MKS INCORPORATED

Moderator: Ellyn Winters Robinson
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4:45 pm CT

Operator: Ladies and gentlemen, thank you for standing by.

Welcome to the MKS First Quarter Fiscal 2008 Financial Results Conference Call.

During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question and answer session. At that time, if you have a question, please press the 1 followed by the 4 on your telephone.

A rebroadcast of today's conference will be available beginning today, September 6, 2007 at 7:00 pm Eastern Standard Time through September 13.

To access the rebroadcast, please dial 1800-558-5253 or 416-626-4100 and enter reservation number 21337074.

As a reminder, this conference is being recorded, Thursday, September 6, 2007.

I would now like to turn the conference call over to Mr. Philip Deck, CEO of MKS. Please go ahead, sir.

Philip Deck: Good afternoon and welcome to the MKS First Quarter Conference Call. I'm here with Michael Harris, the President and Chief Operating Officer, and Doug Sawatzky, our Chief Financial Officer in Waterloo. But I'll first turn to Larry Wasylishyn, our legal counsel for the legal disclaimer.

Larry Wasylishyn: Thanks, Phil and good afternoon.

Some of the statements made on this call, including those relating to our strategies and other statements that are predictive in nature that depend upon or for a future events or condition or that include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates" or similar expressions are forward-looking statements within the meaning of securities laws.

Forward-looking statements include information concerning possible or assumed future results of operations of MKS and its subsidiaries are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. These statements are not historical facts but instead represent only our current expectations, estimates and projections regarding future events.

The future results and shareholder value of MKS may differ materially from those expressed in these forward-looking statements due to among others those factors set out on MKS's filings with Canadian securities regulators.

MKS does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events and circumstances after this call or to reflect the occurrence of unanticipated event except as required by law.

I now will turn the call back to Phil.

Philip Deck: Thanks, Larry.

Today, MKS reported record quarterly revenues of $13.6 million, up 8% from the results in both the previous quarter and the comparable period in the previous year led by record ALM revenues of $11.7 million.

We achieved that result with record maintenance revenues and services results combined with continued rebound in licensing. As well our interoperability business contributed slightly better results than expected.

We recorded a net loss of $300,000 after the impacts of unusual severance cost of $500,000, the adverse effect of exchange rates over the previous quarter of 400,000 and also included in the loss with the non-cash deferred tax charge of $160,000.

Our ALM results - license results showed continued sequential improvement in both quantitative and qualitative term. We were up 20% in licensing from our preceding quarter with (over lines) on any blockbuster transaction, and we saw a breakthrough in Asia in our first profitable quarter after six quarters of investment, and we saw the return of substantial license results from our largest customers with almost half of the licensing (signed from) our largest 25 long-term customers.

Our maintenance revenue set an all-time record at 6.2 million and an ALM maintenance record of 5.4 million. Maintenance revenue continues to show the effects of very high renewal rates of 90% overall, with the top half of our maintenance revenue base renewing at 97%.

Service revenue of 1.6 million was also a record-level, as the amount of services delivered continues to rise relative to licensing consistent with our strategy to ensure that customers are deriving as much value as they can from our products.

And like the last two quarters, we booked more services than we delivered, further lightening our backlogs and setting the stage for continued growth in the quarters ahead.

During the quarter, we launched our Integrity 2007 release, a sweeping upgrade to our single platform, ALM offering. The new capabilities have given us dramatically enhanced ability to show the benefits of our unified approach and our customers can now start planning for migration to the new product over the next year.

Closing cash balance at July 31, 2007 was $11.9 million, down from $15.3 million at April 30, 2007, showing the effects of normal maintenance renewal seasonality and an increased investment and receivables resulting from increased sales activities.

I’ll now turn to Michael Harris for a review of Q4 operations.

Michael Harris: Thanks, Philip.

Today, I’m (casting out) the quarterly increase in revenue from Q4 fiscal 2007 of 8% driven primarily by 20% increase in quarterly ALM licensing.

ALM service revenue is up 13% on the quarter to $1.6 million.

Services sold in the quarter amounted to more than $2 million, further building our backlog of services to be delivered in the current fiscal year.

Total company headcount as of July 31, 2007 was 308, a decline of 7% from a year ago. ALM sales headcount was 39, one less in the quarter prior. Q1 showed an improvement in sales productivity of 18% from $157,000 per rep in the quarter in Q4 fiscal 2007 to $185,000 per rep in the first quarter of fiscal 2008.

