

Keynote Systems, Inc
Second Quarter Fiscal 2004 Conference Call
April 26, 2003
2:00 p.m. (PDT)

Operator:

Good afternoon everyone, and welcome to Keynote's Fiscal Second Quarter 2004, ended March 31, 2004 conference call. Today's call is being recorded.

At this time, I would like to turn the call over to Erin Kasenchak, Investor Relations Analyst, for opening remarks and introductions.

Erin:

Thank you. Good afternoon everyone, and welcome to Keynote's conference call for the fiscal 2004 second quarter ended March 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. The replay of this call will be available by telephone by dialing (800) 642-1687 the pass code is 6391384 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. 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 Erin. Now, I will provide you with some details on our accomplishments for the quarter.

GAAP net income for the second quarter was \$1.2 million, or \$0.06 per diluted share, compared to net income of \$667,000, or \$0.03 per diluted share, for the preceding quarter, and a net loss of \$2.1 million, or \$0.09 per share for the March quarter a year ago.

Revenue

Our revenue is composed of subscription and consulting and support services revenue. Our total revenue for the March quarter was \$9.8 million, a 1% increase from the December quarter and a 3% increase compared to the March quarter a year ago.

Subscription vs. Consulting

Subscription revenue was \$8.8 million, or 90% of total revenue for the March quarter, and represented an increase of \$132,000 or 2% from the December quarter. The increase was driven by higher revenue from our Enterprise Solutions, Wireless, Transaction Perspective and Test Perspective services.

Consulting and support services revenue was \$1.0 million, or 10% of total revenue for the March quarter, and represented a slight decrease of \$36,000 or 3% from the December quarter, and an increase of \$25,000 or 3% compared to the March quarter a year ago.

Measurement Services vs. Management Solutions

For the second quarter, our Management Solutions revenue was \$3.0 million, an increase of 11% compared to the December quarter, and an increase of 27% compared to the March quarter a year ago.

Measurement services revenue decreased by 3% compared to the December quarter, and decreased by 5% compared to the March quarter a year ago.

Revenue from the management solutions business represented 30% of total revenue for the second quarter of fiscal 2004, 27% for the previous quarter, and represented 24% of total revenue for the second quarter of fiscal 2003.

Customers

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

Compared to last quarter, the number of customers that purchased on an annualized basis at least \$100,000 or more of our services was

down slightly at 59, yet the percentage of revenue from these customers increased 1% to 59% of total revenue for the March quarter.

As of the end of March 2004, 70% of the most recent comScore Media Metrix Top 50 Web Sites and half of the Fortune 100 companies were Keynote customers.

Measurement Pages & Devices

At the end of March 2004, we measured for revenue 7,217 page measurements, or URLs, and 7,629 Internet-connected devices. Overall, average monthly benchmarking revenue per URL for the quarter was \$288 compared to last quarter's average of \$294.

Operating Expenses

Total operating expenses for the March 2004 quarter decreased approximately \$507,000 or 5% from the prior quarter. Total operating expenses decreased \$4.2 million or 31% compared to the second quarter of last year.

At the end of March 2004, we had over 1,600 measurement computers, connected to major Internet backbones in 124 statistically selected locations in 55 metropolitan areas worldwide.

Balance Sheet

Now moving to the balance sheet, at March 31, 2004, our cash and short-term investments balance was \$170.1 million compared to \$165.7 million last quarter. During the second quarter, we generated \$4.1 million of cash from operations. During the quarter, we invested \$531,000 in property, plant and equipment, and generated approximately \$3.5 million of free cash flow, defined as cash flow from operations less purchases of property, plant and equipment.

Accounts receivable, net, at March 31 was \$4.7 million, and DSOs were 43 days, as compared to last quarter's 44 days. As of March 31, 2004, 96% of accounts receivable were less than 90 days old.

As of March 31, 2004, total outstanding common shares were approximately 19.5 million, and our total number of employees was 160.

Guidance

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

- We expect total revenue to increase to between \$10.0 to \$10.4 million.
- Total expenses are expected to increase by approximately 8% to 10% compared to the March quarter.
- We expect interest income, to be approximately \$650,000.
- Our effective income tax rate is expected to be approximately 8%.
- We expect diluted weighted average common shares outstanding to be approximately 21.0 million shares.
- We expect diluted earnings per share to be in the range of \$0.02 to \$0.04.
- Cash flow from operations is expected to be in the range of \$1.5 to \$2.0 million.
- Capital expenditures are expected to be approximately \$1.1 million.

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

Umang:

Thanks Peter. Welcome everyone and thank you for joining us today to discuss our fiscal second quarter results.

Introduction & Overview

I am pleased with our performance in our second quarter of fiscal 2004 as we continued to execute on our commitment to sustain bottom line profitability, while growing top line revenue.

The most recent quarter represented our third sequential quarterly increase in total revenue and GAAP profitability and our ninth consecutive quarter of positive cash flow from operations. Overall, we are quite pleased with the growth in the performance management portion of our business, and continue to work hard to stabilize the measurement part of the business.

While we made significant product progress in achieving our objectives this quarter, I'd like to start off by speaking about our acquisition of NetRaker, a privately-held company based in Mountain

View, Calif., that is a leader in the customer experience management space.

As many of you know, on April 6 we announced the acquisition of NetRaker, as well as the integration of NetRaker's services with our existing WebEffective service to launch the WebEffective Intelligence Platform. The new platform is available immediately to customers.

