

**Keynote Systems**  
**Fourth Quarter and Year-end Fiscal 2006 Results Conference Call**  
**Tuesday, October 31, 2006**

**I. Operator**

- A. Good afternoon, everyone, and welcome to Keynote's conference call for the fourth quarter and year-end of fiscal year 2006, ending September 30, 2006. Today's call is being recorded.
- B. At this time, I would like to turn the call over to Kirsten Chapman for opening remarks and instructions.

**II. Kirsten Chapman – Lippert/Heilshorn & Associates – IR Contact**

- A. Thank you. Good afternoon, everyone, and welcome to Keynote's conference call for the fiscal 2006 fourth quarter and year-end, ended September 30, 2006. I am here today with Umang Gupta, Chairman and Chief Executive Officer; and Drew Hamer, Chief Financial Officer. Umang and Drew will review our accomplishments for the quarter and then will be available to answer questions.
- B. Hopefully, by now, you have seen our press release that was distributed over Business Wire and the major wire services. For your convenience, the press release has also been posted on our website at [www.keynote.com](http://www.keynote.com). The replay of this call will be available by telephone by dialing 800-642-1687 -- the pass code is #8354422 -- or by webcast at the investor relations section of our website at [www.keynote.com](http://www.keynote.com).
- C. I would like to remind you that statements made during the course of this call that are not purely historical are forward-looking statements regarding the Company or management's intentions, hopes, beliefs, expectations and strategies for the future. Because such statements deal with future events, they are subject to various risks and uncertainties, and actual results might differ materially from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in today's press release and in the Company's annual and quarterly reports filed with the SEC.
- D. We have provided detailed guidance in our earnings release today, as we have in prior quarters. This guidance assumes no additional acquisitions or other significant or extraordinary transactions, other than those described in our earnings release. We will not comment on this guidance during the quarter, but may provide an update to this guidance in the event of material changes during the quarter.

- E. Before the company reviews the financials, I will review definitions for some metrics, which are not in accordance with generally accepted accounting principles, commonly known as GAAP.
  - 1. The company defines non-GAAP net income as net income adjusted for provision for income taxes and cash tax expense, stock-based compensation, and amortization of purchased intangibles and for in-process research and development associated with acquisitions. Non-GAAP net income per diluted share equals non-GAAP net income divided by the weighted basic or diluted share count as of that period end depending on whether there is a loss or income, respectively.
  - 2. Keynote's SIGOS revenue recognition policy requires the amortization of most of Keynote SIGOS' software license revenues over an approximate 24 month period. Therefore, Keynote's consolidated GAAP and non-GAAP earnings are likely to remain negative until quarterly GAAP revenues normalize with quarterly billings. Consequently, cash provided by operating activities, free cash flow and deferred revenue will be important metrics to measure Keynote's financial performance during that period.
  - 3. Free cash flow is defined as cash flow from operations less cash used for purchases of property, equipment, and software.
- F. Now, I would like to introduce Umang Gupta, Chairman and CEO of Keynote, who will review the company's quarterly highlights. Then Drew Hamer, Chief Financial Officer of Keynote, will provide the financial details for the quarter and the year, and guidance for first quarter 2007. After Umang will summarize the company's vision and open the call for questions. Please go ahead Umang.

**III. Umang Gupta – Keynote Systems, Inc. – Chairman, CEO**

- A. Thanks Kirsten. Welcome, everyone, and thank you for joining us today.
- B. We are extremely pleased with our fourth quarter revenue of \$15.2 million, as recent changes we implemented in sales and marketing drove growth across all of our business segments.
- C. As noted in our press release today, we have renamed the three components of our business to Internet Test and Measurement, Customer Experience Test and Measurement, and Mobile Test and Measurement to better reflect our focus on global test and measurement for mobile communications and Internet performance.
  - 1. Our Internet business includes all of our Internet measurements, monitoring and management services, comprising our traditional benchmarking services, enterprise

private agent solutions, Voice over IP, streaming, load testing and professional services engagements.