Sales over the period included follow-on wins to Abbott, CIBC, Continental, DaimlerChrysler, dSpace, HSBC, Iron Mountain, NCR and Tyco. In the past few quarters, our key accounts had been unusually quiet as far as follow-on license orders are concerned and we are pleased with the contribution from these core accounts which drove a significant portion of our licensing in the first quarter.

During the past quarter, we also signed up to new accounts which include CSG, IT Frontier, Mitsubishi Research Institute, DCS, Northern Trust and Nova Scotia Power. We expect each of these accounts to deploy their first purchase of license as quickly and we’ll be working towards follow-on enterprise deployments in each of them.

We also signed a significant deal with the major US financial institution where we will be helping them in implementing the change management infrastructure across all of their development platforms for Windows through to the mainframe.

Based on some of immediate successes in this first deployment, we are already in discussions with them about further investments and their capabilities such as requirements in cost management.

Although we all experience the decline from the prior quarter and the equivalent period last fiscal year, the segment had another solid performance with revenue at $1.9 million and operating income of $0.5 million.

The management team in this division continues to prove that they can make consistent contributions to our collective success.

From our marketing point of view, the kick off of fiscal 2008 was dominated by our MKS Integrity 2007 product launch. This latest and largest release was surrounded by a broad number of marketing efforts including updates to our Web site, marketing brochures, press and analysts briefings and Webinar showcasing the latest updates which included among other things a revolutionary support for requirements were used and new solutions for package application change management.

According to Tom Clark, the Head of Quality Implementation in HSBC, they looked at the market extensively for a solution to manage the requirements and it became very clear that only one solution provided a complete integration with a development in test environments and this was MKS Integrity.

With MKS Integrity 2000, they have the ability to not only integrate all requirements right down to the source code and across the quality management but also have the capability to represent these requirements as interrelated items and an easy-to-manage document complete with rich text and other document management features.

We also maintained our online advertising efforts to publications such as ComputerWorld, StickyMinds, Gantthead, CM Crossroads, and we're now kicking off advertising efforts with CIO.com and CIO Today in an effort to increase the lead flow even further.

The marketing team also hosted a very successful summertime Webinar series through July on process improvement. The series of events, these are the number of MKS consulting partners speaking on topics such as agile development, business process optimization, CMMI and ITIL.

Our European teams were also busy with road shows throughout year out showcasing the new addition of MKS Integrity. These efforts kept up the lead flow to sales team through the summer season.

Our services growth in building the backlog continues to be a leading indicator for future license growth. Our customers are investing significantly in establishing an automated development processes to help provide them more visibility into their application development department.

The bulk of the services revenue for MKS has been geared towards rapid and efficient deployment of MKS Integrity licenses to ensure that the customers are driving a maximum value from MKS technology. That is the key to further purchases in the development of new references.

In order to further assist in the deployment of MKS Integrity into the market, we signed on more partners globally within ALM and we'll be reporting on the progress in upcoming quarters.

Of particular notes are a couple of new systems integrators, partners in Japan which we feel will help us even further get us into this as of yet untapped market.

On that note, we are pleased for the progress that we have made in our newly formed Asia Pacific Region with that team posting its first profitable quarter with a few key wins into accounts with a great deal of potential and specific plans for enterprise line deployment.

In summary, we started the year with our third straight quarter of ALM license growth, all services indicators are strong, our ALM maintenance continues to grow in a very positive way at 23% over the same period last year and our IO division had another solid financial performance.

Helping our ALM license growth with contributions from our biggest accounts, which has been unusually quiet over the prior few quarters, this activity clearly demonstrates our continued value delivery to these customers.

We are optimistic about the recent trends in licensing and services growth and look forward to reporting on more progress in the quarters ahead.

Back to you, Phil.

Philip Deck: Thanks, Michael.

We are confident that we're steadily regaining our momentum, from license slowdown we experienced in fiscal 2007, not only as to license amount rebounding but the results are broadly-based and include a healthy contribution from our major strategic accounts.

As our shareholders are aware, we have rapidly expanded the scope of our ALM platform in the past few years. Last year, we were disappointed at the rate that our largest customers could deploy these changes as they cope with some of the organizational changes needed to implement the kind of unified software development capability that we can now support. These are issues that we have detailed in the past and that we are now seeing some solid progress on.

But at the same time, our broader capabilities are having a major impact on how we sell our product and why our customers are buying it. We are seeing a much larger segment of our new customers buying into our unified vision and backing it up with deployment plan to expand a much larger set of interrelated processes within software development and extending into the helpdesk, portfolio management, deployment and packaged application management space.

