

**MKS INCORPORATED**

**Moderator: Philip Deck  
November 29, 2006  
7:00 pm CT**

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the MKS Inc. Second Quarter Results for Fiscal '07 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. If at anytime during the conference you need to reach an operator, please press star followed by the 0.

As a reminder this conference is being recorded Wednesday, November 29, 2006.

I would now like to turn your conference to Mr. Philip Deck, who is the Chairman and Chief Executive Officer for MKS Inc.

Please proceed.

Philip Deck: Well good afternoon and welcome to the MKS second quarter conference call.

I have Michael Harris, our COO, joining from Dallas, and Doug Sawatzky, our CFO in Waterloo.

But I'll first turn to Larry Wasylshyn, our legal counsel for the legal disclaimer.

Larry Wasylshyn: Thanks, Phil. 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 refer to future events or conditions 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 those factors set on MKS' filings with Canadian securities regulators and other factors.

MKS does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after this

call or to reflect the occurrence of unanticipated events, except as required by law.

I'll now turn the call back to Phil.

Philip Deck: Thanks, Larry.

Let me first apologize that apparently our press release is not on the wire yet. It is on our Web site, but unfortunately for some kind of formatting reason, it is not yet on the wire. Hopefully, it will be very soon. So apologize for the delay.

For the quarter ended October 31, 2006, MKS reported second quarter revenue of 11.5 million, the same as the second quarter last year. We generated a loss after-tax of 0.7 million compared to a profit of 0.9 million a year ago.

Our legacy interoperability business recorded 1.9 million in revenue down about 5% from last year, but slightly above our expectations. Although ALM revenue was also slightly higher than the results a year ago, license revenue in the ALM business was significantly lower showing a 22% decline to 3.4 million substantially lower than our expectations.

Services and maintenance grew at normal levels and made up for the license decline relative to last year's results. Cash remained stable at 14.7 million, down modestly from the balance of July 31, 2006, at 15.4 million. The net loss of 700,000 included non-cash items amounting to \$475,000.

The current income tax credit of \$330,000 was a cash item. And after changes in working capital, we generated 875,000 in cash. Clearly we were very

unhappy with our ALM licensing result. It was far below our expectations and implies a trend that is not consistent with what we believe is the health of our business.

Since the end of the quarter we spent a great deal of time analyzing our results in long-term trends. The questions that we have asked include those that our shareholders are undoubtedly asking, "Is there a fundamental problem with our strategy, our product line or our organization?"

We believe that we understand several factors that are affecting our business, and I'll try and outline them for you today.

Over the past five years, our long-term strategy has been based on the fundamental belief that CIOs and CTOs will increasingly come to see the management of software development as one that must be part of an enterprise-wide standardized strategy.

And consequently we have built our product to solve that enterprise-wide multiplatform, multi-location, multi-process mission better in our view than any other solution in the world.

But we've also recognized that as a small company among large competitors, we cannot simply attack the market at the top.

We have to make small tactical wins at the divisional or departmental level of large accounts and then spread throughout the organization acquiring more share of the seats and more share of the business processes along the way.

By doing so, we put ourselves in the best position to be chosen as the enterprise standard across our targeted accounts. This has been a successful

strategy. We have penetrated over 65 of what we now call host accounts and have steadily built up our seat count and relevance in those accounts. In many of those accounts we are today the standard or de facto standard.

Our growth in those accounts has been twofold. We've increased the number of users, and we've increased the number of uses to which our software is applied.

This latter growth and the number of uses is fundamentally important not just for the extra license revenue, but because as our customers use our single platform for more operations and processes, the overall customer value increases dramatically and the customer relationship between us and our customer becomes more secure.

We have facilitated the growth of the uses of - for our software by extending its capability. From core version management and defect tracking back in 2001 to now encompassing requirements management, tests management, deployment management, portfolio management and more recently package to application change management and service desk management.

The unification of these processes within customer organizations delivers far more value because they all share common process management and enforcement, security and data analysis capabilities.

When we analyzed the changes in license trends that have occurred in the past quarter, we find the most prominent feature to be a significant reduction in the amount of business generated by our oldest and largest customers.

These perennial customers, in other words, which have been with us for a long time and our regular and frequent follow-on buyers of MKS Integrity, new

customer acquisition has been impacted less and business from smaller customers is stable.

Well this is not entirely encouraging news at first glance. No one likes to see business from our best customers decline. When we have examined the state of our relationships with each of these perennial customers, however, we do not find unhappiness in the product, lack of new opportunities for growth, competitive threats or adverse changes in their strategy.

Rather we find customers delighted with our products, happy with the relationships we have established and enthusiastic about the expansive vision of our unified platform.

However, we find many customers who are taking more time to roll out the new capabilities that they have added and who have less expertise in how to manage those disparate processes.

While most of our customers have well-established processes and core development that we have successfully implemented and automated, the same is not true with the newer capabilities that we have embraced in the platform.

We've already begun consulting engagements with many to a system and planning and executing their implementations. We believe that we have not proactively provided the support that they need to execute on the promise of our products.

And we are moving quickly to address that failing through our internal services organization and through our growing roster of services partners.

To be clear, our best and longest standing customers are our most valuable assets. Those assets are in good condition and remained the largest opportunity for license and services revenue.

