Cash and cash equivalents are represented by</b>		
Balances with banks	2,099	621
Cash equivalents	242	3,251

See accompanying notes to the consolidated financial statements

# **Sandvine Corporation**

Notes to the Consolidated Financial Statements

**November 30, 2009**

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

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## **1 Basis of presentation**

Sandvine Corporation and its subsidiary companies (collectively “the Company”) develops and markets Network Policy Control solutions for high-speed, or “broadband”, Internet service providers. The Company’s solutions help identify network traffic and trends and apply network policies, with the aim of enhancing the subscriber’s quality of experience and improving the profitability of service providers.

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

## **2 Summary of the significant accounting policies**

### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated. The Company has a trust vehicle to facilitate its employee share ownership program and hold shares of the Company allocated to individual employees. This trust is considered to be a variable interest entity and has been consolidated by the Company.

### **a) Business Combinations**

The Company allocates the purchase price of a business acquisition to tangible assets, intangible assets and liabilities based on their estimated fair values at the date of acquisition with the excess of purchase price amount over these fair values being allocated to goodwill.

Contingent consideration associated with any business acquisition is reviewed to determine if it should be accounted for as an adjustment of the purchase price or as compensation for services rendered subsequent to the acquisition. When the contingent consideration is related to an adjustment of purchase price and the amount of any contingent consideration can be reasonably estimated at the date of acquisition and the outcome of the contingency can be determined beyond reasonable doubt, the contingent consideration is recognized at that date as part of the cost of the purchase. When the contingent consideration is related to compensation for services, the additional consideration is recognized as compensation expense based on management’s best estimate of the outcome of the performance condition related to the payment of the contingent consideration.

# **Sandvine Corporation**

## Notes to the Consolidated Financial Statements

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

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### **b) Cash and cash equivalents**

Cash and cash equivalents include cash on hand, balances with banks and short-term investments that have maturity dates of less than 90 days at acquisition and that are readily convertible to cash. All cash and cash equivalents are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net income during the year.

### **c) Marketable securities**

Marketable securities include interest bearing securities with original maturities of greater than three months and remaining maturities of less than one year. All marketable securities are classified as available-for-sale and are initially measured at settlement date. The marketable securities are recorded at fair value. Subsequent changes in fair value are accounted for through accumulated other comprehensive income until such investments mature or are sold. Related interest income is included in "Interest and other income" on the consolidated statement of operations.

The Company assesses declines in the value of individual investments for impairment to determine whether the decline is other-than temporary. The Company makes this assessment by considering available objective evidence, including changes in general market conditions, specific industry and individual company data, the length of time and the extent to which the fair value has been less than cost, the financial condition and the near-term prospects of the individual investment. In the event that a decline in the fair value of an investment occurs and the decline in value is considered to be other than temporary, an impairment charge is recorded and a new cost basis in the investment is established.

### **d) Inventory**

Raw materials, work-in-process, deferred cost of sales and demonstration systems are stated at the lower of cost and net realizable value. Net realizable value is the estimated selling price less applicable selling costs and estimated costs of completion. The cost of raw materials is determined using the first-in, first-out method. The cost of work in progress, deferred cost of sales and demonstration systems are assigned by specific identification of their individual costs. Cost includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The allocation of fixed production overheads is based on the normal production capacity of the production facilities.

### **e) Income taxes**

The Company follows the liability method of tax allocation to account for income taxes. Under this method, future tax assets and liabilities are determined based upon the difference between the financial reporting and tax basis of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized. The Company does not provide for income taxes on undistributed earnings of foreign subsidiaries that are not expected to be repatriated in the foreseeable future.

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## f) Plant and equipment

Plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided using the following rates and methods:

Computer hardware	30- 50% declining balance
Furniture and fixtures	20% declining balance
Leasehold improvements	Straight-line basis over relevant lease term

## g) Intangible Assets

Intangible assets are comprised of computer software, as well as acquired non-patented technology purchased through the Company's business acquisitions.

Computer software is recorded at cost less accumulated amortization. Computer software assets are amortized on a declining balance basis using rates of 30 – 50%.

Acquired non-patented technology is initially recorded at fair value based on the estimated net present value of future cash flow streams associated with these technologies. Acquired non-patented technology assets are amortized on a straight line basis over their estimated useful life of five years.

## h) Impairment of long-lived assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the carrying amount over the fair value of the asset.

## i) Goodwill

Goodwill represents the excess of the purchase price of business acquisitions over the fair value of identifiable net assets acquired in such acquisitions. Goodwill is not amortized but is tested for impairment annually, or more frequently if events or changes in circumstances indicate the asset might be impaired. The Company tests for impairment of goodwill on an annual basis as of March 31.

## j) Research and development

The Company is engaged in research and development activities. Research and development costs, other than plant and equipment acquisitions, are charged as an operating expense of the Company as incurred, unless they meet generally accepted accounting criteria for deferral. To date, no development costs have met the criteria for deferral.

# Sandvine Corporation

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## **k) Revenue recognition**

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured. Generally, where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. The following describes the specific revenue recognition policies for each major type of revenue.

### *Networking equipment (including related software)*

The Company's networking and communications products are integrated with software that is essential to the functionality of its equipment.

