

**Keynote Systems, Inc**  
**First Quarter Fiscal 2005 Conference Call**  
**January 25, 2005**  
**2:00 p.m. (PDT)**

**Operator:**

Good afternoon everyone, and welcome to Keynote's conference call for the first quarter of fiscal year 2005, ended December 31, 2004.

Today's call is being recorded.

At this time, I would like to turn the call over to Jack Andrews, for opening remarks and introductions.

**Jack:**

Thank you. Good afternoon everyone, and welcome to Keynote's conference call for the fiscal 2005 first quarter ended December 31, 2004. I am here today with Umang Gupta, Chairman and Chief Executive Officer, and Peter Maloney, Chief Financial Officer.

Umang and Peter will review our accomplishments for the quarter and they will be available to answer questions.

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 Web site at [www.Keynote.com](http://www.Keynote.com). The replay of this call will be available by telephone by dialing (866) 271-6293 the pass code is #3280131 or by Web cast at the Investor Relations section of our Web site.

I'd 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.

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.

Now, I would like to introduce Peter Maloney, Chief Financial Officer of Keynote.

**Peter:**

Thanks Jack. Now, I will provide you with some details on our accomplishments for the quarter.

GAAP net income for the first quarter was \$791,000, or \$0.04 per diluted share, compared to GAAP net income of \$1.3 million, or \$0.06 per diluted share, for the preceding quarter, and GAAP net income of \$667,000, or \$0.03 per diluted share for the December quarter a year ago.

## **Revenue**

Our total revenue for the December quarter was \$13.6 million, a 12% increase from September quarter, and a 40% increase compared to the December quarter last year.

### **Subscription vs. Consulting**

Subscription revenue was \$10.3 million, or 76% of total revenue for the December quarter, and represented an increase 1% from the September quarter and an increase of 19% compared to the December quarter last year. The increase was driven primarily by higher revenue from our Customer Experience Management and Wireless Perspective businesses.

Consulting and support services revenue was \$3.3 million, or 24% of total revenue for the December quarter, and represented an increase of 66% from the September quarter, and an increase of 214% compared to the December quarter last year. The increase was primarily associated with higher revenue from our Customer Experience Management business.

## **Customers**

Our customer count was over 2,100 companies as of December 31, 2004. Our monthly customer retention rate was an average of 99% for the quarter.

The number of customers that purchased on an annualized basis at least \$100,000 or more of our services was up to 88 and the percentage of revenue from these customers increased to 69% of total revenue for the first quarter.

As of the end of December 2004, 74% of the most recent comScore Media Metrix Top 50 Web Sites and over half of the Fortune 100 companies were Keynote customers.

## **Measurement Pages & Devices**

At the end of December 2004, we measured for revenue 8,661 URLs through our Perspective Services, and 7,451 Internet-connected devices. Overall average monthly benchmarking revenue per URL for the quarter was \$264.

## **Total Expenses**

Total expenses for the December 2004 quarter increased 14% from the prior quarter and 39% compared to the first quarter of last year. The increase from last quarter was lower than what we expected, and was primarily due to the Vividence acquisition, and the costs associated with our annual Global Internet Performance Conference held in New York City in October.

At the end of December 2004, we had over 1,620 measurement computers, connected to major backbones in 124 statistically selected locations, in 57 metropolitan areas worldwide.

## **Balance Sheet**

Now moving to the balance sheet, at December 31, 2004, our cash and short-term investments balance was \$149.7 million. During the first quarter, we generated \$2.8 million of cash flow from operations, we invested \$712,000 in property, equipment, and software and generated approximately \$2.1 million of free cash flow, defined as

cash flow from operations less purchases of property, equipment and software.

As of December 31, 2004 accounts receivable, net, was \$5.9 million, DSOs were 39 days, and 93% of accounts receivable were less than 90 days old.

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As of December 31, 2004, total diluted outstanding common shares were approximately 21.4 million. Additionally, we are entering into a trading plan to repurchase up to 2.0 million shares or approximately 10% of our outstanding shares over a twelve month period.

Purchases under the plan will commence as soon as March 1, 2005.

### **Guidance**

Before I turn the call over to Umang, I would like to provide some general financial guidance for the March quarter.

- We expect total revenue to be between \$13.0 million to \$13.6 million.
- Total expenses are expected to decrease by 2% to 4% from the December quarter.