They share our product vision and then the large majority of cases have definable purchase processes moving towards conclusion.

We need to support their initiatives better but any slowdown in purchase appears to be temporary and those relationships are strong. We have seen the sales of services rise as a proportion of license revenue from 20% of license to almost 45% over the past few quarters.

We expect that these ratios to increase further and over time expect to reach a ratio of at least \$1 of services to MKS for each \$1 of licenses to MKS.

This is a positive trend as we consistently see that services lead to additional licensing and because our service business itself is a growing source of margin at 28% in the last quarter.

In new customer acquisition, while we continue to make good progress, regarding several new customers and as usual - recording several new customers as usual in this quarter, we're also struggling with the breadth of our new product capabilities. The complexity of the sale cycle has increased. And we need to be constantly careful not to needlessly complicate it.

We are learning to make sure that initial deployments are focused, and we can offer quick business payback to promote further deployment and then we do not try and sell the entire enterprise in one sale.

The positive experience of deployed users is always our best sales tool. And finally we're seeing changes at the top of the food chain. Increasingly as we have longed expected, CIOs and CTOs are in fact taking ALM seriously.

Our market is showing signs of transition into a true enterprise market where decisions about enterprise platforms are made at the top of organizations. While our product shines best from a technical standpoint in this initiative, we're still relatively unknown and we lack the major services partnerships that are so helpful in this campaign.

The sales cycles are longer. The initial deals potentially larger, and we face fewer but sometimes larger competitors. We have one enterprise deals like this before, and we continue to win even more as we gain experience in this sales initiatives.

The reference accounts we're developing, the partnership we're creating and the steadily improving visibility we're building will all contribute to our success.

I will now turn to Michael Harris, our Chief Operating Officer, for a review of Q1 operations.

Michael Harris: Thank you, Phil.

As Phil reported, MKS recorded flat year-on-year second quarter revenue and declines in ALM licensing.

Offsetting the license declines were strong maintenance renewals and services delivery results as well as another solid performance from our IO segment both in revenue and profitability.

Over the past few quarters, we have spoken about the new feature sets which have rounded out our platform to what it is today. A rich performance solution to enable end-to-end management of application development assets while integrating the various desktop-specific and platform-specific development and application-related tools.

Our strategy to build out these capabilities is based on the premise that as the use of MKS Integrity propagates to the enterprise, the value that our customers received increases significantly.

Our accounts typically begin with a small (deployment) of one key feature set, configuration management as an example. And from this starting point, tend to deploy outward and to the enterprise.

We are encouraged by the ongoing nature of repeat business into our customer base yet. As Phil explained, are also finding some of these sales require longer sales cycles than we have become accustomed to when the feature set was more narrowly defined.

The broad sweeping enterprise nature of our software is where the most value is to our customers and therefore we must continue to work towards the goal of full deployment of the entire feature set where relevant.

In order to better support these deployments, MKS will be investing more time and more resources in building out our services team, while at the same time working closely with external partners to more fully and better extend our reach.

The emphasis will be on using services to extract as much value from our solution as possible. Our services revenue has been climbing on a quarter-by-quarter basis, and we are seeing good operating margins on a new headcount that we bring to MKS.

The trend of growing services revenue while managing appropriate gross margin is expected to continue into the coming quarters.

To a more effective use of our internal services resources as well as external service partners, we should be in a position to move forward to follow on deployments with our customer base in a more effective way while driving overall beneficial revenue and improve the operating margins.

The external services partners are not only in a position to assist with deployment of MKS Integrity in our current customer base, but are also excellent end customer themselves and finally are in a great position to bring us referrals into new accounts.

Our relationship with Mitsui Knowledge Industries in Japan is a great case in point. Not only have we partnered with them to get a foothold into the Japanese market where a strong partner strategy is very much a part of our go-to-market plan there, but there are current uses of MKS Integrity.

We started the deployment of our product MKI across the engineering team and are working towards an enterprise-wide deployment. This in turn will provide an excellent reference site and was very important market to us.

The ALM marketplace as a whole continues to grow as more and more companies with the benefit from solutions such as MKS Integrity, which demonstrates outstanding value when deployed and utilized across the entire

enterprise. As such we continue to take the time to invest in growth of the MKS team.

Total company headcount as of October 31, 2006, was 328, up 47 or 17% from a year ago. The biggest change in headcount over this period and in line with our planning was the ALM field team, which have a 31% increase in headcount over the same period last year.

The field team is comprised mainly of the sales, service and support groups responsible for our customer success. It is our belief that in order to continue to serve our larger and more demanding customers by deploying more broad-reaching and integrated deployments that we will need to continue to grow these teams of customer-facing employees.

Specifically, in the recent past we have spoken about our focus of growing our direct sales teams -- RSMs. As of October 31, 2006, the total current - the total count of RSMs was at 29, which is a 38% increase over a year ago when it was 21.

With many of these new hires starting only in the past six or seven months, they are as expected less than fully productive as far as closing opportunities, although they have all been very successful in building a healthy pipeline. We have unfortunately come to expect attrition among new hires.

Of the 15 RSMs hired since March of 2006, we have eleven still on staff. This is slightly better than the long-term rate of success given that we are trying to identify those who will not survive earlier in the relationships than we had in the past.

