

Keynote Systems
Fiscal First Quarter 2012 Results Conference Call
Tuesday, January 31, 2012

Operator

Good afternoon everyone, and welcome to Keynote's conference call for the first fiscal quarter of 2012. Today's call is being recorded.

At this time, I would like to turn the call over to Kirsten Chapman of LHA for opening remarks and instructions.

Kirsten Chapman – LHA – IR Contact

Thank you. Good afternoon, everyone, and welcome to Keynote's conference call for the first fiscal quarter ended December 31, 2011. I am here today with Umang Gupta, Chairman and Chief Executive Officer; and Curtis Smith, Chief Financial Officer.

Hopefully, by now, you have seen the press release that was distributed over 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 (888) 843-7419 - the pass code is 31488045# - or by Webcast at the investor relations section of our Website at www.keynote.com.

I would like to remind you the 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 most recent annual report and quarterly reports filed with the SEC.

Today, we have provided detailed guidance in our quarterly press release, as we have in prior quarters. This guidance assumes no acquisitions, no material change in interest rates or foreign currency exchange rates, and no 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.

Before the company reviews the financials, I will review definitions for some metrics the company provides which are not in accordance with generally accepted accounting principles, commonly known as GAAP.

Non-GAAP net income (loss) is calculated as GAAP net income (loss) adjusted for the provision (benefit) for income taxes, cash taxes from on-going operations, stock-based compensation expense, amortization of purchased intangibles and any unusual items. In this quarter, the change in fair value of acquisition-related contingent consideration was considered an unusual item. Non-GAAP net income (loss) per diluted share equals non-GAAP net income (loss) divided by the diluted weighted average shares outstanding for the period.

Adjusted EBITDA is defined as earnings before interest income, taxes, depreciation, amortization of purchased intangibles, stock based compensation, other income (expenses), net and any unusual items.

Free cash flow is defined as cash flow from operations less cash used to purchase property, equipment, and software.

During the call, Umang Gupta, Chairman and CEO, will review the recent accomplishments, and Curtis Smith, CFO, will detail the financial results. Then Umang will deliver closing remarks and open the call for questions. Now, it is my pleasure to welcome Umang Gupta. Please go ahead sir.

Umang Gupta – Chairman and CEO of Keynote Systems, Inc.

Thanks Kirsten. Welcome everyone, and thank you for joining us today. We began fiscal 2012 with strong quarterly results. As you know, we benefit from seasonality during the December quarter, yet this time we exceeded our own expectations and reached \$33.1 million in quarterly revenue. The increase includes contributions from the October acquisition of DeviceAnywhere, as well as growth in all of our businesses. Our Internet cloud business delivered record revenue fueled again by positive secular trends such as the growth of ecommerce and cloud computing. Our mobile business grew to \$17.6 million, including contributions from Keynote-DeviceAnywhere and from some early acceptances at Keynote-SIGOS.

In addition to top-line growth, we also were pleased with our profitability. For the first quarter, non-GAAP income was \$6.0 million, compared to \$5.1 million a year ago. Adjusted EBITDA was \$7.4 million, or 22% of revenue, compared to \$6.1 million, or 24% of revenue, in the same quarter last year. And all of this occurred

despite the anticipated accounting headwinds associated with our Keynote–SIGOS business, which Curtis will elaborate on later.

Now, I will review our mobile test and monitoring business performance:

For the first quarter, mobile revenue increased to \$17.6 million, compared to \$11.9 million for the first fiscal quarter of 2011. The increase includes \$4.1 million from Keynote-DeviceAnywhere. Excluding Keynote-DeviceAnywhere revenue, we achieved approximately 13% organic growth.

Keynote-DeviceAnywhere deferred revenue at the date of the acquisition was reduced by approximately \$2.0 million for acquisition related adjustments, of which \$600,000 impacted first quarter revenue. This is commonly referred to as a “purchase accounting haircut.” In addition, the quarterly results do not include the revenue from Keynote-DeviceAnywhere for 18 days during the quarter prior to the acquisition. Had both of those items been included, the total revenue would have been \$5.3 million from Keynote-DeviceAnywhere, instead of the reported \$4.1 million.