This is a big part of the reason we are seeing larger service engagements relative to licensing. This trend is extremely gratifying to all of us at MKS, who had been preaching the message of unified application life cycle management for so many years. What we are seeing is the much closer correlation between our customer's objective and our biggest competitive advantage.

It's often easier to get new customers to buy into the vision of unified ALM that it is to get customers who bought our system for single departmental use to see us in a broader context and implement that broader vision.

We continue to be the obvious choice for any customers who want true integration of application development processes as our competitors increasingly admit that their loosely coupled point products just can't deliver that level of traceability and visibility that is increasingly in demand from customers around the globe.

Based on a survey of 300 of their customers, Borland reports with frustration -- "disconnected processes, lack of visibility and traceability across the life cycle, lack of metric, poor interoperability between tools and functional silos."

We don't think that our other competitors - customers would report much different. In contrast, we consistently find that the ability to manage interdepartmental collaborations, artifact sharing, traceability and the enforcement of consistent processes among the greatest advantage reported on our platform.

While our primary focus has been in working with new and old customers alike to reestablish license growth, we have had a strong focus on cost management to ensure that we can return to profitability as soon as possible. We have reduced head count modestly and mainly through attrition but we did encourage some unusually large severance this quarter notwithstanding. We also continued to pay headwinds from further increases in the value of Canadian dollar - both $400,000 in US dollar cost relative to the immediately preceding quarter.

The exchange rate changes in the first quarter bring to the total additional expense to the higher currency to over 50% relative to 2001 when we lost our ALM strategy.

Since then, we have managed those expenses primarily through an increasing mix of maintenance revenue, a tight control of our overhead, which has dropped as a percentage of revenue in local dollar terms, and the increasing productivity of our field operations.

We continue to expect that ALM license revenue will improve in fiscal 2008 from the level of fiscal 2007 which combined with continued increases in maintenance and services revenue will result in higher total revenue for the fiscal year compared to fiscal 2007 more than offsetting expected declines in interoperability revenue.

We are committed to an early return to quarterly profitability and we're managing our cost base with a view to sustaining current capacity and making further investments in sales resources only when acceptable levels of profitability are reestablished. We expect full-year profitability for fiscal 2008 based on increasing revenue and carefully managed cost.

We expect to maintain more than sufficient cash balances through fiscal 2008. The combination of expected improvements in net income, reduced capital expenditure over those in fiscal 2007 and expected continuation of lower overall receivable days and expected stock option exercises usually expiry exit schedules are expected to more than offset the anticipated cash needed to fund higher license sales in the maintenance of our dividend policy. We expect that seasonal factors will continue to cause outflows of cash in first half of the fiscal year and inflows in the second half.

Our board of directors yesterday approved our regular dividend of 2 cents per share in US consistent with our policy to return cash not needed to fund growth to shareholders to a regular dividend. The board of directors has a great deal of confidence and the - of our business plan and the opportunity this had had in our changing markets and our short term plans to reestablish growth.

We are encouraged by the progress we had made this past quarters in that regard. We appreciate the supporting confidence of all our shareholders and look forward to reporting on our progress in the months to come.

I'd now be delighted to answer any questions from analysts.

Do we have the operator there?

Operator: Yes.

Ladies and gentlemen, if you would like to register a question, please press the 1 followed by the 4 on your telephone. You will hear a three-tone prompt to acknowledge your request.

If your question has been answered and you would like to withdraw your registration, please press the 1 followed by the 3. If you were using a speakerphone, please lift you handset before entering your request.

One moment, for our first question.

Our first question comes from the line of Tom Liston from Versant Partners.

Please proceed with your question.

Tom Liston: Hi. Thank you and good afternoon.

First Phil, just on license revenue, I think it's the first time that's ever been up from Q4 to Q1. Can you comment - and well, obviously, there's been a lot of deals that you expect in Q4, probably fell in the Q1. Was there a little bit of pent-up deal flow that made Q1 exceptionally strong or, in other words, do you think you can maintain this rough level through Q2 or was there, again, a bit of a pent-up deal flow that we're closing early in the quarter?

Philip Deck: You know, there is always deals that push from one quarter to the other so I suppose this wasn't any different. And by the same token, we probably push a few from Q1 into Q2. So, I'm not sure if I can say that Q1 was any different from any other quarter in that sense.

You know, clearly, we had some quarters of lower license production last year, you know, that we're rebounding from, and I suppose that overcomes any seasonal effect that we usually show. So I think it's more of a rebound from some pretty low levels in the last year.

Tom Liston: And was most of the delta really on the - and you eluded to existing customers coming back a little bit quicker or was there some better closure of new pipeline wins as well?