Productivity gain from the new RSMs has been slower than we would like, possibly due to the broader product line that they are selling. We are nonetheless encouraged by their progress on an individual basis and expect much better results this coming quarter.

In order to help drive growth in future quarters and to replace normal attrition, we currently have a few open headcount all in North America and are looking to hire immediately.

Our average sales productivity declined to \$180,000 per RSM this past quarter from \$283,000 in the second quarter of fiscal of 2006, largely due to the fact there's (unintelligible) (lined about).

In particular our longest serving reps covering our largest customers were uncharacteristically silent in the past quarter. However, some of the opportunities that we did closed include repeat wins with Abbott Labs, BNSF Railway, Centers for Medicare and Medicaid Services, Neiman Marcus, (Suva) and (Teva Pharmaceuticals).

In the past quarter we also added (Hastings Mutual Insurance), (Carl Stewarts) and Mitsui Knowledge Industries to our list of customers.

Our IO segment had another quarterly result above expectations with revenue of \$1.9 million or a 5% decrease from one year prior.

Year-to-date, the segment is ahead of last year's equivalent period revenue performance. And IO continues to be an important source of earnings for MKS.

In the quarter, MKS also announced the release of MKS X/Server, which provides for a low-cost, high performance transparent PC X Server that delivers full integration between the Windows desktop and UNIX or Linux server.

We have already established numerous evaluations and expect to make some sales of these new products in the coming quarters.

The second quarter is historically one of MKS' busiest times for marketing event as the IT industry swings back into full power following December months.

Our collaboration with industry analyst leader Gartner continued in the quarter with MKS' participation in the firm's annual application development summit in Phoenix and Gartner Symposium and IT expo in Orlando.

These events alone generated significant interest in MKS' platform with the team is bringing back hundreds of leads. We also sponsored road shows with Gartner in Boston, Philadelphia, Toronto and Minneapolis. Meeting with executives for many of our strategic accounts both current customers and new targets.

We continue to be well referenced by Gartner analysts in their client discussions, which confirm our confidence in MKS' technology as well as our ability to execute upon our longer term vision.

During the quarter, MKS also exhibited at (Culmen), a marquee iSeries trade show, where we met with many of our enterprise accounts. The iSeries platform continues to be a fantastic (jump enough) points for larger enterprise opportunities for the companies.

To round up the quarter, we participated in the embedded system show in Boston, kicked off a sponsorship with Computerworld (unintelligible) two executive summits in Maryland and Chicago and presented to Motorola's technical and engineering teams at the Motorola Technology Symposium an event open only to strategic vendors and partners of the company.

We look forward to reporting on the continued growth of our ALM segment as we work to execute on our expanded services and partnership strategy and to help our strategic customers to fill the promise of the unified ALM platform.

Back to you, Phil.

Philip Deck: Thanks, Michael.

I'll conclude by making some comments about our research and development activity.

We completed a major cycle of product improvements last spring with some very substantial architectural and functional upgrades.

Our efforts are currently focused on a smaller overall release due sometime this spring, which in some respect cleans up and level sets all of the features that we've rolled out in the past few years.

The biggest new features will be the support version management across all development artifacts, a first in the ALM industry, to provide a document-centric view to configuration items and the ability to cash (non-quote) artifacts in remote servers for better bandwidth utilization.

We believe that anticipated growth in ALM revenue will lead to annual fiscal 2007 revenue in the range of 52 million to 55 million, down 5 million in each case from the outlook provided last quarter, and income before tax in the range of 0 to 2 million, down 4 million in each case from the outlook provided last quarter.

The material factors and assumptions we applied at arriving at these ranges and that could materially affect our liquidity are; our ability to successfully expand ALM sales services and research and development staff and to generate higher revenue in the ALM segment, our ability to make increased marketing expenditures in our ALM segment, increase the ALM research and development expenditures to ensure that we maintain our technical leadership in the ALM market, our expectations that we will incur increased cost relating to stock compensation charges and our expectation that our interoperability business will decline on an annual basis of approximately 10% over the course of this year.

Income tax expense is recorded on our financial statement at the prevailing tax rate in the jurisdiction where the income was generated, to the extent that a deferred tax asset has been recorded in that jurisdiction. Such rate may be higher than the average weight - rate we expect to pay in the future across all jurisdictions.

We expect that the long-term tax rate to be approximately 35% to 36%. This will be subject to an ongoing quarterly assessment of evaluation allowance by jurisdiction, which may give rise to further increases or decreases to the existing tax asset.

The MKS board of directors yesterday approved our regular dividend of 2 cents US per share.

Our dividend was put in place several quarters ago to manage a very specific issue that our cash balance exceeded the amount needed to fund our growth and that we should not be accumulating further excess cash but should instead return it to our shareholders.

We set the rate at a level that we thought would prevent further accumulations of cash given our medium-term forecast taking into account both generations from expected operational profits, the effects of seasonal maintenance renewals and from external sources such as option exercises while the issues that I have discussed regarding license growth are at the forefront of our minds, it's worth noting that in spite of the low level of licensing in the past period, our cash usage before working capital items over the last six months was only \$200,000.