Revenue for network equipment that does not require significant production, modification or customization is generally recognized when the product is shipped and all other revenue recognition criteria, as described above, have been satisfied.

The percentage-of-completion method of accounting is used for sales generated from certain contracts, primarily those related to significant production or customized network solutions and network build-outs with durations greater than three months. The units-of-delivery or units-of-work performed method is used to measure progress on each contract. Revenue and cost estimates are revised periodically based on changes in circumstances. Profit estimates on long-term contracts are revised periodically based on changes in circumstances and any losses on contracts are recognized in the period that such losses become known. The Company uses historical experience, project plans and an assessment of the risks and uncertainties inherent in the arrangement to establish these estimates.

### *Software*

Certain software is licensed to customers on a perpetual or per-use basis. Revenue from perpetually licensed software is recognized at the inception of the license term if all other revenue recognition criteria, as described above, have been satisfied. Revenues for software licenses which are paid for on a per-use basis are recognized at the time a reliable estimate can be made of actual revenues generated from usage.

### *Post contract support*

Post contract support (PCS) revenue is deferred and recognized ratably over the period during which the services are to be performed, which is typically one year.

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## *Multiple-element arrangements*

When a sale involves multiple elements, such as sales of products that include PCS, the entire fee from the arrangement is allocated to each respective element based on its relative fair value as determined by internal or third-party analysis of market-based prices and recognized when revenue recognition criteria for each element are met. In situations where there is objective and reliable evidence of fair value for all undelivered elements, but not for delivered elements, the residual method is used to allocate the contract consideration. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. If the Company is unable to establish fair value for an undelivered element, and the only undelivered element is PCS, the entire arrangement fee is deferred and recognized ratably over the PCS period. In all other situations, if the Company is unable to establish fair value for an undelivered element, the entire arrangement fee is deferred until sufficient evidence exists or all elements have been delivered.

## **l) Earnings (loss) per share**

Basic earnings (loss) per share is computed by dividing net earnings (loss) by the weighted average number of common shares and common share warrants outstanding during the year. Diluted earnings (loss) per share represents the amount of earnings available or loss attributable to each common share and each potential common share, if dilutive, outstanding during the year and is calculated using the treasury stock method.

## **m) Stock-based compensation plans**

The Company has a stock-based compensation plan, which is described in note 13. In accordance with CICA Handbook Section 3870, *Stock-based Compensation and Other Stock-based Payments*, awards granted on or after December 1, 2003 are accounted for using the fair value method of accounting, whereby the Company recognizes compensation expense equal to the fair value of the award over its vesting period. The fair value of awards is determined using the Black-Scholes option pricing model. On the exercise of stock options, the consideration paid and any related compensation expense recorded through contributed surplus, is credited to share capital.

The Company has an employee share ownership program which allows employees to voluntarily participate in a share purchase plan. Under the terms of the plan, the employees can contribute up to a specified percentage of their salary. Subject to certain conditions the Company will match a percentage of the employee's contributions. All contributions are used by the plan's trustee to purchase common shares in the open market. The Company's contributions are recognized over the vesting period for the underlying shares.

## **n) Government assistance**

Government assistance towards research and development expenditures received in the form of investment tax credits on account of eligible expenditures is recorded when there is reasonable assurance that the Company will realize the assistance. Investment tax credits related to the acquisition of plant and equipment used for research and development is credited against the related plant and equipment, while other investment tax credits are credited against related expenses as incurred.

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

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The Company participates in other government programs which include both non-repayable and repayable government assistance (fully described in note 17). Assistance related to these programs is recorded in the same method as investment tax credits, as described above. For repayable government programs, repayments are based on certain revenue streams. Repayments are charged to income when the related sale is recorded.

### **o) Use of estimates**

The preparation of these consolidated financial statements, in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. In particular, significant estimates include those related to revenue recognition, the valuation of inventory, income taxes, valuation allowance related to future income taxes, investment tax credits, impairment of long lived and intangible assets, fair value of reporting units and goodwill, determination of estimated useful lives of intangible assets and plant and equipment, allowances for accounts receivable and valuation assumptions related to stock based compensation. Actual results could differ from these estimates.

### **p) Financial Instruments**

The Company classifies its financial instruments as held for trading, available for sale, loans and receivables or other financial liabilities. Financial assets that are purchased and acquired with the intention of generating profits in the near term are classified as held for trading. These instruments are accounted for at fair value with the change in fair value recognized in net income. Financial assets classified as available for sale are carried at fair value with the changes in fair value recorded in other comprehensive income until such investments mature, are sold, or an impairment charge has been recognized. Loans and receivables and other financial liabilities are accounted for at amortized cost.

### **q) Hedges**

The Company may enter into forward contracts to reduce its exposure to fluctuations in foreign exchange rates. The Company does not use any derivative financial instrument for speculative purposes. Designation as a hedge is only allowed if, both at the inception of the hedge and throughout the hedge period, the changes in the fair value of the derivative financial instruments are expected to substantially offset the changes in the fair value of the hedged item attributable to the underlying risk exposure. The Company has elected to apply hedge accounting for certain forward foreign exchange contracts used to manage foreign currency exposure on anticipated operational expenditures and has designated these as cash flow hedges.

