

Keynote Systems
First Quarter Fiscal 2007 Results Conference Call
Tuesday, January 30, 2007

I. Operator

- A. Good afternoon, everyone, and welcome to Keynote's conference call for the first quarter of fiscal year 2007, ending December 31, 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 2007 first quarter ended December 31, 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. The replay of this call will be available by telephone by dialing 800-642-1687 -- the pass code is #5680745 -- or by webcast at the investor relations section of our website at 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. 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 first quarter, and guidance for second quarter 2007. Afterwards, 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 have posted a great start to fiscal 2007; First quarter results exceeded all of our previous guidance. We believe our strong financial results are the culmination of improved execution and strong market opportunity – especially in Mobile Testing, which is served by Keynote SIGOS.
 - 1. Total first quarter revenue reached \$15.8 million, increasing 15 percent compared to the same period last year. Total net deferred revenue reached \$14.7 million increasing over 140 percent compared to the same period last year. And our gross deferred revenue, defined as sum of net deferred revenue and unpaid deferred revenue, reached \$23.6 million, up 185 percent compared to the same period last year. When one looks at our gross deferred revenue increase during the past quarter of almost \$12 million, or 83 percent, it is important to realize that Keynote did even better in terms of new business growth than was reflected purely by our GAAP reported revenues of \$15.8 million. Much of this increased deferred revenue will flow through to our top-line results in the coming quarters.
 - 2. Keynote SIGOS is clearly outperforming our expectations and fueling growth. We are extremely pleased that the increased revenue combined with cost controls we implemented drove cash flow, GAAP income and non-GAAP net income. Providing that Keynote SIGOS continues to perform at the same level as last year for the remainder of the fiscal year 2007, we expect to deliver non-GAAP net income throughout fiscal 2007. Drew will provide more detail in his financial review.
- C. I'll review the operations of each of our businesses: Mobile Test and Measurement; Internet Test and Measurement; and Customer Experience Test and Measurement.
- D. Our Mobile Test and Measurement revenue was \$3.2 million in the first quarter compared to \$2.4 million for the fourth quarter. Additionally, total deferred revenue increased by approximately \$4.1 million during the quarter, most of which was driven by Keynote SIGOS.
 - 1. Keynote SIGOS' solutions supply users with valuable customer data. We replicate the exact mobile network transaction experience - voice or data – and provide detailed performance and quality metrics to enable our customers to make cost-effective decisions to improve their networks and customer service.
 - a) We are thrilled with Keynote SIGOS performance as it has exceeded our expectations and complemented our Mobile Device and Application Perspective® services.

- b) In the last quarter, Keynote SIGOS obtained orders from 14 new customers including major telecom operators across the globe in the following countries: Austria, Australia, Bulgaria, Croatia, Iceland, Luxembourg, Mauritania, Romania, Russia, Slovenia, Spain, South Africa, and The United Arab Emirates. And in the last nine months since the acquisition, Keynote SIGOS has obtained 13 new customers for SITE Test System and 23 new customers for GlobalRoamer.
 - c) Additionally, today we announced an expanded relationship with Vodafone. Our new strategic direct sales team entrenched Keynote as Vodafone's preferred supplier for end-to-end mobile network test and measurement systems in Germany, the UK and Spain, and more than 15 additional countries. With our new worldwide master agreement signed with Vodafone Global, we anticipate a long and fruitful business relationship with one of the largest telecom operators of the world.
2. On to Internet Test and Measurement: This quarter Internet revenue grew to \$10.4 million, above \$10.2 million last quarter.
 3. Our Internet Subscriptions generated \$8.9 million, up from \$8.8 a year ago and down slightly from \$9.1 million last quarter. Our Internet Engagements increased to \$1.5 million from \$1.1 million both a-quarter and a-year ago, reflecting greater acceptance of our load testing services.
 4. In the first quarter, key Internet deals included American Honda, Hallmark Insights, Hertz, McKesson, MTV and Autobytel.
 5. Additionally, in early November, we launched Transaction Perspective® version 7.0. Customer reception has been strong with users citing last mile and high frequency monitoring as useful features.
- E. Now, I will provide an update on our Customer Experience Test and Measurement business, or CEM:
1. CEM revenue was \$2.2 million, compared to \$2.6 million last quarter and \$3.3 million last year. While we were disappointed with the sales of our syndicated Competitive Research studies, our Custom Engagements revenue was the highest in 4 quarters. We also have a plan for increasing the number of competitive studies to be delivered in the second quarter and in the remainder of the fiscal year.
 2. We forged ahead signing a number of deals this quarter including AOL, Expedia, Hilton, HP, MetLife and Union Bank of California.