Our analysis continues to show that based on our expectations for operations over the foreseeable future, we expect stable to rising cash balances and accordingly we have maintained our dividend at its existing level.

Your board of directors has a great deal of confidence in the soundness of our business plan, the opportunities at hand in our changing markets and our short-term plans to reestablish license growth.

We appreciate the support and confidence of all our shareholders and look forward to reporting on our progress in the months to come.

And I now be delighted to answer any questions from analysts.

Operator: Thank you.

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

If your question has been answered and like to withdraw your registration, please press the 1 followed by the 3.

If you're using a speakerphone, please lift your handset before entering your request.

Our first question comes from the line of Scott Penner from TD Newcrest. Please proceed.

Scott Penner: Thanks.

Phil, just, first of all, let me - a couple of questions on the guidance.

The, you know, from what (extent that was), (unintelligible) the preannouncement, you (unintelligible) sure of that by (unintelligible) 2 million, 2.5 million, I think. You've taken 5 million off the range. Yeah, I know you did give (unintelligible), you give estimates (unintelligible) but is this a sense that somebody's yields are just being pushed out further and further?

Philip Deck: Well I think, you know, certainly in those ranges, we expect better results in the back half and, you know, when we look at the existing pipelines we have and specifically the existing pipelines, not so much for new transactions, but for follow-on deals with our large customers.

We think that their contribution to our revenue in the last quarter and even in the last couple of quarters has been abnormally low and will rebound. And, you know, we based that on, you know, the kind of detailed interactions we have with those customers and that the plans they have in place.

So, we looked at the back half more in its totality and trying to set the annual guidance numbers and, you know, we feel that we can stage a fairly strong recovery in the back.

Scott Penner: Now, the large customers that didn't do as much business this quarter, I guess, that's a little bit surprising given that, I guess, as you said, the legacy and relationship that you have on (unintelligible) (nature) in the past.

And so I think is this a case for some of these sales reps were not having the kind of regular contact, let's say, they needed to have, and we're just counting on revenues that at the end wasn't there. I'm just surprised you didn't have a little bit of visibility on this.

Philip Deck: Well, I think that the, you know, there's a different story for every account and, you know, we've tried to nail down some general trends but, of course, as you look closer and closer you find different things going on at every account.

I guess if we try and pin down the most common thing going on, it tends to be, you know, pilots and projects that have been going on to implement new features where the sluggishness in the project has really come from a lack of really good understanding of the process they're trying to implement.

I mean, you know, virtually, every customer we deal with, we'll have a fair bit of experience in how to structure development processes. They may be, you

know, not very good process that can be improved on, but they're pretty quick to implement what they're doing on an existing basis and roll its software.

For some customers, things like requirements management are much newer to their organization, and when you start having to deal with many different departments, even within a particular division, and now you're dealing with the requirements management folks and the test management folks and in some cases senior development planners, then you just increase the complexity of those implementation plans.

And so while, you know, people - our customers seemed pretty excited about what they're deploying, they're just more to deal with in those processes and they get pushed out.

Scott Penner: And what is the - I guess the majority of some these services, relationships that you - that you talked about and who were they with? I mean, is this - are these services relationships that are up and running and, you know, I'm just trying to get...

Philip Deck: Are you referring to relationships with customers or with service partners?

Scott Penner: Sorry, with service partners.

Philip Deck: We've had a fairly ambitious services partnership program going on for about a year and a half. In fact, it was really a year and a half when we set out our '06 financial plan and budget to the company that we really stress services as a very key part of our strategy going forward.

I'm not sure that we've done a good enough job in impressing on the whole organization how important those services are. And, you know, we in the

management team are, you know, really responsible for not pushing that as hard, but we have done a good job, nonetheless, in starting to sign up implementation services partners.

I can't give you a percentage to - as to how much of our services revenue they represent. But right now there's seven or eight medium-sized services partners that are doing implementations and are, you know, trained and up and running and engaged in customer sites.

We're bringing on several more firms that have particular consulting expertise not just software implementation but various kinds of consulting whether it relates to requirements management or test management or specific areas of the development life cycle.

So the program has been going for quite a while, and it's been successful to the extent that we've kind of guarantee a quota of services for our partners to make sure that they have an incentive to, you know, develop expertise in the product line.

And there's a tremendous amount of enthusiasm among services partners because the nature of our product is they can add a lot of value on top of our product. They can sell their expertise in process. They can sell their library of implementations and configurations and methodologies.

And so we become a great platform for them to actually show some proprietary value on top of it.

So I think the program is going well. I think we've probably done better in building the capacity to supply services than we have in, you know, really

making sure that we're selling the services and explaining to customers why it's important that they should be using more.

And I think that mainly comes from our culture, you know, as a company where you deal with the core development activities, development departments, core development departments don't really want a lot of consulting.

And so, you know, you get that 20% of license rate that, you know, we've had in the past. Once you get out of the core development department. The appetite to users is as much higher, and we have to learn to make sure that we go and sell those services.

And where we've gone into large customers and said, listen, lets do a three-month or four-month consulting project to, you know, create the master plan for deployment of the platform.

We found a great deal of enthusiasm. And where we've done that, we started to really speed the process towards more deployment.

So we think it's really important to do that in a much more general basis, and we think that there's a tremendous number of customers that need a lot more help.