For cash flow hedges which meet the criteria for hedge accounting, the effective portion of the change in fair value of the derivative are initially recorded in other comprehensive income and are reclassified to the consolidated statements of operations in the same period that the hedged anticipated transaction affects earnings. Any ineffective portion of the gain or loss on the derivative is recognized in income immediately. Hedge accounting is discontinued prospectively when it is determined that the hedging relationship is no longer effective, the derivative is terminated or sold, or the Company terminates its designation of the hedging relationship.

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The Company formally documents all relationships between the hedging instruments and hedged items. This process includes linking all derivatives to forecasted foreign currency cash flows or to a specific asset or liability. The Company also formally documents and assesses, both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that are used in the hedging transactions are highly effective in offsetting the changes in the fair value or cash flows of the hedged items.

The fair value of these derivatives is included in "Other" when in an asset position and in "Accounts payable and accrued liabilities" when in a liability position. Gains or losses arising from hedging activities are reported in the same caption on the consolidated statements of operations as the hedged item.

### r) **Embedded derivatives**

Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are initially measured at fair value with subsequent changes in fair value recognized in earnings.

### s) **Foreign currency translation**

The parent Company maintains its accounts in Canadian dollars. The accounts of the Company's foreign subsidiaries are maintained in the local currency where the subsidiary is incorporated. The Company's foreign subsidiaries are considered to be integrated operations. Accordingly, the foreign operations are translated to Canadian dollars using the temporal method. As such, monetary assets and liabilities are translated using the exchange rates in effect at the consolidated balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenue and expense items have been translated using the average exchange rate prevailing during the year. The gains and losses resulting from changes in exchange rates are recognized in earnings.

### t) **Recently issued accounting standards**

In January 2009, the CICA issued Section 1582, *Business Combinations*, replacing Section 1581, *Business Combinations*. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is currently assessing the future impact of this new standard on its financial statements.

In January 2009, the CICA issued Section 1601, *Consolidated Financial Statements*, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is currently assessing the future impact of this new standard on its financial statements.

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In December 2009, the CICA issued EIC 175, *Multiple Deliverable Revenue Arrangements*, replacing EIC 142, *Revenue Arrangements with Multiple Deliverables*. This abstract was amended to (1) exclude from the application of the updated guidance those arrangements that would be accounted for in accordance with Financial Accounting Standards Board Statement (FASB) Statement of Position (SOP) 97-2, *Software Revenue Recognition* as amended by Accounting Standards Update (ASU) 2009-14; (2) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (3) require in situations where a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence of selling price, require that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (4) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (5) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance.

FASB ASU 2009-14 removed from the scope of accounting for software arrangements that is contained in the SOP 97-2 guidance, tangible products containing software components and non-software components that function together to deliver the product’s essential functionality.

The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If the Abstract is adopted early, in a reporting period that is not the first reporting period in the entity’s fiscal year, it must be applied retroactively from the beginning of the Company’s fiscal period of adoption.

The Company is currently assessing the future impact of these amendments on its financial statements and has not yet determined the timing and method of its adoption.

### 3 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 required 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.

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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.

### 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.

### Goodwill and Intangible Assets

Effective December 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3064, *Goodwill and Intangible Assets*. This standard establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The adoption of this standard required the Company to retroactively reclassify its computer software assets on its consolidated balance sheet from plant and equipment to intangible assets. The net book value of computer software reclassified as of November 30, 2008 was \$1,109. In addition, the amortization of computer software has been reclassified from depreciation expense to amortization of intangible assets. The reclassification of amortization for the year ended November 30, 2008 was \$588. As of November 30, 2009, computer software of \$1,121 is included within intangible assets. For the year ended November 30, 2009, amortization expense of \$530 has been recorded relating to computer software.

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## 4 Goodwill

Goodwill represents the excess, at the date of acquisition, of the cost of an acquired business over the fair value of the identifiable assets acquired and liabilities assumed. Goodwill is not amortized but is subject to an annual impairment test or more frequently if events or circumstances indicate that the fair value of a reporting unit is below its carrying amount. The impairment test requires the identification of reporting units and a comparison of the estimated fair value of each reporting unit to the carrying value recorded on the Company's consolidated financial statements, including goodwill. Based on the Company's review, only one reporting unit has been identified for the purpose of performing the annual impairment test. If the carrying value of the Company exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of the impairment loss. The second step of the impairment test involves comparing the implied fair value of the Company's goodwill with its carrying amount to measure the amount of impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination.

During the first quarter of fiscal 2009, in connection with a sustained, significant decline of the Company's market capitalization at a level lower than its net book value, the Company concluded that an indicator of impairment was present. As a result, the Company tested goodwill for impairment in the first quarter of 2009. Under step one, the Company's estimate of fair value was principally determined by reference to its externally traded share price over a reasonable period of time prior to performing the impairment test. Based on the first step of the analysis, the Company determined that the carrying value of the reporting unit was in excess of its fair value. As a result, the Company performed the second step of the goodwill impairment test and determined that the fair value of the Company, including both recognized and unrecognized intangible assets, did not support the carrying amount of goodwill. Accordingly the Company recorded a non-cash goodwill impairment charge of \$2,425 during the year ended November 30, 2009.