This quarter the percentage of mobile revenue overtook Internet revenue for the first time.

During the quarter, Keynote won several enterprise mobile customers, including US Bancorp, Blue Cross & Blue Shield of Louisiana, Google, Liberty Mutual, Phillips, JM Family Enterprises, and Expedia. Additionally, several existing Internet customers began using our enterprise mobile services in earnest, including Kohls, Best Buy, Kelley Blue Book, and Vegas.com. Keynote-DeviceAnywhere was active, too, winning General Motors, Maritz, Allegis Group, Valic, AQmetrix, Humana, Union Pacific, Ford, H&R Block and Diversinet.

New telecom mobile customers this quarter included MTS of Armenia, Nar Mobile of Azerbaijan, ARPT of Guinea; Vodafone of Hungary; Asiacell of Iraq; NTT DoCoMo and KDDI of Japan; Unitel of Mongolia; Qtel of Qatar; Turemove of Thailand; INT of Tunisia; and Telecom of Uganda.

Regarding our Keynote-DeviceAnywhere acquisition, we are pleased with our progress to date. In January, the Keynote-DeviceAnywhere team moved into the Keynote headquarters building in San Mateo. Our sales teams have conducted several joint product education sessions, and we hope to announce joint customer wins as 2012 progresses.

We continue to constantly update our industry-leading offerings.

- Keynote broke new ground in delivering HTML Browser support for Mobile Web Perspective and for MITE, Mobile Internet Testing Environment.
- Keynote-DeviceAnywhere won “Best-of-Show” at ITEXPO West 2011 in Austin, TX for Test Center Enterprise (TCE) in the “Best On-Site Product Launch” category and also announced support for HTML5. In addition, Keynote-DeviceAnywhere launched two free online resources: Device Planner™ and Test Planner™ that help organizations optimize the rollout of their mobile apps and websites.
- Keynote-SIGOS unveiled SITE 2.5 – the SIGOS Integrated Test Environment – which is one of the first active end-to-end test systems ready for LTE networks. Now network operators have the ability to actively monitor LTE access networks in addition to other technologies like CDMA, GSM and UMTS.

After the quarter closed, we announced that Google has selected Keynote’s MITE to power the howtogomo.com site. This site enables developers to test the end user experience for any mobile website before putting it into production. This is a great endorsement of our leadership position in mobile monitoring and testing.

Now, on to our Internet cloud monitoring and testing business.

Driven by strength in load testing engagements, Internet revenue reached \$15.5 million this quarter, compared to \$12.9 million in the first fiscal quarter of 2011, which represented a 20% increase. In addition, Web measurement subscriptions revenue continued its improvement and posted its eighth sequential quarter of uptrend.

As you may recall, the December quarter typically has been seasonably strong for our Internet business. This year it was even stronger than usual due to secular e-commerce trends being in our favor. As reported in IBM Coremetrics Report on Cyber Monday for 2011 as compared to 2010:

- Online sales were up 33%, and
- Mobile traffic grew by more than 200%.

During the first fiscal quarter, we signed Internet subscription and engagement deals with Orange Business Services, Softbank, Federal Reserve Board, JM Family Enterprise, Xoom, All Star Directories, Expedia, Lonely Planet, McGraw Hill Education, and Oracle University to name a few.

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With that, I'd like to turn the call over to Curtis, Curtis?

Curtis Smith – CFO of Keynote Systems, Inc.

Thank you Umang. I will review our financial results for the first fiscal quarter of 2012 compared to the first fiscal quarter of 2011, and then discuss our outlook for next quarter. As a reminder, our results for 2012 will be based on the same revenue recognition standards as were implemented at the beginning of fiscal year 2011.

For the first fiscal quarter of 2012, our results include 74 days of operations from Keynote-DeviceAnywhere, which we acquired on October 18, 2011.

