

FY 2009-Q2 RESULTS CONFERENCE CALL

**Moderator: TBA
November 25, 2008
6:00 pm CT**

Operator: Ladies and gentlemen thank you for standing by. Welcome to the Fiscal 2009 Q2 Financial 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 any time during the conference you need to reach an operator please press star 0.

As a reminder this conference is being recorded today Tuesday, November 25th 2008. And now I would like to turn the conference over to Philip Deck, Chairman and CEO.

Please go ahead sir.

Philip Deck: Good afternoon and welcome to the MKS 2nd Quarter conference Call. I'm here in Waterloo with Michael Harris, President and Chief Operating Officer of MKS and Doug Sawatzky our Chief Financial Officer. But first I'll turn to Larry Wasylyshyn our legal counsel for the legal disclaimer.

Larry Wasylshyn: Thanks all, 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 expect, anticipate, intend, plan, believe, estimate or similar expressions are forward looking statements within the meaning of securities laws,.

Forward looking statements including information concerning possible or assumed future results of operations at MSK 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 both factors set out in 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 disaster circumstances after this call or to reflect the occurrence of an anticipated event except as required by law.

Back to you Phil.

Philip Deck: Thanks Larry. Today MKS reported record financial results for our fiscal quarter ended October 31 2008. We had a very strong quarter. We grew all categories of revenue relative to the same quarter last year and boosted profits substantial.

ALM license revenue was 22% higher than last year. I'll leave it to Michael Harris to talk about some of the new contract wins this quarter but I will note the broad strength of revenue generation across our operating regions world wide.

All regions grew from their fiscal Q1 levels and all performed well relative to our expectations. We also had a healthy mix of new customers and follow on license deals and we continue to see relative strength in the advance manufacturing customers of our customer base relative to IT departments, a trend that's been in place for a few quarters.

Our services continue to show strength as we work to implement increasingly large scale implementations of MKS Integrity across our international markets. And although we continue to build backlog in services, we expect to show modestly lower revenue in Q3 to the normal holiday slowdown.

Maintenance revenue grew at normal rates in local currencies, but due to the large devaluation of the pound and euro only increased slightly in US dollar terms from Q1 of this year.

Maintenance renewal rates however were unchanged from historical norms. We see no impact from the turbulence in the economy on maintenance renewals to date and we have had no major customers involved in recent corporate failures to our knowledge.

We had some unusual items this quarter both positive and negative. We had services revenue above trend due to the recognition of about \$350,000 in services that had been delivered in the previous quarter.

We also had a particularly strong quarter in our legacy interpretability business, approximately \$300,000 over trend due to several larger transactions than normal.

On the other hand we had an unusual foreign exchange charge of about \$500,000 due to the markdown of our Canadian dollar cash balances and the revaluation of inter company loans to our European subsidiaries.

As well we had a \$200,000 higher than usual non-cash compensation charge. These unusual items pretty much offset each other and we ended up with an operating profit of around \$2 million, the second highest in our history.

Trades receivables declined for the second quarter in a row from the unusually high level that we reached at the end of fiscal 2008. Our day sales outstanding ended the quarter at 55 days, our receivables balances continue to remain solid with no concerns about collectibility.

Closing cash balance at October 31 2008 was \$11 million, down from the \$12 million July 31 2008. We have now reached the seasonal low point for cash and are headed into the back half of the year when the larger proportion of maintenance contracts renewals are schedule and our cash balance typically grows.

As the Canadian dollar began to fall over the summer, we put in place a hedging facility to ensure that declines in the dollar could be extended through our planning horizon to build stability in our operations and our results.

We did not foresee the magnitude or rate of decline, and consequently the hedges that we put in place have slowed the realization of a significant cost advantages that the lower Canadian dollar offers.

In the quarter just completed, our Canadian dollar costs averaged 96 cents US, about 20% higher than they would cost at today's rate.

We remain committed to the hedge program however and have recently extended it into the 3rd quarter of next year at prices most recently around 79 cents.

These forward purchases of cash ensure that the cost of our Canadian dollar spending will decline steadily through most of next year, providing some measure of stability and certainty in a climate where those things are hard to find.

The declining cost of Canadian dollar expenses that we have now locked in place can provide steady declines in operating costs through the foreseeable future.

I will now turn to Michael Harris for review of Q2 operations.

Michael Harris: Thanks Phil. So we're pleased to report on the results of another great quarterly financial result for MKS. They arrived at a strong finish, each of the regional teams within the ALM group contributed significantly to the overall outcome, as did the IO team.