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

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### 5 Marketable securities

Marketable securities include the following:

	2009 \$	2008 \$
Canadian dollar bonds, debentures and interest bearing securities	83,423	88,676
	<u>83,423</u>	<u>88,676</u>

As at November 30, 2009, net unrealized cumulative gains of \$29 have been recorded in accumulated other comprehensive income for bonds, debentures and interest bearing securities (year ended November 30, 2008 - \$46). These unrealized gains were related to short term interest rate decreases. No individual securities have a market value less than their amortized cost as of November 30, 2009 (2008 – none).

### 6 Inventory

Inventory includes the following:

	2009 \$	2008 \$
Raw materials	5,820	6,292
Work-in-process	712	3,416
Deferred cost of sales	818	1,819
Demonstration systems	2,394	3,433
	<u>9,744</u>	<u>14,960</u>

During the year ended November 30, 2009, the amount of inventory recognized as an expense and included in product cost of sales was \$14,101 (2008 - \$8,366). During the year ended November 30, 2009, the Company recognized an inventory write down of \$2,234 relating to its inventory balances (2008 - \$1,275), and reversed previously recognized write downs of \$51 (2008 - \$236).

# Sandvine Corporation

Notes to the Consolidated Financial Statements

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## 7 Plant and equipment

	<b>Cost</b>	<b>Accumulated</b>	<b>2009</b>
	<b>\$</b>	<b>Depreciation</b>	<b>\$</b>
		<b>\$</b>	
Computer hardware	23,602	12,291	11,311
Furniture and fixtures	1,062	501	561
Leasehold improvements	1,501	347	1,154
	<hr/>	<hr/>	<hr/>
	26,165	13,139	13,026

	<b>Cost</b>	<b>Accumulated</b>	<b>2008</b>
	<b>\$</b>	<b>Depreciation</b>	<b>\$</b>
		<b>\$</b>	
Computer hardware	18,792	7,756	11,036
Furniture and fixtures	891	369	522
Leasehold improvements	1,224	187	1,037
	<hr/>	<hr/>	<hr/>
	20,907	8,312	12,595

## 8 Intangible assets

	<b>Cost</b>	<b>Accumulated</b>	<b>2009</b>
	<b>\$</b>	<b>Amortization</b>	<b>\$</b>
		<b>\$</b>	
Computer software	3,664	2,543	1,121
Non-patented technology assets	7,967	3,867	4,100
	<hr/>	<hr/>	<hr/>
	11,631	6,410	5,221

	<b>Cost</b>	<b>Accumulated</b>	<b>2008</b>
	<b>\$</b>	<b>Amortization</b>	<b>\$</b>
		<b>\$</b>	
Computer software	3,132	2,023	1,109
Non-patented technology assets	7,967	2,267	5,700
	<hr/>	<hr/>	<hr/>
	11,099	4,290	6,809

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

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### 9 Financial Instruments

#### a) Categories of financial assets and liabilities

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:

	2009	2008
	\$	\$
<b>Held for trading</b>		
Cash and cash equivalents	2,341	3,872
Derivatives designated as held for trading – gain / (loss) *	6	39
Derivatives designated as cash flow hedges – gain / (loss) *	(119)	-
<b>Available-for-sale</b>		
Marketable securities	83,423	88,676
<b>Loans and receivables</b>		
Accounts receivable	20,741	19,202
Other receivables	776	311
<b>Other financial liabilities</b>		
Accounts payable and accrued liabilities	10,487	8,552

(\*) Derivative financial instruments have been included in other current assets or accounts payable and accrued liabilities on the Company's consolidated balance sheet.

#### b) Fair value

The estimated fair values of cash and cash equivalents, accounts receivable, other receivables, accounts payable and accrued liabilities approximate their respective carrying values due to the short period to maturity. For fair value estimates relating to derivatives and marketable securities (described below), the Company classifies its fair value measurements within a fair value hierarchy, which reflects the significance of the inputs used in making the measurements as defined in CICA Handbook section 3862 – *Financial Instruments – Disclosures*.

Level 1 - Unadjusted quoted prices at the measurement date for identical assets or liabilities in active markets.

Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs which are supported by little or no market activity.

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

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The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's derivative financial instruments include foreign exchange forward contracts and embedded derivatives. The fair values of currency forward contracts and embedded derivatives is the difference between the forward exchange rate and the contract rate. The Company's foreign exchange forward contracts and embedded derivatives are classified within Level 2 because they are based on foreign currency rates quoted by banks and other public data sources.

The fair value of marketable securities are classified within Level 2 because they are based on quoted prices for similar assets in active markets, and/or observable inputs such as interest rates. As at November 30, 2009, the fair value of the Company's marketable securities was \$83,423 resulting in net unrealized cumulative gains of \$29 being recorded in accumulated other comprehensive income (November 30, 2008 - \$46). 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 in the statement of operations on the Company's marketable securities.

### **c) Risks arising from financial instruments and risk management**

The Company is exposed to financial risks that may potentially impact its operating results including market risks (foreign exchange rate and interest rate risks), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

#### *Foreign currency risk*

The Company's financial results are reported in Canadian dollars. The Company transacts business in multiple currencies, the most significant of which are the Canadian dollar, the U.S. dollar, the Euro, the Great British Pound and the New Israeli Shekel. As a result, the Company has foreign currency exposure with respect to items denominated in foreign currencies. The Company's objective with regard to its foreign currency risk is to minimize the impact of foreign exchange movements on the Company's consolidated financial statements.