2. This quarter, Internet Test and Measurement revenue grew to \$10.2 million, the highest level in the past five years. If you look within our Internet subscriptions business, you'll find our multi-page and broadband measurements grew approximately 25 percent compared to the corresponding quarter a year ago. This compares to our legacy single page, single device business, which declined by 21 percent. Our customers today are demanding in greater numbers our advanced products, such as Application Perspective®, Transaction Perspective®, Streaming Perspective® and, increasingly, Voice Perspective®. These products currently make up 62 percent of our overall Internet subscriptions, compared to 51 percent in the prior year quarter.
  3. Our Internet engagements revenue increased to \$1.1 million, up 54 percent compared to last quarter, primarily due to many companies utilizing our load testing services in advance of the anticipated online holiday buying season.
  4. In the fourth quarter, key Internet deals included Chevron Texaco, McKinsey & Co., and Research in Motion.
- D. Our Mobile Test and Measurement revenue was \$2.4 million for the fourth quarter, compared to \$1.9 million in the prior quarter. Total deferred revenue increased by approximately \$900,000, most of which was driven by Keynote SIGOS. We also saw increased demand for our Mobile Device and Application Perspective® services.
1. Customer wins in the fourth quarter for Keynote Mobile Perspective services included MobiTV. We also were awarded major orders from Agilent for Keynote SIGOS' systems to meet mobile project needs at Telstra, Australia's leading telecommunications and information services company, and Bharti Airtel, India's leading provider of mobile telecom services.
  2. The SIGOS acquisition has significantly contributed to our overall Mobile business growth, and we also believe that SIGOS business' growth has been positively impacted by being a part of the Keynote family. Our stability, public company status, and quality reputation with customers has enabled the mobile business to attract and close certain deals faster than when SIGOS was a standalone company.
  3. We are very pleased with the progression of Keynote SIGOS, and continue to see success in our efforts at leveraging our customer base and our brand to bring Keynote SIGOS' products to market across the world.

- E. Now, I want to provide an update on our Customer Experience Test and Measurement business, or CEM:
1. As you are aware, we have been making adjustment to our sales and marketing strategies to improve our revenue performance in this area. This quarter, we began to experience the initial benefits from these efforts.
    - a) Notable, was the recent appointment of Don Aoki as Senior Vice President and General Manager of the CEM group. Don has been with Keynote for over eight years as a senior executive and has served in various positions, including VP of Engineering, SVP of Product and Operations, and head of corporate development. His leadership has already started to have an impact in the CEM group; we are seeing higher morale, higher revenues and low attrition. Our CEM revenue of \$2.6 million this quarter is a good start to getting us back on track to our historical levels and beyond. Additionally Don is keeping a close eye on expenses, and I am happy to report we achieved a 51 percent gross margin this quarter.
    - b) Our CEM group signed a number of deals this quarter, with key customers including Best Buy, Check Free Services, Merrill Lynch and MTV Networks.
  2. As we shared with you on our last conference call, our goal is to transform CEM into “software as subscription – plus consulting.” Our WebEffective™ product, Version 5.0, is currently slated for launch in the middle of November. This new version will offer a fully self-service functionality, which is expected to increase the license subscription component. It is worth noting that in the most recent quarter, the total CEM subscriptions revenue was \$647,000, which is the highest it has ever been since we entered this business.
- F. Before I turn the call over to Drew, I want to highlight a couple of other key products we will be releasing this quarter.
1. We are focusing on the upcoming launch of Transaction Perspective®, version 7.0, which features advanced Web diagnostics, last mile performance, and increased value for the same price. With Transaction Perspective 7.0, we believe we now offer the industry’s most advanced Internet measurement service for capturing the true experience of Web 2.0 applications across the globe.
  2. We will also be releasing Mobile Device Perspective®, version 2.0, which we recently demoed at CTIA. This new service will provide both automated monitoring and interactive testing capability, using real handsets from multiple locations and multiple operators across the world.

3. Finally, as part of our aggressive move to refresh the Keynote brand, this morning we launched a new website that details Keynote's value proposition for our four solution areas: Mobile Quality, Web Performance, VoIP & Streaming, Customer Experience/UX and our new endorsed brand Keynote Competitive Research. We encourage you to visit [WWW.KEYNOTE.COM](http://WWW.KEYNOTE.COM). An important new element of this campaign is to convey that Keynote is not just the pioneer of Internet performance measurement, but today is the global test and measurement leader for mobile communications and Internet performance.
- G. In summary, all our business segments did well last quarter. Keynote SIGOS is contributing strong growth to our business and our subscription services revenue continue to show positive traction. We are optimistic about our growth opportunities in fiscal 2007. I'll now turn the call over to Drew Hamer, our Chief Financial Officer.