Total net revenue was \$33.1 million, compared to \$24.8 million. This reflects growth in all of our businesses and the Keynote-DeviceAnywhere revenue contribution of \$4.1 million. Excluding the reduction in deferred revenue, or the "haircut," and including a full 92-days of operations would have resulted in an additional \$1.2 million in revenue.

Total Internet revenue was up 20% to a record \$15.5 million, compared to \$12.9 million, reflecting increased demand for our web measurements and especially strong seasonal strength in our load testing business.

Total mobile revenue was \$17.6 million, compared to \$11.9 million in the first fiscal quarter of 2011. Please note:

- Excluding Keynote-DeviceAnywhere revenue, mobile revenue organic growth was 13%; and
- Total mobile revenue grew in spite of the ratable license "headwind" that we expect in all of fiscal 2012, and which is related to the new revenue recognition standards adopted at the beginning of fiscal year 2011.

Keynote-DeviceAnywhere revenue is reported in all of our mobile revenue line items: Subscriptions, Ratable licenses, System licenses and Maintenance and Support. Please also note this quarter, we began reporting mobile net revenue by customer type: enterprise and telecommunications.

- Mobile subscriptions revenue was \$5.6 million and increased for the twelfth consecutive quarter.
- Mobile ratable licenses revenue was \$1.6 million, compared to \$4.6 million a year ago. As a reminder, mobile ratable licenses consists primarily of SITE

license contracts signed prior to implementation of the revenue recognition standards in fiscal year 2011 and will eventually decline to an immaterial amount. We expect the ratable mobile license “headwind” for the year to be approximately \$10 million, which represents the difference between ratable license revenues in fiscal year 2011 of \$14.3 million and the approximately \$4 million of ratable license revenue we expect in fiscal year 2012 from pre-2011 SITE contracts.

- Mobile systems licenses revenue and maintenance and support revenue were \$5.8 million and \$4.6 million, compared to \$2.0 million and \$2.2 million, respectively. The increases reflect both organic growth and Keynote-DeviceAnywhere contributions.
- For the quarter, enterprise mobile revenue was \$5.9 million and telecommunications mobile revenue was \$11.6 million, compared to \$1.1 million and \$10.8 million, respectively.

For the first fiscal quarter of 2012, our total costs and expenses were \$27.6 million, compared to \$21.2 million. The \$6.5 million increase was due to:

- \$5.7 million in costs and expenses for 74 days of Keynote-DeviceAnywhere operations; which includes \$1.5 million of amortization of purchased intangibles, acquisition expenses and stock-based compensation;
- The full reinstatement of 2009 salary reductions in April 2011;
- The direct and operating costs associated with higher revenue; and
- The headcount increase associated with investments in international and mobile growth areas of our business in the third and fourth quarters of fiscal year 2011
- These increases were partially offset by the \$2.0 million benefit from the release of the earnout liability. At the acquisition date, under GAAP principles, we recorded an estimated \$2 million contingent liability associated with the potential earnout to DeviceAnywhere shareholders. Based upon the results through December 31, 2011, we determined that the DeviceAnywhere shareholders will not be eligible for both the 2011 and 2012 earnout. Accordingly, the liability recorded at acquisition date was released without a cash payment and reflected in our operating expenses under the caption “Change in fair value of acquisition-related contingent consideration.”

Operating income was \$5.4 million, compared to operating income of \$3.7 million.

GAAP net income was \$4.1 million, or \$0.22 per diluted share, compared to net income of \$3.6 million, or \$0.23 per diluted share. Due to the release of the valuation allowance in the fourth fiscal quarter of 2011, our tax rate for the first fiscal quarter under GAAP excluding the unusual item was 39%.

As a reminder, deal related expenses are not excluded from our non-GAAP net income and Adjusted EBITDA calculations. Deal related expenses were \$330,000 this quarter and \$450,000 last quarter. Non-GAAP net income was \$6.0 million, or \$0.32 per diluted share, compared to \$5.1 million, or \$0.32 per diluted share.