The Company generates the majority of its revenues in major foreign currencies, primarily the U.S. dollar, which exceed the natural hedge provided by expenditures in those currencies. In order to manage this net foreign currency exposure the Company enters into forward foreign exchange contracts. The timing and amount of these forward foreign exchange contracts are estimated based on customer contracts on hand and expected future cash outflows. The Company does not account for these forward contracts using hedge accounting. As a result these instruments are measured at fair value with changes in fair value recognized in earnings.

The Company incurs costs in New Israeli Shekels which exceed the natural hedge provided by inflows in this currency. During fiscal 2009, the Company initiated a hedging program to manage this net foreign currency using forward foreign exchange contracts. The timing and amount of these forward foreign exchange contracts is based on expected future cash outflows. The Company applies hedge accounting to these forward contracts. As a result these instruments are measured at fair value with the effective portion of the change in fair value initially recorded in other comprehensive income and reclassified to the consolidated statements of operations in the same period that the hedged anticipated transaction affects earnings.

# Sandvine Corporation

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The following table summarizes the Company's commitments to buy and sell foreign currencies under foreign exchange forward contracts, all of which have a maturity date of less than one year, as at November 30, 2009:

Designation	Currency Sold	Currency Bought	Notional Amount Sold	Weighted Average Rate
<b>2009</b>				
Held for trading	USD	CAD	9,580	1.0581
Held for trading; cash flow hedges	CAD	ILS	2,566	3.4175
<b>2008</b>				
Held for trading	USD	CAD	11,000	1.2400

Management estimates that a loss of \$113 would be realized if these forward contracts were terminated on November 30, 2009 (2008 – gain of \$39). Forward contracts designated as cash flow hedges have unrealized losses of \$119, which are recorded in accumulated other comprehensive income (loss) (“AOCI”) (2008 - \$nil). The net losses included in AOCI will be reclassified to net loss within the next twelve months and are expected to offset the impact of foreign exchange fluctuations on the underlying hedged items. All hedging relationships are formally documented, including the risk management objective and strategy. On a monthly basis, an assessment is made as to whether the designated derivative financial instruments have been and continue to be effective in offsetting changes in cash flows of the hedged transactions.

An unrealized gain of \$6 on forward contracts not designated as hedges is included in net loss which offsets losses recorded on the foreign denominated items, namely accounts payable and accounts receivable (2008 - \$39).

The Company has assessed the net foreign currency exposure of its foreign denominated financial instruments relative to the Canadian dollar. A fluctuation of +/- 5%, provided as an indicative range in a volatile currency environment, would, with all other variables held constant, have an effect on accumulated other comprehensive income for the year ended November 30, 2009 of approximately +/- \$129 (2008 - \$nil) and on net loss for the year ended November 30, 2009 of approximately +/- \$339 (2008 - \$233).

For the year ended November 30, 2009, general and administrative expenses included a foreign exchange loss of \$317 (2008 – gain of \$712).

### *Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to interest rate risk mainly arises from the interest rate impact on its marketable securities. The Company's marketable securities are comprised of various interest bearing securities with fixed interest rates and varying maturities. The Company's objective with regard to these investments is to minimize liquidity and credit risk while maximizing the interest income earned. The Company only invests in marketable securities that have remaining maturities one year or less at the date of purchase. The Company believes that fluctuations in interest rates do not have a significant impact on the fair value of its marketable securities due to the short term maturity of its marketable securities. The Company does not use financial instruments to mitigate this interest rate risk. During 2009, there were no significant changes to the Company's exposure to interest rate risk, or its

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

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objectives and policies to manage these risks. Recognized interest income for the Company's marketable securities for the year ended November 30, 2009 was \$639 (2008 - \$3,194).

At November 30, 2009, a change in interest rates of +/- 100 basis points, which is indicative of the change in the prime lending rate over the preceding twelve month period, with all other variables held constant, net loss for the period ending November 30, 2009 would be +/- \$26 arising from changes to forward rates used to value foreign currency forward contracts (2008 - \$19). Other comprehensive income would have been +/- \$298 arising mainly as a result of increasing fair values for fixed rate financial assets classified as available for sale (2008 - \$39).

### *Credit risk*

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss being incurred by the Company. Recent events in the global financial markets continue to have an impact on the global economic environment. These events are not directly related to the Company or the industry in which it operates, however, there may be an impact on the Company over the course of time. It is possible that reduced economic activity may adversely affect the Company's operating results and financial condition through, among other matters, increased credit risk surrounding the Company's financial instruments.

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. The Company's objective with regard to credit risk in its investing activities is to limit its short term investments to those that meet or exceed specific credit ratings. The Company's objective with regard to credit risk in its operating activities is to reduce its exposure to losses. During 2009, there were no significant changes to the Company's exposure to credit risk, or its objectives and policies to manage these risks. 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 asset or face value of open derivative financial instruments. The Company minimizes the credit risk of balances with banks and currency forward contracts by depositing with or transacting with Schedule 1 banks in Canada and reputable financial institutions in other countries and monitoring the credit risk, including counterparty credit risk, of these financial institutions. Significant levels of cash are not held in financial institutions outside of Canada. The Company believes its counterparty credit risk is not significant. The Company minimizes its credit risk of cash equivalents and marketable securities by only 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 November 30, 2009 no one issuer represented more than 33.5% of the total marketable securities (2008 - 34.3%). The Company minimizes its credit risk of its accounts receivable and other receivables by performing credit reviews for each of its customers, routinely reviewing the status of individual accounts receivable balances and contacting customers who have overdue balances.