While we did not disclose the terms of the acquisition, we expect NetRaker to contribute revenue of approximately \$500,000 to our results for the fiscal third quarter ending June 30. Based on NetRaker's recent historical growth rates, we believe that NetRaker is capable of contributing revenue in the range of \$3.0 million to \$5.0 million for Keynote's fiscal year 2005.

The acquisition of NetRaker is the company's ninth since our public offering and it's a strategic one since NetRaker has a strong following among Fortune 500 customers and especially among marketing executives. The acquisition allows us to broaden and deepen our appeal to e-business marketing executives within Fortune 500 companies, such as usability and market research managers by

offering a comprehensive platform for e-business usability research and Web site effectiveness testing.

We are quite pleased with how smooth the integration between the two companies has been so far. As part of the acquisition Douglas van Duyne, NetRaker's president and CEO and George Papazian, NetRaker's chief operating officer have both joined Keynote. Doug is well known in the customer experience management space, speaks widely on the topic at national and international conferences and has co-authored a book related to customer experience called, "*The Design of Sites*." I'd like to warmly welcome Doug, George and NetRaker's other employees to Keynote. We look forward to great results from this latest addition to the Keynote team!

Now let me move on to speak about how we did this quarter.

Performance Measurement Services

The most important product announcement for the quarter in performance measurement was the launch in mid-February of Application Perspective Outside Edition, our outside-the-firewall transaction monitoring service that complements the recently

delivered Application Perspective Inside Edition inside-the-firewall solution for transaction monitoring and diagnostics.

With Application Perspective Outside Edition, our goal was to broaden our customers' available choices in such a way that we could meet nearly every functional requirement and price point in the Web transaction performance measurement and monitoring market. We are very pleased with the uptake of these new offerings among existing and new Keynote customers.

Application Perspective Outside Edition leverages the same high throughput measurement agent announced as part of Application Perspective Private Edition in late October.

As a reminder, Application Perspective Private Edition customers typically place our transaction agent behind their own corporate firewalls, while with Application Perspective Outside Edition, we have co-located our transaction agents on key Internet backbones and ISPs both inside and outside the United States.

We believe, the Keynote Application Perspective platform is now the industry's most cost-effective and comprehensive transaction monitoring and root cause diagnostics solution on the market today.

Also in the measurement area in the second quarter, we announced that our Streaming Perspective service for optimizing audio and video streams over the Web now includes support for QuickTime, making the product the only service to offer support for all three of the leading streaming formats.

New Performance Measurement customers for the second quarter include the Automobile Club of Southern California, Compuware Corporation, Friendster, Inc., Interwoven, Sun Country Airlines, the State of Colorado and Tommy Hilfiger USA.

Performance Management Solutions

Let's turn to the performance management side of our business.

30% of the quarter's revenue came from performance management solutions compared to 24% for the corresponding quarter of last year. This represented a 27% growth rate from the same quarter a year ago, a trend we are quite pleased with.

We held an extremely successful Total Performance Management Symposium in mid-February that was attended by over 120 IT executives from among our customers and prospects. Geoff

Penney, the CIO of Charles Schwab, and a member of the Keynote board, set the tone for the day with an opening presentation discussing how important performance management is to Schwab. Paul Avenant, of HP's management software division was the next presenter, which was followed by the first live demonstration ever of Application Perspective for HP OpenView. All in all, a very successful event!

We enjoyed good success during the quarter with our LoadPro Inside service, in which we install a set of LoadPro agents inside a customer's premises so they can run their own highly realistic load tests using our appliance, rather than the load-testing software of our competitors. LoadPro Inside is an excellent example of the innovative ways we are expanding our services-based business model to include hassle-free low cost appliances to do jobs that were previously possible only with complex software.

During the quarter we also announced a joint sales and marketing partnership with Segue Software, a global leader in enterprise application quality software. The Keynote/Segue solution offers a complementary full lifecycle approach to testing, monitoring

and isolation of performance problems, both pre- and post-deployment.

New Performance Management customers for the second quarter include AMD, Boeing, Broadwing Communications, Fidelity Investments, Gallup Inc., General Nutrition and Marvel Enterprises.

Public Services

Last quarter was an extremely productive one in Public Services with the launch of two new Web transaction indices.

On February 18th, we launched the world's first e-government Web transaction index measuring the speed and reliability of leading federal government Web sites. Government Computer News, a leading technology publication for government, is now running the index every week in its publication and on its Web site.

On April 1st, we launched another first; the world's first Travel and Hospitality Web transaction index that measures the transaction performance of over 25 leading airline, hotel and online travel agency Web sites.

Both new indices are offered for sale, while the weekly aggregate results are published on our Web site. Keynote now

publishes and offers for sale seven Web transaction indices: broker, e-commerce, e-banking, e-government, airline, hotel and online travel agency. We are very proud of all the progress we have made in this area. Our indices underscore and strengthen the Keynote brand as The Internet Performance Authority.

Conclusion

In closing, we continue to be pleased with the progress we make each quarter. Our focus on optimizing operational efficiencies is reflected in our third consecutive quarter of profitability, ninth consecutive quarter of positive cash flow from operations, and the \$3.5 million of free cash flow generated this quarter.

We also continue to focus on developing new sources of revenue both organically and through acquisitions, as we target sustained GAAP profitability and positive free cash flow for our fiscal 2004 third quarter. As always, we appreciate our stockholders' interest and are grateful for your support.

That concludes today's formal remarks.

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 me.

Operator:

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

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