- We expect interest income, to be approximately \$700,000.
- Our effective income tax rate is expected to be approximately 6.5%.
- We expect diluted weighted average common shares outstanding to be approximately 21.5 million shares.
- We expect diluted earnings per share to be in the range of \$0.03 to \$0.06.
- Cash flow from operations is expected to be in the range of \$2.0 million to \$2.5 million.
- Capital expenditures are expected to be approximately \$1.0 million.

And now I would like to turn the call over to Umang Gupta, Chairman and Chief Executive Officer.

**Umang:**

We are pleased with our first quarter results, which represented our sixth sequential quarterly increase in total revenue, our sixth consecutive quarter of profitability and our twelfth consecutive quarter of positive cash flow from operations.

Before discussing the quarter's highlights, I'd like to review the broader changes and effects occurring across the business as a result of the acquisition of NetRaker, Hudson Williams and Vividence.

During the last year, we made a gearshift change upwards in the scope and size of our business. Our quarterly revenue is approximately 40% higher than it was a year ago, and our headcount during the same period has gone up approximately 36% from 165 to 225 people. In the past quarter, approximately 48% of our business came from our more complex, higher value Management solutions compared to a year ago, when it was around 27%.

Our primary focus at present is on integrating the Hudson Williams, NetRaker and Vividence organizations tightly into the rest of our business and getting maximum value from the investments we have made. Specifically, in the last six months, we have more than doubled the number of consulting professionals at Keynote thereby dramatically increasing our customer engagement capacity -- we now have approximately 25 Service Level Management consultants and

25 Customer Experience Management consultants in the company overall. Our goal now is to ensure we utilize this capacity efficiently and increase the margins in this growing part of our business.

During the previous quarter, we also expanded our field sales organization from 10 territories to 15 territories to increase our focus on selling to our large enterprise customers, especially our expanded portfolio of Customer Experience Management solutions. We have recently combined the Vividence and Keynote sales organizations into one group under a unified field sales management structure. Our goal now is to ensure we get maximum productivity from this high performance field sales team through better coverage of our high potential enterprise accounts, and through more extensive cross selling of our Customer Experience and Service Level Management offerings.

During the previous quarter, we expanded our marketing message to include our expanded Customer Experience Management value proposition, by launching our very successful Global Internet Performance Conference under the theme of "broadening our

perspective on e-business performance.” We are now working on refining our overall corporate messaging to focus even more on our unique industry position as the pre-eminent, trusted third party provider of services that deliver actionable data, research and insights to improve the overall customer experience and to resolve service level disputes within and across organizations.

We have also added people in Engineering, Operations and Finance although proportionately these additions were not as large as in Sales and Consulting. In short, the entire business is not only bigger than before, it’s also more multi-faceted. A large part of our focus this past quarter went into organizational restructuring to help drive maximum productivity in the future from our unified sales organization, while still maintaining the cost-efficiencies of our service delivery organizations. We believe we have made an excellent start towards achieving these objectives, but we have more work to do in this area.

Now let’s talk in more detail about the quarter’s highlights in the performance measurement and management sides of our business.

## **Measurement and Monitoring Services**

52% of the quarter's revenue came from performance measurement solutions compared to 73% for the corresponding quarter last year. In general we are pleased, as this is the 5th consecutive quarter where measurement revenue has remained largely stable.

We recently announced Transaction Perspective 5.7, a new version of our market-leading service for measuring the speed and reliability of Web-based transactions that now fully supports most non-Latin based alphabets. This enhanced version of Transaction Perspective is a strategic move that helps support our international presence and helps strengthen our position with multi-nationals and companies based outside the U.S.

New Measurement customers secured during the quarter include Sun Microsystems, Bloomberg LP and RealNetworks.

## **Performance Management Solutions**

Let's now turn to the performance management side of our business. 48% of the quarter's revenue came from performance management

solutions compared to 41% for the prior quarter and 27% for the corresponding quarter of last year. Total Management solutions revenue increased 31% compared to the prior quarter and 143% from the same quarter a year ago, a trend we are quite pleased with.

As you know our Management solutions consist of Service Level Management (SLM) and Customer Experience Management (CEM) solutions.

Service level management news during the quarter included Microsoft's selection of Keynote as its "certification partner" for its newly enhanced Windows Media Hosting Provider Certification Program. To achieve "Premier" certification status, members of Microsoft's program must pass stringent network quality assurance tests administered by Keynote using our Streaming Perspective service.

