

**Keynote Systems, Inc**  
**Fourth Quarter Fiscal 2003 Conference Call**  
**October 27, 2003**  
**2:00 p.m. (PDT)**

**Operator:**

Good afternoon everyone, and welcome to Keynote's Fourth Quarter and Fiscal Year ended September 30, 2003, 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 fourth quarter and fiscal year ended September 30, 2003, conference call. 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 the year ended September 30<sup>th</sup> 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). You can log onto our web site now and find the audio web cast of this call at the Investor Relations section of our site, and it can also be heard at [www.vcall.com](http://www.vcall.com) and [www.streetevents.com](http://www.streetevents.com). The replay of this call will be available by telephone by dialing (800) 642-1687 the pass code is 2729175 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, consistent with prior quarters. This guidance assumes no additional acquisitions or other significant or extraordinary transactions. We will not comment on this guidance during the quarter and 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 would like to provide you with some details on our accomplishments for the quarter and year.

GAAP net income for the fourth quarter was \$652,000, or \$0.03 per share, compared to a net loss of \$1.3 million, or \$0.06 per share, for

the preceding quarter, and a net loss of \$53.9 million, or \$1.93 per share for the fourth quarter a year ago.

The net loss for fiscal 2003 was \$4.7 million, or \$0.21 per share, compared to a net loss of \$65.5 million, or \$2.35 per share, for fiscal 2002.

The net loss for the quarter and fiscal year ended September 30, 2002 included a lease termination charge of \$52.0 million related to our headquarters facility.

In summary, our overall operating results continued to improve both sequentially and year over year, as we exceeded our goal of bottom line breakeven results for the fourth quarter ending September 30, 2003.

## **Revenue**

Our revenue is composed of subscription and consulting and support services revenue. Our total revenue for the September quarter was \$9.5 million, a 1% increase from the June quarter's \$9.4 million and a 2% decrease from the September quarter a year ago of \$9.7 million.

Subscription revenue decreased by \$300,000 or 4% from the June quarter to \$8.4 million or 88% of total revenue for the September quarter. The decrease was mainly due to a distributor in Germany that filed for bankruptcy protection, and the impending withdrawal of Cable & Wireless from the US market. We expect a portion of these revenues to be reinstated in the December quarter as we are providing service directly to end users in Germany, and we have begun to contact the Cable & Wireless end users to secure direct relationships.

Consulting and support services revenue increased by \$388,000 or 52% sequentially for the September quarter to \$1.1 million or 12% of total revenue. The increase was due to increased load testing revenue, and an increase in the number of consulting customers and engagements and the average revenue per engagement compared to the June quarter.

## **Measurement Services vs. Management Solutions**

We recently realigned our sales force, operations, and customer support groups into a dedicated telesales group in Plano, Texas in order to sell and service our entire line of subscription based Measurement Services, so that our field sales group is focused on large customer opportunities involving our higher-end Performance Management Solutions. Measurement services include all of our subscription based Perspective services for website, transaction and streaming benchmarking, plus our Red Alert and NetMechanic monitoring services. The Performance Management Solutions business, includes all of our testing, APM services for the enterprise, Wireless and Webeffective services, and our consulting and advanced technical support services.

Beginning this quarter, we will disclose revenue for our Measurement Services business and our Management Solutions business separately, so that our investors may view the progress of these two businesses consistent with how we manage them internally. We have provided three years of historical quarterly revenue data for these two segments in our earnings release.

For the fourth quarter, our performance management solutions revenue increased sequentially by 20%, compared to the June quarter, and 30% compared to the corresponding quarter a year ago. Measurement services revenue decreased sequentially by 5%, compared to the June quarter, and 10% compared to the corresponding quarter a year ago.

Revenue from the performance management solutions business represented 24% of total revenue for fiscal 2003 and 17% for fiscal 2002.

### **Customers**

Our customer base remained relatively flat at approximately 2,200 companies as of September 30, 2003. As a result, our monthly customer retention rate was an average of 99% for the quarter, consistent with our historical rate of 95% or better.

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

approximately the same at 60 representing 57% of total revenue for the September quarter.

As of the end of September 2003, 80% of the most recent comScore Media Metrix Top 50 Web Sites and over half of the Fortune 100 companies were Keynote customers.

### **Measurement Pages**

At the end of September 2003, we measured for revenue 7,429 page measurements, or URLs, compared to 7,622 at the end of June, a 3% decrease. Overall, average monthly benchmarking revenue per URL for the quarter was \$298 compared to last quarter's average of \$304.