**IV. Drew Hamer – Keynote Systems, Inc. – CFO, VP of Finance**

- A. Thank you Umang.
- B. Now I will review the financial details for the quarter and the year.
  1. Our total revenue for the September quarter was \$15.2 million, compared to \$13.5 million in the same period last year and \$13.9 million last quarter. Total subscription services revenue was \$12.2 million or 80 percent of total revenue for the quarter, which is the highest amount of subscription revenue for the quarter in the past five years. Subscription revenue posted a 22.7 percent increase compared to the same period last year and a 6.1 percent increase compared to last quarter, reflecting greater demand for transaction, broadband and mobile monitoring services, as well as the Keynote SIGOS acquisition. Professional services revenue was \$3.0 million, or 20 percent of total revenue for the quarter, and declined 15 percent compared to last year and increased 25 percent compared to last quarter.
- C. Now, I will discuss our customers.
  1. Our customer count was approximately 2,600 companies at the end of September – up from over 2,300 from September 30, 2005 and consistent with 2,600 at the end of June. Excluding Keynote SIGOS, the number of customers that purchased in the recently completed quarter, on an annualized basis, at least \$100,000 or more of our services was 79, AND the percentage of revenue from these customers was 73 percent. In the fourth quarter of 2005 and the third quarter of 2006, we had 83 and 71 customers

purchasing over \$100,000 on an annualized basis, representing 71 percent and 70 percent of revenue, respectively.

2. At the end of September 2006, we measured over 10,000 pages through our Internet Test and Measurement business, which we previously referred to as Service Level Management (SLM) subscription services. This compares to 8,307 in the quarter a year ago and 9,671 last quarter. For the fourth quarter 2006, overall average monthly revenue per page for the quarter was \$235, compared to \$246 and \$235 for the quarter a year ago and last quarter, respectively.

D. Now, I'll review our expenses.

1. Total expenses were \$18.4 million, including \$1.1 million in stock-based compensation expenses and a \$771,000 charge for amortization of intangible assets. Last quarter, total expenses were \$18.1 million, including \$925,000 of stock-based compensation expenses, a \$798,000 charge for amortization of intangible assets and an \$840,000 charge for in-process research and development associated with the SIGOS acquisition. In the fourth quarter 2005, total expenses were \$12.7 million, which did not include any stock-based compensation expenses. The increases in expenses are primarily due to the Keynote SIGOS acquisition and investments that we are making in Keynote's sales and marketing infrastructure.

E. Now, I'll discuss the effect of certain annual income taxes related adjustments.

1. For the period ended September 30, 2006, we had a \$3.9 million charge for the adjustment of net deferred tax assets on our balance sheet. Last year for the period ending September 30, 2005, we recorded \$3.1 million benefit for the corresponding adjustment.

F. For the fourth quarter of fiscal year 2006, the net loss was \$6.0 million, or \$0.35 per share, on a GAAP basis, which included the aforementioned charges. For the fourth quarter of fiscal year 2005, the net income was \$4.3 million, or \$0.21 per diluted share, on a GAAP basis, which included the income tax benefit associated with the partial recognition of net deferred tax assets. The non-GAAP net loss for the quarter was \$797,000, or \$0.05 per share, compared to non-GAAP net income of \$2.2 million, or \$0.11 per diluted share, for the same quarter a year ago.

G. Now, moving to the balance sheet and our cash performance metrics,

1. At September 30, 2006, our cash and short-term investments balance was \$90.8 million. Please note this was after we acquired SIGOS for approximately \$30.0 million in cash on April 3<sup>rd</sup>.