And this morning, we announced an expanded partnership with HP to deliver a comprehensive service level management solution. Under our expanded relationship, HP will resell and recommend Keynote's

award-winning LoadPro load testing solution as a component of its newly announced Application Readiness suite of services.

The market for our wireless performance testing services continues to show great promise. This quarter we enjoyed our highest revenue to date from wireless carriers such as Cingular and Sprint and content portals such as MSN and Yahoo. During the quarter we announced a global marketing and development partnership with France's Zandan, a pioneer in mobile telephone data services in Europe. This unique partnership combines the world's largest geographically distributed infrastructure for measuring the performance of real end user handsets, from Keynote, with the world's largest software database simulating the features of more than 750 mobile handsets. With this new solution, still under development, we will be able to offer an extraordinarily unique and powerful mobile service level management performance and testing solution to enterprise customers.

We also launched the first ever end-to-end monitoring service for Instant Messaging over wireless networks with support for MSN Messenger, Yahoo Messenger and AOL IM.

On the CEM side of our business, highlights include the announcement of the results of three distinct and important customer experience studies focused on business travelers, online banking and search engines. These syndicated research studies are being actively marketed and sold.

With the acquisition of Vividence complete, Keynote is now the largest supplier of customer experience management solutions for a wide variety of e-business customers. We are now moving forward aggressively to integrate the unique technology strengths provided by NetRaker and Vividence and to build a unified WebEffective platform. A unified platform will increase the delivery efficiencies of our CEM solutions to customers. Additionally, we continue to enhance the CEM technologies that underlie our CEM solutions. During the quarter we added advanced survey capabilities that complement existing behavioral and attitudinal capture and analysis.

New SLM and CEM customers secured during the quarter include Kodak, 3M and Bank of America. (note: Kodak and BofA are CEM, 3M is SLM)

### **Public Services**

Public services had a very active quarter reporting performance data and analysis to the media on significant site availability issues experienced by a handful of leading retailers over the holidays. More recently Delta had a well-publicized outage and many of the larger charity giving sites experienced problems due to overwhelming traffic generated by the crisis in South Asia. Keynote reported data to the media on both these events as well. Public services also launched a publishing partnership with the newly launched Digital Transactions Magazine, who will regularly publish the results of Keynote's Credit Card and E-Banking Transaction Performance Indices on its site. Finally, Northwest Airlines issued a press release heavily citing its Keynote Performance Award for top performance on our Travel & Hospitality Index.

Our success gained recognition with significant crossover business press over the last two months. In December, a feature story appeared in The New York Times discussing our successful acquisition strategy. And the week before last, a large feature article appeared in The Wall Street Journal detailing the results of our syndicated customer experience research into the large search engine sites including Google, Yahoo! and MSN. This study has received broad attention in many additional leading business and technology publications, and drives the message forward that Keynote is now also an expert independent authority in Web-based customer experience management, in addition to service level management.

## **Conclusion**

In closing, we continue to be pleased with the progress we make each quarter. Our focus on growing the business while optimizing operational efficiencies is reflected in our sixth quarter of sequential revenue growth, sixth consecutive quarter of profitability and twelfth consecutive quarter of positive cash flow from operations.

Our emphasis going forward will be on achieving revenue growth and cost synergies from the acquisitions that we recently have completed. We believe we can deliver increased profitability as long as we can deliver even modest increases in Customer Experience Management and Service Level Management revenue while holding capacity/costs constant. However, given the more consultative nature of our SLM and CEM businesses, revenue from future CEM engagements or SLM projects is not likely to be as predictable on a sequential quarterly basis as that from our measurement subscriptions business.

That said, we are confident we will achieve year over organic growth in the overall business while remaining actively engaged on the M&A front to ensure even greater top line revenue through new, reasonably priced acquisitions in additional high growth areas such as mobile performance management and testing. We are also looking for companies in Europe and Asia, to expand our reach in the areas of Service Level and Customer Experience Management. Ultimately, we remain focused on growing both the top line and the bottom line of Keynote at greater rates than in the past. As always, we appreciate our stockholders' interest and are grateful for your support.

Peter and I would be more than happy to take any questions you have.

**Operator:**

We will now begin the question and answer portion of the call. To ask a question.....

**Q&A**

**Umang:**

Thanks for joining us today. If you have any additional questions, please feel free to contact Peter or myself.

**Operator:**

That concludes today's conference. Thank you for your participation.

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