Further demonstrating the breadth of the results, our largest single transaction, licensed transaction was less than \$700,000 this quarter. We added some great new names to our customer list, each of which have much more revenue potential in them in the quarters and years ahead.

These new accounts include Caterpillar, Diehl, Japan Airlines and Xerox. We also concluded some key follow on deals with our current customers such as Knorr-Bremse, Magna, NCR, Northrop Grumman and Toronto Dominion Bank.

The IO team had an exceptional quarter with revenues \$2.1 million and earnings of more than \$500,000 due in large part to a couple of key add on wins.

We've historically planned on approximately a 10% decline in revenue for this business, yet the team continues to prove that this planning may be too pessimistic.

This past quarter demonstrates that there continues to be a great deal of further value in their customer base.

Even as our business prospers we remain committed to managing headcount and other related costs carefully.

We finished the quarter with 308 employees essentially unchanged from the July 31st total of 310. ALM sales head count at the end of the quarter was 34, a decline of 3 from the prior period.

Second quarter per rep sales productivity increased over the same period from last year to \$255,000 from \$175,000 per rep in the quarter, showing more than a 40% improvement.

We intend to add modestly to our sales force as we build our organization focusing in Asia, Scandinavia and parts of the US, in particular with new sales reps and ALM consultants alike.

Our year on year services growth continues to be exceptionally strong with a 33% increase over the 2nd quarter of fiscal 2008 to \$2.8 million.

We continue to focus the vast majority of our services revenue around our key implementation projects with the strategy to deploy MKS Integrity license as fast as possible so that our customers see the return of this investment.

Our sales team understand very clearly that the quickest way to sell more seats into the account is to deploy the seats already sold.

The next major release of MKS Integrity will shift in April of 2009. Integrity of 2009 has been under development for almost two years and it will show with significant new capabilities that will extend our technology lead and motivate customers to upgrade and expand their use.

First and foremost for many customers will be the introduction of our advanced test management capabilities. In the same way that we leveraged the MKS Integrity platform to bring to market the industry leading solution for managing requirements, we're going to change the game in the test management market with the first enterprise class test management capability built within a leading ALM platform.

The power of MKS Integrity launched us to the top ranked technology for requirements management, and we believe that we can repeat that success by bringing the sophisticated artifact configuration, reuse space lining and traceability of MKS Integrity to the test manager market that urgently needs those capabilities.

With the introduction of Integrity 2009 in our sites, we are busy arming our global field team with the necessary resources to communicate the benefits of our new product to our targeted market.

The biggest beneficiaries of the new test management capabilities will be the customers which have made the most significant investments in deploying MKS Integrity to date who can take advantage of the new features quickly and easily and extend their ALM infrastructure seamlessly into test management.

Those are primarily the customers we have built Integrity 2009 for by working closely with them and understanding the business challenges they most want to resolve.

We will also benefit by providing a new reason to look at MKS Integrity. Right now although we positioned MKS Integrity as a seamless ALM platform, most customers come to us with one burning need to address relating to one of the main areas of capability with ALM.

Whether or not they be requirements management, software change management, defect management or software deployment. It's after that initial installation that a customer is then extended the use of MKS Integrity to another capabilities.

Test management therefore gives us a new entry point for MKS Integrity and we expect to be able to attract many new users who will first try us for test and then extend our use across the board to rest of ALM.

In summary, we are pleased with our performance in the first half of 2009. We're making good progress and building to profitability levels that we have never seen before.

Our breadth of revenue performance across all sectors demonstrates that we made the right investments in the right areas in both geographic and market sector terms.

We are engaged in multi year development infrastructural renewal projects with our key customers and are adding value to our platform all the time.

We enter the back half of our year with continued license pipeline expansion and growing services backlog. Our continued focus is on customers who are most motivated to reduce the complexity of managing the software embedded in their products and we're lowering the cost of software delivery as a compelling reason to implement MKS Integrity even in difficult times.

In spite of the current economic situation, these continue to be very exciting times for those of us committed to building a business around MKS Integrity. Back to you Phil.

Philip Deck: Thanks Michael. One of the greatest benefits of MKS Integrity is its ability to help customers who are trying to deal with the increasing complexity of the software they embed in their products.

Manufacturers of automotive components, medical devices, consumer electronics, wireless devices and integrated circuits are seeing a dramatic rise in the importance and the complexity of software embedded in those products.

Software components are taking on an increasingly large share of the value of these products and a number of software engineers involved in their creation has caught up and in many cases passed the number of mechanical engineers working on them.