Scott Penner: So just one more, then is this - the services organizations, I mean this is the kind of Accentures of the world that could get you in at the CIO and CTO level?

Philip Deck: No, they're not. And, you know, I think that we're at the point where for a company our size, it's difficult for us to get international deals established with the likes of Accenture.

Most of the services organizations that we've made partnerships with are those, you know, between 30 employees and in some, you know, hundreds of employees, and in some cases we have some slightly larger than that, but these are the medium-sized boutique, consulting and development process shots.

We are starting to make relationships with a larger services companies like Accenture, but it's only on an account-by-account basis, where they see that we're a strategic vendor into that account and they want to learn more about what we're doing and get involved in what we're doing.

But realistically, for a company our size, you know, we can't hold our breaths waiting for Accenture to make us their corporate standard. I think it's unlikely.

Having said that, we're a great alternative to some of our competitors who also have consulting organizations that are competitive with the independent services one.

Scott Penner: Great. Thanks (unintelligible).

Philip Deck: Sure.

Operator: Our next question comes from the line of Susan Streeter from Spratt Securities. Please proceed.

Susan Streeter: Thanks. Good afternoon.

Philip Deck: Hi, Susan.

Susan Streeter: (Unintelligible), if you can expand on - just I want to make sure I understand the new hiring. You mentioned I think that there were 29 RSMs in the quarter.

Philip Deck: Right.

Susan Streeter: And is that down from 31 in the prior quarter?

Philip Deck: Maybe 32 in the prior quarter, so we hired quite a surge of new salespeople really starting last March, and I think the total was 15.

And so we normally expect about 50% of those salespeople will survive the year. You know, it's by far the lowest survival rate of any category in the company, and - but it's been a consistent level for quite a few years. And so we're running a bit better than that at this point. But, you know, we'll see how the rest of the year goes as they roll out.

Their performance hasn't been terrific to date in terms of production, but when we, again, when we go through on an individual RSM by RSM basis, we're pretty happy with where the bulk of them are.

And we've made a lot more attempts to weed out the people who aren't going to make it much earlier and being a bit more aggressive that way.

So I think the ones that we have now are mainly people who are going to do well for us over the longer term.

Susan Streeter: Okay. And where is that number? Do you see it sort of flat lining at these levels, or are you still looking to hire a few more beyond the 29?

Philip Deck: Yeah. I mean there's always going to be attrition, you know, through every part of our sales organization. So, currently we have a few approved hires out there and really the rate at which we fill those is just totally dependent on the kind of people we find, but we expect to at least see the net number go up and that will require us to hire a little more than that in order to accomplish it.

Susan Streeter: Right, okay.

And just the other question I had related to - you mentioned that some of your - sort of veteran salespeople were uncharacteristically quiet in the quarter. I mean obviously that probably goes hand in hand with lower licensing revenue. Is there, you know, is there anything out that you could sort of give any color on that would explain that?

Philip Deck: Well I think it's a kind of one-to-one relationship between - the RSMs that have been the most successful in our company are exactly the RSMs that have been with us for a long time. You know, there's very tight correlation between tenure and production.

There's also a very tight correlation between kind of annual quota and finding long-term strategic accounts that can represent, you know, more than \$1 million of business in a year.

And, you know, in other words, the most successful salespeople we have are really driving 90% of their business from one, two, or three accounts because they're well developed.

And it's in fact those accounts that we've seen lower production from, and those accounts that are pretty lumpy.

So the reason that they were quiet, they were quiet in terms of closing deals, not quiet at all in terms of the activities that they were engaged in pushing initiatives forward.

And I think it's a sign that not that there's an inherent problem happening with those folks, but that they're working on big deals and they just haven't brought them to a close yet. But I think they all think they're in pretty good shape and we agree when we actually look at the individual sales situation and customer relationships.

Susan Streeter: Okay thanks.

And then just lastly, I'm wondering if you can touch on the competitive landscape and if you've seen any shifting there in terms of who you're up against on some of the house accounts.

Philip Deck: I don't think overall there's too much change. I would say that the air gets thinner as you move up the organization, and we find that fewer and fewer competitors are really able to deliver the scalability and multi-process ability to deals at the CIO level.

So there's much fewer competitors that can really play in that space. So as we move higher in the organization, you know, we're going to - our competitive landscape is going to change somewhat because, you know, we're dealing with more of those deals at the CIO office.

I would say that, you know, universally we still find that on a technical basis, we virtually always win. Our technology is the most modern and most scalable and most suited to large enterprise deployment.

I would say we don't have as much experience in that area, and we're having to learn more as we go, and some of the non-technical factors probably make a bigger difference when you get to that level, and we have to learn how to manage those. But I wouldn't say there's any great change in the competitive landscape.

Susan Streeter: Okay thanks. I think that's it.

Philip Deck: Sure.

Operator: Our next question comes from the line of Lawrence Rhee from Genuity Capital Markets.

Please proceed.

Lawrence Rhee: Just - could you comment on whether or not some of - have you lost, (you know), those veterans sales guys that were as unproductive this quarter, (how to do) attrition?

Philip Deck: We haven't lost anyone who had ever got to a big quota, so I don't think we've ever lost anyone who had been \$1-million quota player in the entire history of this strategy.