Philip Deck: Well, we are pretty happy with some of our new pipeline wins not only because of the amount of them but the kind of deals we are signing, the kind of customers that we think will drive a fair bit of follow-on business.

But in terms of the kind of base customers that has taken a bit of holiday last year, they were back with a vengeance. And no real blockbusters among them - in fact, our biggest deal was a new deal, not a follow-on deal, and I think the biggest deal we did was around 650 in licensing.

But in terms of follow-on deals, we had I think seven or eight of our Big 25 contributing to the total and fairly broadly based among that.

So, it would certainly go to - those larger customers coming back into the license number.

Tom Liston: And, Mike, when you said half the license was from the largest 25 existing, do you have the overall split between existing and new customers?

Michael Harris: Of the top of my head, Tom, I don't - I can get that to you but I'm guessing it's in the 70% to 80%...

Tom Liston: Okay.

And with the sales productivity, can you just comment on - I think, originally - and we're hoping to get that number eventually towards 300,000. Is there a different goal? And just talk a little bit the sales conference you had and any potential changes with comp structure or go-to-market type strategies.

Michael Harris: Yes. The - I mean the way we used to talk about the sales productivity number was in sales team, so we have an RSM and an area account manager - one or two people on each team.

So, now we're reporting it because there's a lot of more independence between the direct sales and the indirect sales channel.

So, you know, in $185,000, we're - you know, we're pretty pleased with that when you take into consideration. That includes a fair amount of the inside sales reps who, you know, aren't out on the road, they're here in the (unintelligible) here in Chicago.

So - and I wouldn't be expecting to see $300,000 per rep when you include inside and outside any time soon but I'm sure we can continue to improve on our $185,000 that we did this time.

I would imagine that that number would translate to much closer to $300,000 if you look at the way we used to look at it - per rep.

Tom Liston: Okay. And can you give us a breakdown between direct field reps and then indirect and those numbers?

Michael Harris: That's 25 direct and 14 indirect.

Tom Liston: And - okay.

And just with the significant deal, the financial services deal, was that the deal over 500,000 and was that on the change management side?

((Crosstalk))

Tom Liston: Okay.

Michael Harris: (It was that). Yes.

Tom Liston: And I mean the next step there is they're actually looking at requirements as well.

Michael Harris: Yeah, there's a lot more business in that account rep, actually, deployment as well. I think we're going to be finding a lot more revenue in that account.

Tom Liston: And with the launch on Integrity 2007 in the quarter, was there any bit of delays to customers as they were trying to wait to see some of our functionality comes true in terms of licensing and that maybe why Q1 maybe was a little bit stronger or maybe Q2 can hold or - how do you find that?

Philip Deck: It's amazing how active a non-event our product release date is to just about our entire business other than the R&D team because we tend to be demoing the new product well before (it chips), so we've been using, you know, we are using that the product that we shipped probably four months ago internally as it was going through the last phase of testing that ends up on our demo platform. So we're showing that to customers all the time.

None of them are in - none of them have any particular pressure on when it comes out because they can, you know, in most cases, just as easily implement the original version and didn't get the pre-upgrade and most of our existing customers take some time after we released to implement anyway. So it doesn't really affect the pace of business closing, you know, went a whole lot.

Tom Liston: And finally, just on the severance, I'll pass the line, can you just talk with the number of people and what functionalities they're in?

Philip Deck: The severance hit was among - really, almost all of it among a very small number of people and mainly outside of North America.

Tom Liston: Okay, all right. Thanks. I'll pass the line.

Man: Okay.

Operator: Our next question comes from the line of Izet Elmazi from TD Newcrest. Please proceed with your question.

Izet Elmazi: Hi guys. Nice quarter.

Can you just talk a bit about the competitive environment, some of your smaller competitors like Borland, like Serene and Telelogic before they were taken out by IBM. We're all struggling along to with yourselves; you've come back a bit this quarter. IBM has been doing fairly well with the rational business. Can you just talk about some of the dynamics there?

Philip Deck: Well, I think there is a general - and we might have commented on this before.

I think there is a general disappointment in how well the whole integrated ALM pitch has worked among the Borlands and the Telelogics and Serenas, and we, of course, think that that's because they don't deliver it very well, I think it's a very appealing message, and it certainly resonates with our customers.

And we're finding it - you know, I encourage you to go to Borland's Web site where you can find the press release on their customer survey because it's somewhat instructive that they did a, you know, a survey among their 300 customers and found a great level of dissatisfaction over the level and integration you could get among those products. And I think you'd find the same thing with other customers.