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As at November 30, 2009, three companies, with greater than ten percent concentration in accounts receivable, accounted for 41.3% of the Company's total accounts receivable (2008 – four; 88.1%). The Company's allowance for doubtful accounts is not significant. Of the Company's accounts receivable, \$3,670 was past due as of November 30, 2009 (2008 - \$8,352). The definition of items that are past due is determined by reference to terms agreed with individual customers. Of the overdue balances at November 30, 2009, \$3,088 has been subsequently collected (2008 - \$7,901). As at January 14, 2010, the remaining overdue balances are as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
0 – 30 days past due	421	5
31 – 60 days past due	-	345
61 – 90 days past due	146	48
Greater than 91 days past due	15	53
	<hr/>	<hr/>
	582	451
	<hr/>	<hr/>

No material 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 these balances are not fully collectible in the future.

The Company's accounts receivable could be sensitive to changing market risk conditions in particular geographic regions. Accounts receivable is attributed to geographic regions based on the location of the reseller, when applicable. The geographic allocation of the Company's accounts receivables is as follows:

	<b>2009</b>	<b>2008</b>
	%	%
United States	33.0	30.5
United Kingdom	20.6	-
Japan	10.7	10.8
China	8.3	51.1
Other	27.4	7.6
	<hr/>	<hr/>
	100.0	100.0
	<hr/>	<hr/>

### *Liquidity risk*

Liquidity risk is the risk that the Company will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset. 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

# Sandvine Corporation

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marketable securities in excess of anticipated needs. The Company invests in marketable securities which are highly liquid, which enables their use to meet financial obligations if necessary. During 2009, there were no significant changes to the Company's exposure to liquidity risk, or its objectives and policies to manage these risks. A summary of the Company's other financial liabilities at November 30, 2009 are as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
Due within 1 month	6,875	5,840
Due later than 1 month and not later than 3 months	2,966	2,148
Due later than 3 months and not later than 1 year	646	564
	<hr/>	<hr/>
	10,487	8,552
	<hr/>	<hr/>

## 10 Capital Management

In the management of capital, the Company considers shareholder's equity, excluding accumulated other comprehensive income and the balance of purchase price or earn out obligations of its acquisitions (note 12) to be capital. 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 to 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.

## 11 Income taxes

The provision for (recovery of) income taxes consists of the following:

	<b>2009</b>	<b>2008</b>
	\$	\$
Current		
Canadian	-	-
Foreign	165	100
	<hr/>	<hr/>
	165	100
Future		
Canadian	-	1,075
Foreign	(196)	(179)
	<hr/>	<hr/>
	(196)	896
	<hr/>	<hr/>
	(31)	996
	<hr/>	<hr/>

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The current provision primarily relates to taxes owing by the Company's foreign subsidiaries.

The difference between the amount of the provision for (recovery of) income taxes and the amount computed by multiplying income before income taxes by the statutory Canadian rate is reconciled as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
Combined federal and provincial tax rate	31.04%	33.72%
Expected tax recovery	(6,068)	(6,285)
Foreign tax rate differences	2,544	(1,300)
Enacted tax rate changes	1,353	-
Goodwill impairment	753	-
Stock based compensation and other differences	2,248	2,617
(Decrease) / increase in valuation allowance	(861)	5,964
	<u>(31)</u>	<u>996</u>

The tax effects of significant temporary differences are as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
<b>Assets</b>		
Share issuance costs	587	1,183
Research and development incentives	7,354	3,069
Tax losses	1,518	6,373
Deferred revenue	1,012	720
	<u>10,471</u>	<u>11,345</u>
Less: Valuation allowance	7,166	8,423
	<u>3,305</u>	<u>2,922</u>
<b>Liabilities</b>		
Plant and equipment	2,356	1,802
Intangible assets	949	1,316
	<u>-</u>	<u>(196)</u>
<b>Net carrying value</b>		
	<u>-</u>	<u>(196)</u>
The allocation is as follows:		
Current future tax asset	-	-
Non-current future tax liability	-	196
	<u>-</u>	<u>(196)</u>

In assessing the value of the future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is dependent upon future taxable income. Management considers the likelihood of future profitability, the character of the tax assets and any applicable tax planning strategies to make this assessment. To the extent that management believes that the realization

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of future tax assets do not meet the more likely than not criterion, a valuation allowance is provided against the future tax assets.

During the year ended November 30, 2008, the Company determined that it was no longer able to conclude, based on the assessment of available evidence, that it was more likely than not that its future tax assets associated with temporary differences and unused loss carry forwards would be realized. As a result, the Company increased its valuation allowance against its future tax assets which resulted in the recognition of a future tax expense of \$1,075 on the consolidated statement of operations.