So in the past year, I think we've lost two people that were - maybe three people that were more than a year in tenure, but I would say that's the normal rate.

So there's modest attrition among people who have been with us for more than a year, not any different than any other time.

The real, you know, where you really have to be focused on the success rate is on the new hires. And, you know, I suspect unfortunately we're going to be at our normal level or maybe a bit better over time.

Lawrence Rhee: And I guess was the veterans being, I guess, uncharacteristically low in terms of productivity this quarter. Are there fears there that they're not going to be able to meet their annual budget and therefore maybe cause some tension in the sales ranks as...?

Philip Deck: No, I'd say they're all pretty happy with what they have. I mean these are all individuals that have spent, you know, a couple of years, at least, developing relationships with account to the point where they can produce a couple of million a year.

And, you know, that just doesn't get spread out through the calendar year, so I don't think there's any concern among those people at all.

Lawrence Rhee: And just push this right to the new hires, can you quantify in terms of how many increase in headcount they expect, I guess over the remaining part of this fiscal year? And specific...

((Crosstalk))

Philip Deck: Michael, do you want to comment on those numbers specifically?

Michael Harris: Yeah. I mean I think that the plan is roughly to get to 32 by the end of this quarter, and then I think it's 34 or 35 by the end of Q4 is what the plan is, so, you know, we'll need to hire probably (call it), you know, nine to ten more reps between now and then to make those numbers.

Lawrence Rhee: Okay. And the actual sales and marketing figure coming down sequentially, obviously, (unintelligible) I guess due to kind of the lower license (unintelligible) figures, but I think you're mentioning that this is also a pretty active quarter for marketing events. We just want to kind of try and figure out the dynamic there in terms of the decrease in sales and marketing one?

Philip Deck: Part of the decrease was that in the first quarter we have our worldwide sales conference and that cost us between \$400,000 and \$500,000, so that's when we get all the salespeople in from around the world and do training and product strategy and things like that with them.

So that's an expensive event that happens in the first quarter. And when you remove, it has an impact to the second quarter.

And then as you say the commission impact of significantly lower license revenue also has a big impact.

Doug, I don't know if you have any other parts of sales and marketing that you'd call out as significant changes.

Douglas Sawatzky: No, I think you hit the two main points right on the head.

Lawrence Rhee: And were there any FX impact or one-time cost in the quarter at all?

Philip Deck: Doug?

Douglas Sawatzky: No. You know, in terms of the foreign exchange, things - you know, there was a slight impact to the bottom line, you know, that's over \$100,000 but, you know, it isn't that - really there's no other one-time cost but that came out in this quarter.

Philip Deck: That was a negative impact?

Douglas Sawatzky: Yeah, negative impact.

Lawrence Rhee: Got you.

Philip Deck: We're running slightly below the currency rate that we are at last quarter, so hopefully that will save us a little bit of money this quarter.

Lawrence Rhee: Okay thanks guys.

Philip Deck: Sure, Lawrence.

Operator: Our next question from the line of Tom (Lacson) from Versant Partners. Please proceed.

Tom Liston: That's close enough.

Just on the - yeah, talking about the traditional customer base and if you want to call the host account is probably the best way to describe it.

But what specifically need to be done? Do you think it's more on the internal services that you're providing to help them get over the hump on getting those projects accelerated or is it more - can you rely on the partner side? How

much is just enhancing the partner side of business versus just adding internal resources to help those projects move on?

Philip Deck: Well we'd like to be at a point where a majority of our services come from external services partners. But I think you're correct to use the word "rely." We're not prepared to rely on them to move our customer relations forward.

I mean this is tremendously important to us and, you know, we will staff up internally to make sure that customers are able to deploy software. It's certainly our preference that if those services partners, you know, are enthusiastic and they keep making progress and they learn about their product, and we have successful engagements with them, then, you know, we'll just feed them more and more and more business.

And it's tremendously important for us to build up that base because they offer much more than labor. The labor is probably the least important of it because we can hire labor ourselves. But they offer a lot of methodology and expertise and credibility and, you know, those things are really important to us.

So we prefer to be using them. We're happy enough to use our own people for the kind of bread and butter stuff because, you know, as far as implementing software and setting up servers and migrating code, we really know the most about that and we can really make our product work best in terms of implementation.

What we really want the partners to do is, you know, plan implementations and, you know, work on developing process and methodology and helping managed their relationships between different departments that are trying to deploy and working with senior management.

So we're happy to give them, you know, our partners the, you know, that in some ways a more strategic parts of the services engagement, you know, if they kind of can bring there expertise up and take the ball and run with it.

So we won't rely on them, but we sure are working hard to develop that base of partnerships and to make sure that there are great extension of our field organization.

Tom Liston: And do you have any metrics on how many - in terms of the (unintelligible) probably add internally?

Philip Deck: No, you know, we're doing a lot of planning actually next week on what this will actually mean in terms of what our goals for services revenue growth are and how we're going to manage it and, you know, I think, you know, it's fair to say that we're going to be stepping up the focus on service - on our services organization tremendously.

And so we haven't developed the metrics yet, but I think that over the next maybe six to eight quarters, we're likely going to try and get close to that one-to-one service to license relationship. So it's not going to happen overnight, but it's going to be the substantial focus for us.