So I think there's a bit of a retrenching among some of the aggregators in the whole integrated pitch because it's difficult for them to actually deliver on, and there's a fair bit of let down among the customers when they buy into it and find it.

In fact, those are a bunch of point products. And I think for those that have - that are trying to, you know, that have a different financial reality because now they may be private companies and they may have debt. They've had to take a knife to some of the costs that are inherent in selling at the enterprise level and selling that integrated capability.

You know, frankly, if you have point products, you can sell them a lot more on inside sales and that's a lot cheaper. And for those of us that really want to commit to enterprise business, you know, you spent a lot of money in your field operations and, you know, in sales people and field engineers and all of the services that go along with it. It is a very expensive way to do business.

But ultimately, you know, if you have the technology to deliver that integrated capability, you can create a much more attractive business long-term and attract better customers long-term.

So, you know, even - I think even before Telelogic was acquired, they had, to some degree, stepped back a bit on the whole integrated message and focused on the point product lines and I think they continued to do that.

You know, on the other end, certainly, IBM and HP who really are the two kind of giants in the industry now, you know, focus on the their brand relationships, and I think that hasn't changed very much at all.

So, you know, my - I guess my prediction is that as we move forward, we're going to find a lot of the aggregators continuing to retrench as point product vendors even if they may be having a, you know, even if they may be offering a lot of point products from a single vendor.

And there’s going to be a couple of companies, probably IBM and HP and our self competing at the enterprise level for enterprise business.

And between us and those larger two, you know, we will be offering the technology-focus solution the kind of responsiveness that a small company can provide, and they will tend to rely on their brand equity and relationships and services partnerships. And that's effectively where the competition will lie.

Izet Elmazi: That's a perfect segue into my next question, and that is penetration into CIO’s office that's typically been a challenge for you guys. You’ve undertaken a lot of marketing programs and launched a new product. How are things going? Is it getting any better out there?

Philip Deck: Well, I think we’ve kind of organized that our customer types so that we understand them pretty well.

You know, there are two ways we get into a customer, either we, you know, our traditional way with large customers have to be, you know, find some road division that's prepared to buy us, buy our product without a lot of involvement from the head office, CIO. So kind of sneak us in there.

And then we can prove ourselves over time and hopefully get to know the CIO through, you know, doing great things in that one division.

So that message seems to continue to be a good strategy for us, but, you know, we have to keep away from the CIO’s office typically when that happens because, you know, sometimes it's harder for us to compete until we’ve made that beachhead.

And we’re doing really well with companies like defense contractors on that front, with financial services companies, with, you know, and particularly embedded systems companies where (unintelligible) is important and where they tend to be a bit divisional still and so we can grab the division and work through that. So that traditional method is working pretty well.

The way - the other place that we tend to do well is in slightly smaller companies, you know, the companies with 500 to 1000 developers where the initial engagement really is at the CIO level. And the sale is very much based on the appeal of the single integrated platform.

And I guess that the thing that struck us most over the last year was the expanding scope of our product line is, how much appeal there is to those companies slightly smaller than the multinational so that they’re still really operating chiefly as one business, not a whole bunch of fairly disconnected divisions where we can really go in and show how they can - how an entire development department can put all of their artifacts in one repository, get great transparency to what’s going on, great collaboration, really the idea of putting it all in one system.

And that's immensely appealing to those companies. That's actually the appeal of the financial services deal that we did this quarter, which was at the CIO level.

And we seem to be having a great time winning over the companies based on the integrated sell.

And the reason we’re so excited about that is that really is our biggest sustainable advantage. That, you know, everyone can improve their products, but the ability of our competitors to take kind of loosely connected point products and suddenly turn out some kind of integrated capability is very unlikely.

So, we love trading on the integrated story because that's the advantage that we think we can sustain the longest.

Izet Elmazi: Okay, switching gears. Thanks for that insight.

Just a couple of more questions.

Were there any marketing costs in the first quarter that won’t continue going forward?

Philip Deck: Not to any large degree. I can’t think of - other than our normal sales conference which I guess is kind of an internal marketing cost, no, nothing terribly unusual.

Izet Elmazi: There was nothing unusual with the new product launch that generally won’t continue…

((Crosstalk))

Philip Deck: No, you know, a lot of the expenses through our product launch, we - or relate - a lot of the activities around our product launch relates to expenses we paid throughout the year to industry analysts and, you know, doing other kinds of marketing. So there’s not a lot of extra cost when we actually launch.