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 investment tax credits, tax loss carry forwards and undeducted scientific research and experimental development deductions ("SR&ED") which expire as follows:

	<b>Investment tax credits</b>	<b>Tax loss carry forwards</b>	<b>Undeducted SR&amp;ED</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
2022	247	-	-
2023	628	-	-
2024	140	-	-
2025	513	-	-
2026	1,299	-	-
2027	2,497	2,857	-
2028	3,429	504	-
2029	3,170	649	-
Unlimited	-	-	25,501
	<hr/>	<hr/>	<hr/>
	11,923	4,010	25,501

The Company has not recognized the benefit associated with its non-refundable investment tax credits.

One of the Company's subsidiaries has foreign net operating loss carry forwards of US\$3,129 (CDN\$3,309) that are subject to a cumulative limitation of US\$189 (CDN\$200) per annum. As at November 30, 2009, the Company has not recognized the benefit related to US\$2,105 (CDN\$2,226) of these losses.

In addition, the Company has net operating loss carry forwards of NIS 39,387,242 (CDN\$10,989) in a foreign jurisdiction in which the Company has been granted a 10 year tax holiday. The Company expects that during the period these tax losses are utilized, its income will be subject to a nil tax rate and the earnings will not be repatriated. Accordingly, the Company has not recognized the tax benefit associated with these losses.

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, as these earnings are intended to be reinvested indefinitely.

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### 12 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	400,259	250	-	-	250
Transfer from contributed surplus	-	56	-	-	56
Issued as compensation on business acquisition	-	318	-	-	318
Cancelled due to working capital adjustment on business acquisition	(51,380)	-	-	-	-
Cancelled from the key employee escrow	(2,798)	(6)	-	-	(6)
Repurchased	(1,946,683)	(2,083)	-	-	(2,083)
<b>Balance, November 30, 2008</b>	135,381,698	144,713	1	390	145,103
Issued under the employee stock option plan	230,423	127	-	-	127
Transfer from contributed surplus	256,523	1,330	-	-	1,330
Issued as compensation on business acquisition	-	260	-	-	260
Cancelled from the key employee escrow	(5,913)	-	-	-	-
<b>Balance, November 30, 2009</b>	135,862,731	146,430	1	390	146,820

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 issuance of this warrant was a non-cash transaction. The Company determined that the fair value of the warrant was \$390 at the time of issue.

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On June 30, 2007, the Company acquired all of the outstanding shares of Simplicita Software, Inc. (“Simplicita”), a provider of subscriber mediation software for IP networks, for consideration of 643,395 common shares of the Company valued at approximately \$3,423. In addition to the purchase consideration, common shares were issued and allocated to a key employee escrow to be released over time contingent on the continued employment of certain individuals over a three year period. On April 24, 2009, the Company cancelled 5,913 shares under the terms of the escrow agreement. Net of share cancellations, 163,192 shares were issued and allocated to the key employee escrow. During the year ended November 30, 2009, the Company released 53,592 shares. The Company will recognize up to a maximum of \$825 as non-cash compensation expense over the period in which the services are rendered. During the year ended November 30, 2009 the Company recognized \$260 as compensation expense relating to this key employee escrow (2008 - \$312). As at November 30, 2009 the maximum remaining non-cash compensation to be recognized is \$115.

During the year ended November 30, 2009, the Company issued 256,523 common shares relating to additional contingent consideration available to specified Simplicita employees on the achievement of certain performance targets, and who continued their employment with the Company through to November 30, 2008. The Company recorded \$1,298 of non cash compensation cost (representing 256,523 common shares) related to this contingent consideration during the year ended November 30, 2008.

On April 14, 2009, the Company obtained the necessary regulatory approvals from the Toronto Stock Exchange (“TSX”) to repurchase up to 10,173,673 common shares. This represents approximately 7.5% of the Company’s outstanding shares as of the date of approval. During the year ended November 30, 2009 no common shares were repurchased by the Company (2008 - 1,946,683 common shares repurchased at a total cost of \$2,206).

During the year, the Company issued 230,423 common shares for cash proceeds of \$127 as a result of option holders exercising their options (2008 – 400,259 common shares for net proceeds of \$250).

The Company has a trust vehicle to facilitate its employee share ownership program and hold shares of the Company allocated to individual employees. This trust is considered to be a variable interest entity and has been consolidated by the Company. Included in the outstanding common shares of the Company as of November 30, 2009 are 12,010 unvested common shares which are held by the trust (2008 – nil).

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### 13 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 November 30, 2009, there were 3,513,173 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 year		
Granted	2,902,175	1.93
Forfeited	(674,351)	3.12
Exercised	(400,259)	0.62
<b>Options outstanding, November 30, 2008</b>	9,667,528	2.22
Option activity for the year		
Granted	2,377,250	0.97
Forfeited	(636,255)	2.45
Cancelled	(780,000)	5.74
Exercised	(230,423)	0.55
<b>Options outstanding, November 30, 2009</b>	10,398,100	1.69

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### Stock based compensation

Stock based compensation (related to the Company's stock option plan) recognized for the year ended November 30, 2009 was \$4,722 with a corresponding credit to contributed surplus (2008 - \$2,745). Of the stock based compensation expense for the year ended November 30, 2009, \$1,695 relates to the surrender of 780,000 options by certain employees for no consideration. Previously recognized compensation expense of \$32 relating to options exercised during the year has been transferred from contributed surplus to share capital (2008 - \$56).