In the first fiscal quarter of 2012, cash provided by operating activities was \$1.5 million, compared to \$2.3 million in the first fiscal quarter of 2011. We used \$98,000 in free cash flow, compared to generating \$1.9 million in the first fiscal quarter of 2011. Cash used to pay dividends totaled \$1.0 million for the first fiscal quarter of 2012, compared to \$898,200 in the same period a year ago. As illustrated by the cash flow data included in our press release, our December quarter is typically light for cash flow due to:

- Calendar year end collections patterns; and
- Increased PP&E related to the Keynote-DeviceAnywhere move into our building during this quarter.

Adjusted EBITDA was \$7.4 million, or 22% of revenue, compared to \$6.1 million, or 24% of revenue.

Our board of directors approved a quarterly cash dividend of \$0.06 per common share, payable March 15, 2012 to common stockholders of record at the close of business on March 1, 2012.

Now, on to the review of our balance sheet.

Our cash and short-term investments were \$40.0 million at December 31, 2011, compared to \$101.4 million at September 30, 2011, reflecting the purchase of Keynote-DeviceAnywhere on October 18th for \$60.0 million in cash. Net deferred revenue was \$17.4 million at December 31, 2011, compared to \$18.5 million at September 30, 2011. The total shares outstanding were 17.3 million at both September 30, 2011 and December 31, 2011. Diluted weighted average shares outstanding were 18.5 million for the first fiscal quarter of 2012, compared to 18.4 million for the fourth fiscal quarter of 2011.

Now for our guidance for the second fiscal quarter of 2012.

Please remember, the second fiscal quarter results are seasonally lower than other quarters for Keynote's Internet business and, due to the new revenue recognition standards implemented at the beginning of fiscal year 2011, this seasonality now extends to Keynote-SIGOS and Keynote-DeviceAnywhere. Also as mentioned before, our first quarter revenue included some early acceptances of Keynote-SIGOS projects that had been expected in the second fiscal quarter.

- Total revenue is expected to range from \$29.0 million to \$31.0 million.
- GAAP results are expected to range from GAAP net loss per diluted share of 3 cents to GAAP net income per diluted share of 3 cents.
- Non-GAAP net income per diluted share is expected to range from \$0.12 to \$0.18.

This guidance assumes the following:

- Keynote-DeviceAnywhere deferred revenue reduction, or "haircut," is approximately \$2.0 million for 2012. The impact in the second quarter of 2012 is expected to be approximately \$700,000 to recognized revenue.
- The foreign exchange rates are expected to have a negative impact on the second quarter, and depending on rate trends, could also be felt in future quarters.
- The cost structure in the second quarter will be approximately the same as the cost structure for the first quarter excluding any unusual items related to the acquisition of Keynote-DeviceAnywhere.
- Total stock-based compensation expense and amortization of intangible assets is expected to be approximately \$3.0 million.
- Depreciation is expected to be approximately \$1.3 million.
- Interest income and other, net is expected to be approximately \$(100,000) assuming no material changes in interest rates, foreign exchange rates and currently planned uses of cash.
- Cash taxes paid from on-going operations is expected to be \$200,000.
- Diluted weighted average shares outstanding are expected to be approximately 18.7 million shares, assuming some additional issuances of equity or equity-related securities and no significant changes in our stock price.

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

Umang Gupta – CEO of Keynote Systems, Inc.

Thank you Curtis. In summary, fiscal 2012 began stronger than expected, and we are most pleased with our results.

As discussed earlier, our expansion into enterprise mobile testing with the acquisition of Keynote-DeviceAnywhere is going well, and we are optimistic about the additional opportunities afforded to us.

We are confident in our solid fundamentals and our prospects in the end markets we serve. I would now like to open the call up to questions. Operator?

Umang Gupta - CEO of Keynote Systems, Inc.

Thank you for joining us today and for your continued interest in Keynote. Curtis and I are presenting at the 2012 Pacific Crest Emerging Technology Summit on February 15th in San Francisco and we look forward to seeing some of you there.

Thank you. Have a nice day.