### **Operating Expenses**

Total operating expenses for the September 2003 quarter declined nearly \$2.2 million or 19% from the prior quarter and \$4.9 million or 34% compared to the fourth quarter of last year.

For the fourth quarter, the costs of subscription services decreased by \$254,000 or 14% from the June quarter, due to reduced bandwidth

costs and lower depreciation expenses as a result of lower capital investments.

Costs of consulting and support services also decreased by \$254,000 or 24% in the September quarter due to a reduction in personnel and bandwidth costs.

Additionally, our focus on profitability and cost reductions across all areas of our business resulted in further decreases in operating expenses for the September quarter driven by reductions in personnel and fewer marketing programs.

At the end of September 2003, we had approximately 1,700 measurement computers, connected to major Internet backbones in 120 statistically selected locations in 54 metropolitan areas worldwide. These statistics have remained fairly consistent over the last few quarters.

## **Balance Sheet**

Now moving to the balance sheet, at September 30, 2003, our cash and short-term investments balance was \$160.2 million compared to \$159.4 million last quarter. During the fourth quarter, we generated \$2.2 million of cash from operations, and invested \$910,000 in property, plant and equipment. We generated approximately \$1.3 million of free cash flow, defined as cash flow from operations less purchases of property, plant and equipment.

Accounts receivable, net, at September 30 was \$4.3 million, and DSOs were 41 days, a decrease from last quarter's 43 days. As of September 30, 2003, 94% of accounts receivable were less than 90 days old.

Total outstanding common shares were approximately 18.8 million, and our total number of employees was 158 as of September 30, 2003.

## **Guidance**

Before I turn the call over to Umang, I would like to provide some general financial guidance for the December quarter. We expect total revenue to be \$9.3 to \$9.7 million for the quarter ending December 31, 2003.

We expect costs of subscriptions to represent approximately 17% to 21% of subscription revenue, and costs of consulting and support services to represent approximately 80% to 85% of consulting and support services revenue for the December quarter.

Total expenses for research and development, sales and marketing, operations, general and administrative, and excess occupancy costs are expected to increase by approximately 5% as compared to the September quarter, due to expenses associated with our 2003 Global Internet Performance Conference. The amortization of the remaining intangibles will amount to approximately \$400,000 in the December quarter,

We expect interest income, net, to be approximately \$650,000 for the December quarter. Due to loss carryforwards and tax credits, no tax provision is expected in the December quarter. We expect diluted weighted average common shares outstanding for the December quarter to be approximately 20 million shares. Capital expenditures are expected to be approximately \$700,000 for the December quarter.

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 fourth quarter and year end results.

**INTRODUCTION AND OVERVIEW**

I am very pleased with our performance in Q4 as we exceeded our commitment to GAAP breakeven and achieved profitability.

Before discussing the details of the quarter further, I want to first thank and recognize our faithful shareholders, our many loyal

customers and each and every one of Keynote's employees who have worked so hard and long to achieve profitability.

It is our employees' hard work, and focused efforts, day in and day out on our customer's behalf, that has enabled us to achieve today's significant milestone. It is inspiring to me personally to be associated with such a dedicated and committed group of people.

Second, I'd like to mention the tremendously successful event we have just concluded here in Manhattan at Keynote's annual Global Internet Performance Conference.

In addition to announcing significant new behind the firewall performance management services, which I'll discuss later, I had the great opportunity to meet personally with many of the over 200 customers and partners who attended our conference over the past two days.

It is always gratifying for me to hear directly from customers, since everything we do at Keynote, from the services we develop to the hassle-free way we deliver them, is to ensure that customers love doing business with us!

The story behind this quarter's numbers has been our continued and relentless focus on achieving operational efficiencies,

and without sacrificing revenue, nor the commitment to our customers.

Over the last 12 months we have reduced headcount from 227 to 158 people and shaved approximately \$5 million a quarter in our expense run-rate while maintaining quarterly revenue constant between \$9.4M and \$9.7M. This translates into an average of a \$20 million annual run-rate reduction in expenses. All the while we have managed to increase revenue received from the performance management solutions component of our business, and begun to show greater stability in our measurement revenue.

Our dual focus on growing our performance management solutions business, while reducing expenses, has resulted in GAAP earnings of \$0.03 per share for the fourth quarter, our seventh consecutive quarter of positive cash flow from operations and free cash flow of approximately \$1.3 million for the fourth quarter.