	2009	2008
Number of options granted/assumed	2,377,250	2,902,175
Weighted average Black-Scholes value of each option	\$0.84	\$1.61
Assumptions		
Risk free interest rate	2.82%	3.80%
Expected life in years	8.48	10
Expected dividend yield	0%	0%
Volatility	99.76%	91.22%

The following table summarizes information regarding stock options outstanding at November 30, 2009:

Options Outstanding				Options Exercisable	
Range of exercise price \$	Number outstanding	Weighted average contractual life (years)	Weighted average exercise price \$	Number outstanding	Weighted average exercise price \$
0.40 - 0.82	4,022,282	4.95	0.62	3,034,851	0.57
1.05 - 2.53	4,844,933	8.33	1.47	1,310,159	1.98
4.11 - 5.50	956,204	7.83	4.35	411,070	4.39
6.59 - 6.95	574,681	7.68	6.69	261,851	6.69
0.40 - 6.95	10,398,100	6.94	1.69	5,017,931	1.57

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

November 30, 2009

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

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### 14 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 \$1,000 operating line to provide letters of credit and a \$2,500 contingency 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 plus 0.5%. Marketable securities with a carrying value and fair value of \$3,500 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 of the Company. The facility and the related security will remain in effect until the facility, which has no term, is terminated.

As of November 30, 2009 the Company had issued four letters of credit under its operating line. The individual letters of credit were; US\$203 (CDN\$215) expiring February 11, 2010, US\$16 (CDN\$17) expiring July 24, 2010, US\$292 (CDN\$308) expiring July 15, 2011 and US\$79 (CDN\$84) expiring August 31, 2011.

### 15 Lease commitments

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

	\$
2010	837
2011	619
2012	235
Thereafter	-
	<hr/>
	1,691
	<hr/>

### 16 Accumulated other comprehensive income

	2009	2008
	\$	\$
Accumulated net unrealized gains on available for sale financial assets	29	46
Accumulated unrealized net loss on derivative financial instruments designated as cash flow hedges	(119)	-
	<hr/>	<hr/>
Total accumulated other comprehensive income (loss)	(90)	46
	<hr/>	<hr/>

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

November 30, 2009

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

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### 17 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. Royalties are charged at 2.5% of the Company’s gross revenues. The obligation to pay royalties expires on November 30, 2013. During the year ending November 30, 2009, the Company recognized \$1,722 (2008 - \$1,277) 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 \$4,358 under the agreement.

A subsidiary of the Company participates 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% - 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 Company recognized the fair value of the contingent obligation as an element of the purchase price equation upon acquisition, and is currently carrying a contingent obligation of \$118 USD (\$125 CAD) within “Accounts payable and accrued liabilities”. During the year ended November 30, 2009, the subsidiary received additional funding of \$723 USD (\$885 CAD) under these programs. As of November 30, 2009, the subsidiary has received cumulative grants of \$1,576 USD (\$1,736 CAD) and has paid total royalties of \$197 USD (\$240 CAD) under the agreement.

Non repayable government assistance recorded during the year of \$1,000 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 assistance and repayments, together with investment tax credits, have been applied to research and development expense as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
Research and development	28,162	25,921
Government repayments	1,722	1,277
Investment tax credits / government assistance	(2,203)	(1,026)
	<u>27,681</u>	<u>26,172</u>

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

November 30, 2009

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

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### 18 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 management equipment and solutions for broadband service providers. Selected financial information is as follows:

	<b>2009</b>	<b>2008</b>
	\$	\$
Sales		
Canada	4,589	1,975
United States	31,437	29,061
Caribbean and Latin America	5,776	5,790
Europe, Middle East and Africa	17,562	11,010
Asia Pacific	9,484	3,248
	<hr/>	<hr/>
	68,848	51,084
	<hr/>	<hr/>
	<b>2009</b>	<b>2008</b>
	%	%
Sales		
Canada	6.6	3.9
United States	45.7	56.8
Caribbean and Latin America	8.4	11.3
Europe, Middle East and Africa	25.5	21.6
Asia Pacific	13.8	6.4
	<hr/>	<hr/>
	100.0	100.0
	<hr/>	<hr/>

In situations where a sale is made through a reseller, revenue associated with that sale is attributed to the geographic location of the end customer.

Major customers are customers which represent more than 10% of total revenues for a given period. For the year ended November 30, 2009 one major customer represented 15.3% of total revenue (2008 – two customers, 38.7%).

# Sandvine Corporation

## Notes to the Consolidated Financial Statements

November 30, 2009

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

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	2009	2008
	\$	\$
Plant and equipment, intangibles and goodwill		
Canada	13,535	12,988
United States	2,232	3,968
Europe, Middle East and Africa	2,480	4,873
	<hr/>	<hr/>
	18,247	21,829
	<hr/>	<hr/>
Total assets		
Canada	130,728	140,731
United States	2,377	4,123
Europe, Middle East and Africa	3,164	5,198
	<hr/>	<hr/>
	136,269	150,052
	<hr/>	<hr/>

### 19 Supplemental cash flow information

For the year ended November 30, 2009 the Company paid \$107 for income tax in cash (2008 - \$250). The Company did not pay any interest in cash during the year ended November 30, 2009 (2008 - \$nil).

### 20 Comparative figures

Certain of the comparative figures have been reclassified to conform to the current year presentation.