2. For the quarter, cash provided by operating activities was \$1.3 million, compared to \$3.6 million for the same period last year.
  3. We invested \$874,000 in property, equipment and software this quarter and \$1.2 million in the same quarter last year.
  4. Also, we generated free cash flow of \$415,000 for the quarter, compared to \$2.4 million for the fourth quarter of 2005.
  5. During the fourth quarter, we repurchased approximately 624,000 shares for approximately \$6.6 million. As we mentioned in the press release, as of this quarter, we have completed the stock buyback program. In total, Keynote has spent \$135.3 million in the last six years under its stock repurchase program to purchase a total of 14.3 million shares.
- H. As of September 30, 2006, accounts receivable net was \$7.1 million. DSOs were 43 days and 98 percent of accounts receivable were less than 90 days old.
- I. Long and short term deferred revenue at September 30, 2006 was \$10.6 million, up 9 percent compared to \$9.7 million at June 30, 2006 and up 71 percent from \$6.2 million at September 30, 2005.
- J. For the full year ending September 30, 2006:
1. Total revenue was \$55.5 million.
  2. We generated \$10.7 million in cash from operations and \$7.6 million in free cash flow.
  3. GAAP net loss for the year was \$7.5 million, or \$0.41 per share, which included the aforementioned \$3.9 million charge associated with net deferred tax assets, \$3.7 million in stock-based compensation expenses, a \$2.4 million charge for intangible assets amortization and an \$840,000 charge for in-process research and development associated with the SIGOS acquisition.
  4. Non-GAAP net income for fiscal year 2006 was \$2.0 million or \$0.10 per diluted share.
- K. Now, I would like to provide some general guidance for the December 2006 quarter. The company consolidated Keynote SIGOS' financial reporting under U.S. GAAP rules starting April 3, 2006. U.S. GAAP requires Keynote SIGOS' system license revenue to be ratably recognized over the initial duration of each customer contract, which averages approximately twenty-four months. As a result, Keynote will be able to recognize as revenues only a fraction of Keynote SIGOS sales during fiscal 2006 and 2007. Accordingly, the acquisition will be dilutive to Keynote's U.S. GAAP net income, although cash flow from operations is expected to be positive throughout.

- L. That said, management is providing the following guidance for the 2007 fiscal first quarter ending December 31, 2006:
  - 1. Total revenue is expected to be between \$15.0 million and \$15.5 million.
  - 2. Net loss per share is expected to be between \$0.06 and \$0.09.
  - 3. Non-GAAP loss per share is expected to be between \$0.01 and \$0.04.
  - 4. Cash provided by operating activities is expected to be between \$2.0 million and \$2.5 million.
  - 5. Free cash flow is expected to be between \$1.0 million and \$1.5 million.
- M. The above guidance was based on the following assumptions:
  - 1. Total stock-based compensation expense and amortization of intangible assets is expected to be approximately \$1.8 million.
  - 2. Interest income, net is expected to be approximately \$1.0 million, assuming no material changes in interest rates.
  - 3. Cash paid for income taxes is expected to be approximately \$550,000.
  - 4. And basic weighted average shares outstanding are expected to be approximately 17.1 million shares.
- N. With that, I would like to return the call to Umang.

## **// Umang Gupta – Close**

- A. Thank you Drew.
- B. Over the past few years, our goal has been to position Keynote to take advantage of new opportunities presented by the rapidly evolving Internet and mobile markets. In the last year, we've made great progress on this goal with significant technology enhancements across our flagship products in Internet Performance, Customer Experience and Mobile Testing. During fiscal 2006, we furthered our strategy by completing the very exciting acquisition of SIGOS in the rapidly expanding Mobile industry. Additionally, we made internal investments. We saw the results in the fourth quarter through organic growth in revenue across all of our segments.
- C. We continue to be a strong generator of cash flow. For the fiscal year 2006, we generated cash flow from operations of \$10.7 million and free cash flow of \$7.6 million. As a matter of fact, Keynote has generated cash flow from operations of over \$40 million and free cash flow of nearly \$30 million in the aggregate over the past four years. These cash flows have supported our acquisition strategy and buy back strategy for our stock.

- D. We ended fiscal 2006 with a revenue run rate exceeding \$15 million per quarter, the highest in the company's history. We are continuing to lead in developing innovative test and measurement technologies for Web 2.0 and have broadened our scope to include Mobile quality test and measurement. We closed fiscal 2006 on a strong note demonstrating growth in each of our business segments. We are now seeing early signs from our customers that our investments should pay off well in the coming years.
- E. Now, Drew and I would be more than happy to take any questions you have. Thank you.

**V. Operator Runs Q&A**

**VI. Umang Gupta – Close**

Thank you again for joining us today. As usual, we appreciate your support. Drew will be conducting investor meetings in November, including the AeA Conference on November 7<sup>th</sup> and 8<sup>th</sup> as well as the UBS 2006 Global Communications & Technology Conference on November 15<sup>th</sup> in New York, and we hope to see some of you there.