Izet Elmazi: Okay. And can you give us an update on the number of (house) accounts you have currently?

Philip Deck: You know, we didn’t go and track it exactly…

Izet Elmazi: Okay.

Philip Deck: …so I don't have a number I could give you.

Izet Elmazi: All right. Thanks a lot.

Philip Deck: Sure.

Operator: Our next question comes from the line of Howard Lis of GMP Securities.

Please proceed with your question.

Howard Lis: Good afternoon.

If I could just go back to a couple of things, the severance that you incurred in the quarter, that's part of your sort of cost restructuring program, I imagine. Can you just give us a sense of how many people were involved in that?

Philip Deck: I don't think I would call it part of any kind of cost restructuring program. It's just that there were a couple of individuals that we terminated that had nothing to do with cost-cutting that bore a large severance cost. And that's why it was unusual.

We haven’t undertaken any kind of lay-off or extraordinary reduction. We’ve, you know, we’ve been managing things a little tighter. And when we’ve had attrition, we haven’t replaced people as fast.

But we certainly, you know, the severance we've taken is not related to cost-cutting.

Howard Lis: It just serves - it sounds like it's, you know, half a million dollars is not a rounding here, so I'm just wondering how many - either people are involved or how senior these people were.

Philip Deck: It's based on the countries they came from.

Howard Lis: Okay. And then the sales - the annual sales conference that you held during the quarter, you mentioned in the press release, it was half million dollar expense.

Philip Deck: Yup.

Howard Lis: And talk a bit about through your thought around expending that kind of money on that event, you know, given the reason for, you know, top-line performers of the company.

And so are you planning to do it sort of in a different fashion for this coming year who maybe do it at a more modest level?

Philip Deck: Well, you know, most of the cost is flying people to one place around the earth and, you know, you try and pick the place that will minimize the travel cost the most, but, you know, it's expensive.

The reality is, we have more than half our employees spread across North America, Europe and Asia. And it's absolutely essential that at least once a year, and it's unfortunately we only do it once a year. You get everyone together so that you get people on the same page with, you know, what we're trying to sell, how we're trying to sell it, how we're trying to work together, you know, getting people trained, getting people to know people from the head office.

And it's, you know, this is obviously not a boondoggle. It's an essential part of trying to get a team spread across the globe to actually trying to work as a single company.

So, you know, we don't have the luxury of having everyone come to the same office.

If you look at even at our North American organization, we've got more than half of the people in our North American field operation working from their homes.

Michael Harris: And there's a couple of other things, Howard. I mean there are 200 of us that attend this globally, so it's, you know, the vast majority of the company.

Two other things that happened, we also invited our partners to join as well, so they're meeting the rest of the global team.

And also when we release our product, consequently in June, we can - the timing is perfect so we bring all of our global application engineers together the week before and take them through a full extensive training two months before the product is out.

So, we put a lot of - there's a lot of value in that investment of, you know, $2000 a head over the actual numbers.

Howard Lis: So you said 200 people attend the conference?

Michael Harris: Yes.

Philip Deck: Yes.

Howard Lis: What's your employee headcount right now?

Philip Deck: 304.

Howard Lis: And how many reps?

Philip Deck: Well, put it this way. We have about 140 or 150 people in our field organization. So even though we only have 25 outside reps and 14 inside reps, we have all their pre-sales engineers and their managers and the report people and services organization so that the customer-phasing count in our company is well over 150 people.

Michael Harris: Right. But the rep count went down just by - from 26 to 25, it sounds like.

Howard Lis: And…

Philip Deck: No, no, the outside sales were flat at 25. The inside sales went down by 1 from 15 to 14.

Howard Lis: And just one final question, if I may.

The number of contracts was over $100,000, do you have that figure handy?

Philip Deck: I think we do. I think we did -- 15 in ALM and 2 in I/O for a total of 17.

Howard Lis: Great. Thanks a lot gents.

Philip Deck: Yup.

Operator: Our next question comes from the line of Susan Streeter with Cormark Securities.

Please proceed with your question.

Susan Streeter: Thanks. Good afternoon.

Phil, I'm just wondering, just following on the question about the number of large transactions, they were fewer this quarter over a 100K than prior quarters. I'm just wondering if you can talk a little bit about what cost that.

Philip Deck: Well, it's, you know, in ALM, it's 15 versus 16. So, just statistical noise I think, you know, there's no particular trend, I don't think.

I guess we haven't done an analysis of what's happening to our average deal size over a certain amount very much. And so I can't really draw any particular trend to that.