3. Also our mid-November launch of the WebEffective™ Version 5.0 has received excellent reviews from customers. This version delivers combined benefits of online market research, usability labs and web analytics into a single on-demand solution.
- F. With that, I will 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 December quarter was \$15.8 million, compared to \$13.7 million in the same period last year and \$15.2 million last quarter. Total subscription services revenue was \$12.7 million or 80 percent of total revenue for the quarter. Subscription revenue posted a 29.5 percent increase compared to the same period last year and a 4.6 percent increase compared to last quarter, reflecting greater demand for Keynote SIGOS as well as transaction, broadband and mobile monitoring services. Professional services revenue was \$3.1 million, or 20 percent of total revenue for the quarter, and declined 20 percent compared to last year and increased two percent compared to last quarter.
- C. Now, I will discuss our customers.
1. Our customer count was approximately 2,650 companies at the end of December 2006 – up from approximately 2,300 at December 31, 2005 and approximately 2,600 at the end of September. 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 85, and the percentage of revenue from these customers was 75 percent. In the fourth quarter of 2006 and the first quarter of 2006, we had 79 and 82 customers, respectively, purchasing over \$100,000 on an annualized basis, both representing 76 percent of revenue.
 2. At the end of December 2006, we measured over 10,000 pages through our Internet Test and Measurement business, compared to over 8,800 in the quarter a year ago and over 10,000 last quarter. For the first quarter 2007, overall average monthly revenue per page for the quarter was \$221, compared to \$242 and \$235 for the quarter a year ago and last quarter, respectively.
- D. Now, I'll review our expenses.
1. Total expenses were \$17.7 million, including \$920,000 in stock-based compensation expenses and a \$759,000 charge for amortization of intangible assets. Last quarter,

total expenses were \$18.4 million, including \$1.1 million of stock-based compensation expenses, and a \$771,000 charge for amortization of intangible assets. The reduction in expenses reflects our cost controls and a \$1.1 million decrease in G&A costs relating to reductions in outside auditor and consultancy fees now that the SIGOS acquisition integration is completed. In the fourth quarter 2005, total expenses were \$13.5 million, which included \$796,000 in stock-based compensation expenses.

- E. Now, I'll discuss the effect of certain annual income tax related adjustments.
1. During the quarter ended December 31, 2006, we recorded a \$1.3 million tax benefit, which is reflected in our total net deferred tax liability. This reflects the impact of the FASB-123R on our overall tax rate for the year. For the quarter ended September 30, 2006, we had a \$3.9 million charge for the adjustment of net deferred tax assets on our balance sheet. For the quarter ending December 31, 2005, we recorded a \$732,000 tax provision.
- F. For the first quarter of fiscal year 2007, the net income was \$264,000, or \$0.01 per diluted share, on a GAAP basis, which included the aforementioned charges. For the first quarter of fiscal year 2006, the net income was \$587,000, or \$0.03 per diluted share, on a GAAP basis. For the quarter ending September 30, 2006, the net loss was \$6.0 million, or \$0.35 per share on a GAAP basis, which included the aforementioned charges. The non-GAAP net income for the quarter was \$551,000, or \$0.03 per diluted share, compared to the non-GAAP net loss of \$797,000, or \$0.05 per share, for the quarter ended September 30, 2006 and non-GAAP net income of \$2.4 million, or \$0.12 per diluted share, for the same quarter a year ago.
- G. Now, moving to the balance sheet and our cash performance metrics.
1. At December 31, 2006, our cash and short-term investments balance was \$95.6 million, up from \$90.8 million at September 30, 2006.
 2. For the quarter, cash provided by operating activities was \$5.1 million, compared to \$1.2 million for last quarter.
 3. We invested \$1.1 million in property, equipment and software this quarter and \$874,000 last quarter.
 4. Also, we generated free cash flow of \$4.0 million for the quarter, compared to \$357,000 for the fourth quarter of 2006.
- H. As of December 31, 2006, accounts receivable net was \$7.7 million. DSOs were 45 days and 98 percent of accounts receivable were less than 90 days old.