Tom Liston: Okay. And you talked about the sluggishness of some of the projects that's going on. Do you think the year-end, you know, (unintelligible) thing is a bit of a budget (plush) or at least in terms of year-end dates, do you think they'll be any flow-through there because they try to meet the deadlines that you're...

Philip Deck: There's also - there's always some year-end business that - maybe more so in Europe than in North America. And as much as I would hate to see it happen,

it would appear that we're developing more seasonality in our business. If you look at last year for instance, the back half was substantially stronger than the front half.

This year, this seems to be happening again. I'm not all that enthusiastic about the trend if it in fact is a trend. But we are seeing more of our big customers buying in the back half, and I don't understand why enough to tell you what the motivating factors are but, you know, empirically it's hard to deny that that's happening.

Tom Liston: Okay. And if you look at something on the new customer front and just wanted to get more color on, are they trying to sell perhaps too much of expensive product set, whereas they're really not hitting the one paying point that the customer maybe is really focused in on and maybe selling to what if credit solution and maybe they should be focused more at the end eventually, roll out the rest of it or introduce the rest of the product set?

Philip Deck: Well you know, we're doing that too much when the customer doesn't want it. You know, for a lot of customers, that's what they get enthusiastic about.

In some customers, it's better to solve the paying point and prove ourselves and move on. It's a matter of maybe being more careful to read their customer situations. Sometimes you can talk about the fantastic ability to integrate processes across the entire organization, and that's what sells the account.

And sometimes you can do that and all you do is complicate life. And what you have to really do is figure out what kind of company you're in and what's the nature of the political relationship between the divisions you're talking to and try and figure out should you unleash the whole integration message and

try and sell that way or is it better to, you know, to really focus on that direct paying point.

And, you know, yours truly is probably the biggest defender. You know, when I'm in a customer organization, all I can talk about is integrated process. So, you know, I have to read my audience better, too.

Tom Liston: Okay. And just on the metrics that - your direct sales force, you know, 29 people, correct?

Philip Deck: Yup.

Tom Liston: Fifteen or higher since the merge and 11 are still there?

Philip Deck: Right.

Tom Liston: Okay. So about 35% to 40% of your sales force is basically, you know, eight months into it. So what - you see more of the 9 and 12 months is when they start to get toward productivity and has been that helpful in the remaining half of the year?

Philip Deck: Well I guess, we've always, you know, six months ago, we would have told you it's a bit shorter than that. It's turning out to be nine months to a year. I think, Michael, you might have called it more like six months to nine months.

So, you know, I'm not - I think the effect, you know, certainly, there is a lengthening in the burn-in period, and I'm not sure we have the statistical significance to really say that it's a long-term trend or it's just the way things are going this year.

But, Michael, maybe you have some better insight into that?

Michael Harris: Yeah. I mean I think our, you know, our planning is based on nothing in the first quarter (then) sort of ramp up to sort of 25%, 50% in the following quarters then 100% in the third or fourth quarter.

And, you know, looking at the guys who we hired, the guys and gals that we hired in April and May, you know, a lot of them are working on some much bigger opportunities that are probably tending to be longer sales cycle.

So I think the important point is we probably don't have enough data points to say whether or not this is significant, but it would seem that the newer people that we're hiring are working in the bigger projects is extending the sales cycle for the opportunities they're working on.

You know, we expect - I mean the new hires had another very, very poor quarter in Q2, and we expect them to finally get on the board in Q3.

Tom Liston: Is part of it simply what we just talked about two years ago, it was a simpler sales, it was a more point - not quite a point solution but, you know, an easier (product). Now they're trying to maybe sell the whole solution and trying to sell more products and that just takes longer and maybe (unintelligible) to the client.

Philip Deck: But for sure that effect (is there).

I also think that we've been - and I - you know, importantly, we've been trying to hire salespeople that have less - just core development expertise and an ability to sell more at the enterprise level. And that's a really important trend long term in our business.

But we may have more people especially in the newer ranks that they really like the idea of selling the whole enterprise and - so we have to fine tune it a bit.

Tom Liston: And then finally, just on your - I think comments on your - I know it's new and growing, but your pipeline in Asia, is there anything we can...

Philip Deck: Yeah. Michael?

((Crosstalk))

Tom Liston: ...there?

Michael Harris: Yeah. Well we've already closed some transactions this quarter in Asia for some pretty good names.

(You know), I think we're seeing a lot of interests in Japan than we expect to - the competitive framework in Japan is pretty much the same as it is here.

There's going to be some fairly long sales cycle. The relationship we have with MKI is really helping us, and we're expecting to find a new partner in the next month or so. So we're very, very excited about Japan.

Singapore, we're working on some good accounts, as well in Australia where we have some direct sales there as well, probably less bigger deals and more sort of the core (SEM) focus, so it's a pretty good portfolio across the board.

But, you know, we're having some good ramp up, and we're working on some exceptional names. We're actually - we have the Gartner Symposium right now in Tokyo and apparently (with all sorts of) interest to what we're doing.

So, it's all about getting started because the Japanese market is looking for some reference accounts. So MKI is very important start as well as Panasonic, which is another opportunity that we closed. So it's going and we're looking for the more traction in the next quarter or two.