((Crosstalk))

Philip Deck: I guess - sorry, I guess. Now, I'm reminded by my CFO that maintenance renewals are also in that number and there's a bit of seasonality to that. So we tend to have - that would give us more deals over 100 in the third and the fourth quarter as we saw it.

I think in the third quarter, we had 22, so that's mainly renewals showing out there.

Susan Streeter: Okay. And so, in the third quarter, it was 22, and then down the 16, and now 15?

Philip Deck: Right.

Susan Streeter: Okay. Okay. And you’re saying that that type of seasonality is not unusual?

Philip Deck: Well, the maintenance renewal seasonality is very much a third and fourth quarter peak.

Susan Streeter: Yes.

Philip Deck: It's highest in the third, fourth quarter, and then almost as high in the fourth.

So, that - I’m just - because I don't have the deals in front of me, I’m just guessing that that's likely the cost of it.

Susan Streeter: Okay. I’m just - I guess what I’m wondering is as you move to sort of this bigger sort of solution sale, I would have expected a number of large transactions actually tracking the reverse direction.

But - so to see it decline at the same time as you're saying that you’re seeing some real traction back with large accounts. I’m just…

Philip Deck: Well, the reason that deals - I mean the reason we don't track it very closely is that, you know, whether a deal comes in as one deal or whether it comes in as some license this month and some services next month, and whether they break up services into a bunch of engagements or one doesn’t really change anything.

And - but it does change the number of deals over a 100, so…

Susan Streeter: Sure.

Philip Deck: …you know, I don't know if there’s a whole bunch more $95,000 deals than $110,000 deals to do that.

But, you know, it's just - I’m not sure if it's terribly useful metric in characterizing our business. I think, you know, more useful things are, for instance, the amount of services we sell per dollar of license. I mean you can’t really track it very well in a particular period because, you know, we'll often close a lot of license deals and then have the services deals come in the next quarter.

Susan Streeter: Oh.

Philip Deck: Sometimes they get bundled together, sometimes they don't.

Susan Streeter: Okay. Now, that's quite helpful. Thank you.

And then I’m just wondering with respect to the customers in Asia Pacific, you said you saw a bit of an improvement on that front. Are these sort of counting as larger customers and one that you would expect to grow at this point?

Philip Deck: How many of those were - how many over 100 in Asia, Michael?

Michael Harris: Two of those would have been from…

Philip Deck: Two of those.

Our Asian business, you know, maybe it's interesting, is quite different in nature from our North American businesses. We’re amazingly selling a lot of software, maybe not amazingly but a bit different from North America.

We’re selling a lot of software to people who are also going to be services partners of ours. And so, in fact, we talked about Canonsoft.

Canonsoft is a professional services organization owned by Canon. And so they want to use the software internally, but also work as a partner with us to use the software with their customers.

So, what’s really gratifying about the business we’re generating in Asia is not only that, you know, it's now breaking even and going into profitability, you know, which is an important start to the return on the investment we’ve made. But they were dealing with quite a few companies that are going to form part of the ecosystem for MKS and particularly, in Japan, which is really where the strategy is mainly focused.

So there’s a lot of potential from those accounts, maybe bigger than the actual revenue would suggest based on the fact that we’re getting some really good partners that are going to help us sell and support the product in Japan.

Susan Streeter: Okay. Okay. And then - sorry, go ahead.

Philip Deck: Sorry. Sorry, go on.

Susan Streeter: Okay. And I just wondered with respect to your guidance on the interoperability revenue, are you still anticipating about a 10% decline this year?

Philip Deck: Yes.

Susan Streeter: Okay. That's it.

Thank you.

Philip Deck: Thank you.

Operator: Our next question comes from the line of Lawrence Rhee with Blackmont Capital.

Please proceed with your questions.

Lawrence Rhee: Hi guys. I wasn’t sure if this was covered already.

But can you just touch on the impact of some of these external consultant partners that you’ve established I guess last quarter and some quarters back, and how that's helped contribute to revenues?

Philip Deck: Michael, do you want to…

Michael Harris: You know what, in North America, we’re pretty much in a consistent - we do about 25% of our services revenue through partners so we’re doing - we’re outsourcing to them to fulfill the sort of peaks of services requests that come our way.

Off the top of my head, I don't have the numbers of license deals that they influence, but I know that at least a couple of them in the 100K were greater range actually. We started from partner relationships where they brought us in, and we're working with a lot more of the larger systems integrators in this current quarter and some bigger opportunities.

So, about the same numbers as Q4, I think.