- I. Total net deferred revenue at December 31, 2006 was \$14.7 million, up 38 percent compared to \$10.6 million at September 30, 2006 and up 144 percent from \$6.2 million at December 31, 2005. As mentioned earlier, gross deferred revenue increased to \$23.6 million at December 31, 2006, up 83 percent compared to \$12.9 million at September 30, 2006 and up 185 percent from \$8.3 million at December 31, 2005.
- J. Also in December, Keynote entered a 10b5-1 stock repurchase plan that will enable the company to repurchase up to 2 million shares by the end of the 2007.
- K. Now, I would like to provide some general guidance for the March 2007 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 second quarter ending March 31, 2007:
 - 1. Total revenue is expected to be between \$16.2 million and \$16.7 million.
 - 2. Net earnings (loss) per diluted share is expected to be between \$(0.02) and \$0.02.
 - 3. Non-GAAP earnings per diluted share are expected to be between \$0.05 and \$0.08.
 - 4. Cash provided by operating activities is expected to be between \$3.0 million and \$3.5 million.
 - 5. Free cash flow is expected to be between \$2.0 million and \$2.5 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 \$400,000.
 - 4. Cash paid to SIGOS' shareholders for acquisition related performance fees under the terms of the acquisition agreement for SIGOS is expected to be approximately \$10.6 million.

5. And basic weighted average shares outstanding are expected to be approximately 17.1 million shares and diluted weighted average shares outstanding are expected to be approximately 17.7 million shares.

N. With that, I would like to return the call to Umang.

V. Umang Gupta – Close

A. Thank you Drew.

B. We were very pleased with our execution during the quarter – we continued to expand our products and services and broaden our customer base. Our Mobile business is growing rapidly, which is supported by continued progress in our Internet subscription and CEM businesses.

C. And our future prospects look quite promising.

1. We believe the Mobile Test and Measurement market is still in its infancy, and its eventual size will be determined by the number of ways people can use mobile technology to improve communications and business. With Keynote SIGOS technology, we are in an excellent position and now have more than 85 customers representing major telecom operators worldwide.
2. As these companies continue to increase penetration rate and number of mobile applications offered – their need for testing will only grow. Cell phones have become ubiquitous and essential for consumers and for businesses. As our customers serve these end users and as Mobile content and services continue to proliferate, our telecom customers must differentiate themselves. Poor customer experience is not an option. Keynote SIGOS stands ready to provide solutions to ensure a high quality mobile experience.
3. Complementing Keynote SIGOS will be the growth that will come from mobile content developers and portals plus our enterprise customers. All of these companies will have a growing need for testing their content across the myriad mobile platforms and operators of the world, and Keynote's Mobile Device Perspective and Application Perspective services offer a very cost effective and geographically distributed "on demand" testing and measurement capability that is unmatched by any other competitor today. In the long run we are quite confident that our Mobile business can grow to be as large as our Internet business and possibly larger.
4. We ended the quarter with a revenue run rate of almost \$16 million per quarter, the highest in the company's history. We believe we are poised to show continued growth in

the coming quarters. Drew and I would be more than happy to take any questions you have. Thank you.

VI. Operator Runs Q&A

VII. Umang Gupta – Close

- A. Thank you again for joining us today. As usual, we appreciate your support.
- B. Again we are quite pleased with our execution and the direction of our business, especially Mobile Test and Measurements.
- C. As for upcoming investor events, Drew will be conducting investor meetings in February – please call Lippert / Heilshorn & Associates to arrange a visit, and both Drew and I will be presenting at the B. Riley conference in Las Vegas in mid-March.
- D. We are looking forward to speaking with you about the third quarter in late April.