Additional fourth quarter highlights include the fact that our performance management solutions business has grown to almost 30% of total revenue for the quarter from 21% for the fourth quarter of fiscal 2002 and 9% for the fourth quarter of 2001.

### **Measurement Services**

In the measurement area we announced Streaming Perspective 3.0, a new version of our Streaming performance service based on our recent acquisition of StreamCheck.

New measurement customers for the fourth quarter included AON Corporation, Barclays Capital, Fidelity National Financial, Herbalife International, Homestore, Inc., LoudEye Corporation, MovieLink, MSNBC, MTV Networks, National Public Radio (NPR), RealNetworks, Shareholder.com, Standard & Poor's, WP Carey & Co. and World Savings Bank.

### **Performance Management Solutions**

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

As I stated earlier, almost 30% of the quarter's revenue came from performance management solutions compared to 23% for the third quarter and 21% for the fourth quarter of last year. While we're pleased with our results here, it's important to understand that quarter over quarter revenue may appear "lumpy" as our Enterprise Solutions and Testing businesses are driven quite a bit by a series of customer engagements, which don't necessarily repeat every quarter. Overall,

we have been pleased with the both the growth from last quarter and the trend year to year, which has been quite good.

In the performance management area we announced WebIntegrity 2.2, an enhanced version of our content integrity testing service that now includes the ability to trend Web site health over time.

New Performance Management customers for the fourth quarter include American Greetings, Franklin Templeton Investments, Kbkids.com, Seta Corporation, Shoppers Drug Mart, Sony, Ticketmaster, Timberland, Trustmark Insurance, and Visa International. Additionally, during the fourth quarter, we signed up our first customer through EDS as part of a multiyear hosting commitment.

## **ADDITIONAL HIGHLIGHTS OF THE QUARTER**

Now let's move on to additional highlights of the quarter.

As mentioned earlier, today we finished hosting our annual Global Internet Performance Conference (GIPC) and launched

several significant new behind-the-firewall application performance management services including Keynote Application Perspective

Application Perspective is the industry's most comprehensive end-to-end monitoring and root cause diagnostics solution for e-business applications at the lowest total cost of ownership.

Additionally, we launched Performance Scoreboard a customized portal for the visual management of service level objectives for multi-property, multi-location e-businesses.

Other announcements today included:

- PerformanceTune, an outsourced tuning service that combines Keynote's load testing infrastructure with detailed back-end monitoring to isolate and repair performance bottlenecks.
- Test Perspective for Siebel 7, a load testing service that utilizes our load-generating infrastructure to help companies validate the performance of their entire Siebel 7 application infrastructure.
- Wireless Perspective 3.0, an enhanced version of our existing wireless service with support for camera phones, push-to-talk (PTT) and multimedia message service (MMS).

- and Web Site Perspective Lite Agent Groups, a cost-effective option for outside-in Web page measurements from a broad number of geographic locations.

## **PUBLIC SERVICES**

In Public Services we continued to re-enforce our reputation during the quarter as the Internet Performance Authority, by providing public service reporting to the media on important Web events including the Northeast power outage and the Blaster Worm and SoBig viruses.

We also established a content relationship with E-Commerce Times, under which the publication will have the rights for complete results of Keynote's new Consumer E-Commerce Transaction Index updated weekly on its Web site.

## **CONCLUSION**

In closing, our traditional performance measurement services business has exhibited recent signs of stabilizing, while the performance management portion of our business has grown to close

to 30% of total revenue. Our focus on optimizing operational efficiencies and strict expense controls is reflected in our profitability and seventh consecutive quarter of positive cash flow from operations and the \$1.3 million of free cash flow that we generated this quarter.

We continue to focus on finding new sources of revenue both organically and through acquisitions, as we target sustained GAAP profitability for our fiscal first quarter of 2004. We also anticipate generating positive cash flow from operations for the eighth consecutive quarter. While we do not provide specific guidance beyond the current quarter, currently we believe that even assuming no growth in revenue for the rest of the year we are capable of sustaining profitability for fiscal year 2004.

Achieving GAAP profitability for the fourth quarter and our seventh consecutive quarter of positive cash flow from operations are significant milestones for our business. We are proud of the results we have achieved despite a weak economy. Profitability provides Keynote a significant measure of stability and a platform for growth so we can continue to bring our customers the leading services for improving e-business quality.

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.

END