Tom Liston: Great. Okay. I'll (unintelligible).

Operator: Our next question comes from the line of Matt Walcoff from The Record. Please proceed.

Matt Walcoff: Okay. I know this is an analysts call, not a press call, but I just - I know that Mr. Harris, you went over the overall headcount before and I didn't catch the numbers.

Could you go over the overall headcount as well as the regional sales manager headcount?

Michael Harris: Yeah. We're 328 headcount today. I'm just going through my notes here, Doug. Tell me if I'm saying something wrong. I know it's up 47 from the year ago and with 29 regional sales managers.

Matt Walcoff: Okay thank you.

Michael Harris: (Yeah).

Operator: Our next question is a follow-up question from the line of Scott Penner from TD Newcrest. Please proceed.

Scott Penner: Phil, what is the time frame for the hiring of these internal service people? Is it something that is in the guidance through the end of this year or a long-term plan?

Philip Deck: We have more hires already in the budget for this year. I mean, recognized that we have been building up our services organization. You can see that the sales and margins increasing every quarter. So, hiring, you know, we seem to be hiring more services people everyday.

And now, we'll continue through the balance of the quarter and, you know, how much we increase that, we still have to really determine it.

To some degree, you know, with services, you can almost sell them before you hire all the people. Now, you can't do that for a specific account, but you have some pretty good lead time as to how fast you have to ramp the organization.

So, the focus for us is not so much, you know, hiring them and getting them out there. It's really changing the discussion with our customers to say, listen, you know, if these projects aren't going fast enough, we're here to help and we're prepared to put people onsite for extended periods of time and we're prepared to do projects, and as we're finishing some of the ones that we have with some of our big customers, we're also getting good experience to doing this kind of thing.

So, you know, I think the hiring kind of - is going to be the second part of it. It's really getting the services sold and you'll see that we have been

developing backlog. We're selling services at a higher rate relative to license than you'll see in terms of actually delivering and recognizing revenue from them.

So the backlog is increasing and we can manage that hiring process very well. It's not nearly as hard to find good services people as it is to find good salespeople.

Scott Penner: Now, if we were to look back a couple of years on the ALM side, your services business was (geared) very much towards driving licenses and it wasn't really a profit center in of itself. Is the nature of the services that you're providing changing such that you can continue to make good margins out of this?

Philip Deck: Well yeah. I mean - and changing for the better dramatically. It, you know, services for us used to be installing software on the server, migrating the code from other repositories into the MKS version repository, setting up basic process using the workflow modeler and training either the trainer or training actual people in the customer organization.

And all of those are, you know, real bread and butter kind of services and probably come in the lower range of service rates. Certainly the kind of thing that the Accentures and Bearing Points of the world don't really want to do. It's not their focus at all.

As deployments - as the nature of deployments change, the services that customers (need) are not so much those bread and butter implementation services.

Their consulting and methodology developments and, you know, some more specific consulting around ITELL for Helpdesk or requirements management methodology or testing methodology.

And those tend to be somewhat higher value services. Now, we're not trying to do all of those ourselves. We're happy to let partners do that and in some ways, we're happy to let partners take the highest margin business, but we can still generate a very acceptable margin from the core services ourselves.

So, you know, I think that we probably made a mistake in not - in only looking at services as a means to an end and not also as an end to themselves.

Scott Penner: And on the dividend, you framed it at the beginning as a proactive, (you know), prevention of building up excess cash. Is this - is it more thinking now that the dividend is something that now that it's in place should be - I'll use the word ("extended") or is it still something that falls out of the whole decision?

Philip Deck: Well I suppose that if we had never paid a dividend before, we wouldn't have started this quarter. So if you like, there are some inertia to whatever state of the world is in place.

And so certainly, the board is, I think, would conclude that if you're going to have a dividend, it should be a regular one and that, you know, you'll - all other things being equal, you'd prefer not to change course. You know, certainly not change course very often and if you do change course, it's to increase it, not decrease it.

At the same time, we're obviously focused on liquidity of the company. We're never going to do anything that would endanger that. But, you know, we have

pretty stable cash and our cash generation is good and, you know, we've been through the first two quarters of the year, which tend to be the worst for maintenance renewals and maintenance renewals will now pick up through the balance of the year.

So, you know, cash doesn't appear to be an issue and even with the dividend in place through the balance of the year, we would expect higher cash by the end.

Scott Penner: And, Doug, just quickly on the ALM side. I don't have the breakdown. What was the maintenance revenue for the quarter?

Douglas Sawatzky: The maintenance revenue for the quarter on the...

Philip Deck: Just under 5 million.

Douglas Sawatzky: Yeah. For the (unintelligible) only is little bit under that, but (unintelligible) 4.7 million.

Scott Penner: Okay, thank you.

Operator: Ladies and gentlemen, if you'd like to register for a question, please press the 1 followed by the 4.

At this time, Mr. Deck, there are no further questions. I'll turn the call back to you.

Philip Deck: Well thank you very much for everyone for being on the call, and we look forward to reporting on our progress in the months ahead.

Operator: Ladies and gentlemen, that does conclude today's conference call. We thank you for participating and ask that you please disconnect your line.

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