((Crosstalk))

Lawrence Rhee: Is there a plan - I guess last quarter, you guys hang around and a dozen of those relationships, is there a plan to increase that or is that pretty well steady today going forward?

Michael Harris: No. And we were continuing to increase that every quarter, and we're starting up, you know, the very local partners who were helping us with services delivery and these are the small consulting firms of between 20 and 120 professionals as well as working on the bigger systems integrators who work on a very large projects. And these are the sort of 300 to 3000-sized teams and such as Canonsoft.

So, we continue to - we have a lot of capability to, at the field level, to have our sales teams work with these individuals, so we expect that to continue to grow.

Philip Deck: You know, it's probably worth reinforcing a distinction between consulting partners where our relationship with them is primarily subcontracting and where the referral part of those relationships is nice to have not so much an automatic expect to have in every case.

And the systems integrators where the systems integrators have a great deal, more capability to contribute to pipeline development over time. And I think it's been easier for us to sign up to consulting partners and that strategy has worked well and that it's a lot of new capability to the field organizations and they bring a lot of skills in, you know, different kind of processes in the vertical market things as well.

But in the systems integrators, you know, it's probably that strategy is not as well advanced, and at the same time has a lot more room for growth and room for, you know, contribution to our pipeline building.

And that's where the relationships are really getting interesting as Michael indicated. And as those firms get deployed and trained up, there’s a lot more capability for them to deliver business to us over time. And that's one of the reasons that clearly we’ve gone into the package application management game because there’s a lot of systems integrators, you know, drive a lot of their business that way, and it really helps create those relationships.

Lawrence Rhee: Got you.

And just last question. As I understand that HSBC is one of the larger customers, can you just give us some color on the progress of the deployment you guys have amongst HSBC and Countrywide and how that's being impacted if at all, I guess by the lay-off from the Countrywide side.

Philip Deck: Oh, sorry, I didn’t realize what sense you’re using Countrywide. I’m not aware of any impact of Countrywide on our HSBC business at all.

Lawrence Rhee: Okay. And were you guys - the deployment side, they’re probably one of your largest deployments?

Philip Deck: Yes.

Michael Harris: Yes.

Philip Deck: For sure.

Lawrence Rhee: And that includes Countrywide though?

Philip Deck: I wasn't aware of any connection between the two companies.

Lawrence Rhee: Okay.

Philip Deck: You're thinking of the mortgage company, Countrywide?

Lawrence Rhee: Yes.

Philip Deck: That's currently - I think Banc of America is…

Lawrence Rhee: Yes.

Philip Deck: …making a big investment?

Lawrence Rhee: Yes.

Philip Deck: I'm not sure what that has to do with HSBC. I'm not following the banking industry closely enough as we speak.

Lawrence Rhee: Okay. We'll just talk about that offline. Thanks.

Philip Deck: Okay, sure.

Thanks, Lawrence.

Lawrence Rhee: Thanks Phil.

Operator: Our next question comes from the line of Susan Streeter with Cormark Securities.

Please proceed with your question.

Susan Streeter: Thanks. Just a quick followup.

Phil, the severance charge of 500,000, would that spread between sales and marketing and R&D?

((Crosstalk))

Philip Deck: There was almost - it was predominantly in the R&D/product management category. So it's in the way we present our statements in R&D.

Susan Streeter: Okay, great.

And just with respect to that, I know obviously the (effects), there's nothing you can do about sort of anticipating where that goes.

Uh-huh. On the severance side, do you expect to incur any additional severance charges in the current quarter?

Philip Deck: No, not of any material amount.

Susan Streeter: Okay, great. Thanks. That's it.

Operator: Our next question comes from the line of Izet Elmazi with TD Newcrest.

Please proceed with your question.

Izet Elmazi: Hey guys. Sorry, I might have missed it earlier.

Can you give a comparative for the sales reps under the new measuring formula and the average revenue generator for each in the last quarter and last year?

((Crosstalk))

Philip Deck: Go ahead, (Doug).

Douglas Sawatzky: So yeah, in the first quarter of 2008, as Michael mentioned, it was 185,000. In the fourth quarter, it was 157,000. And going back to the first quarter of fiscal 2007, it was 136,000.

Izet Elmazi: Thank you.

Operator: Ladies and gentlemen, as a reminder to register for a question, please press the 1 followed by the 4.

There are no further questions at this time. I will now turn the call back to you. Please continue with your presentation or closing remarks.

Philip Deck: Well, thank you everyone for joining us on the call. We look forward to reporting further in the months ahead, and hopefully we'll see as many as possible at our upcoming annual meeting.

Thanks everyone.

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