In addition as product cycle times shorten, the complexity of maintaining, customizing, repairing and supporting that embedded software and all of its many permutations is quickly outstripping the ability of many manufacturers to manage it.

In many cases the complexity problems are so significant that they cannot be solved by additional human resources alone even if those could be afforded.

They require a level of control over software development and all of its associated artifacts including the requirements, the functional specifications, test plans, defect reports that is impossible to achieve without a system like MKS Integrity.

Now we strongly believe that there is only one system like MKS Integrity. The creation of an infrastructure to manage the complexities of software development in advanced manufacturing is typically a multi year initiative involving the reengineering of systems processes and organizations.

And the need to put this kind of system in place is essential for maintaining competitiveness whether times are good or bad. The manufacturers that have made commitments to the establishment of renewed software delivery systems range from the most robust to the most troubled.

But all of them need to ensure that their software development capabilities improve and virtually all have committed to multi year programs to put those improvements in place.

Those programs generate steady revenue for MKS from existing accounts and many opportunities for new customers.

We have not remained unaffected by the slowdown in capital spending. We have seen steadily declining IT spending from the financial sector in particular.

We have made it up however and more on the growth of our business and manufacturing industries and in selected financial companies who remain healthy and committed to more robust software development capabilities.

Our license pipeline continues to grow steadily. Although the mix of business has tilted towards manufacturing and towards larger customers and initiatives, the overall size is trending well and we remain optimistic about the growth opportunities for us in the quarters ahead.

We remain committed to profitable organic growth in our primary operating segment, ALM. We strive to maintain a balance between increasing shareholder returns and funding internal investments for long term growth.

The steady growth of our maintenance revenue offers significant potential for operating margin improvement over the long term.

Similarly increases in the scope of our field sales and services teams and the capacity of our engineering organization represent the most significant enablers to our long term growth.

They both require immediate commitments of cash and recognition of costs with the future returns extending over several years.

We plan for slower growth and operating margins than we could otherwise achieve in order to fund investments and sales marketing and engineering that we need to achieve strong long term revenue growth.

The largest uncertainty in maintaining that balance between profitability and long term revenue growth is the variability of license revenue on a quarterly basis.

This variability is expected to continue as the average size of transactions may increase as quickly as the magnitude of overall revenue. We further expect to continue decline in our interoperability business of approximately 10% annually.

Our board of directors yesterday approved our regular dividend of 2 cents per share US. We continue to be enthusiastic about our dividend policy.

While mindful of economic conditions, we're maintaining our view that cash not required to fund our growth should be returned to shareholders.

And as we realize the benefits of the lower Canadian dollar in our cost structure and as our cash builds through a seasonal cycle, we look forward to reevaluating our dividend level in light of those benefits.

We also continue to believe that our shares represent excellent value at current levels. We have completed over 50% of our normal course issuer bid at its midpoint and will continue to purchase shares in the open market under its terms.

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

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

Operator: Thank you. 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 toned 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 are using a speaker phone we ask that you please lift your handset before entering your request.

One moment please for the first question. Our first question comes from the line of Tom Liston with Versant Partners. Please proceed with your question.

Tom Liston: Hi, good afternoon. Phil could you just describe or Michael just on the four deals over \$500K, October was well known to be a rough month for many software companies trying to close large deals.

What - you know is there any substance you can give in terms of you know were they existing customers, you know how do you drive those deals through in a pretty tough environment out there?

Philip Deck: You know I would say that our closing cycle in the quarter was you know unfortunately typical in that a lot of business closed late in the quarter.

In fact you know I think everyone has kind of noticed that the major trouble in the financial markets started early in October. We finished of course at the end of October.

Most of the deals, most of the significant deals had not been closed at the beginning of October. You know as in most quarters they happen close to the end.

We didn't see any significant impact from the events of October and I guess there was enough momentum in all those deals that they weren't affected in any significant way.

Tom Liston: Were they - what would be the split between new in existing customers?

Philip Deck: Of the significant ones you know kind of our normal 50/50 I'd say, maybe at the end of the quarter a little more from new customers, not a ton more.

Tom Liston: Okay. And Michael, I miss exact description but did you say you're going to expand the quota of carrying reps and where you are now and where you think that will get to?

Michael Harris: Yeah, I mean we're focusing our investment all around, obviously high concentration of engineers. So particularly around the embedded technology sector so we're investing pretty heavily in Japan, well pretty heavily as a percentage in Japan right now.

We've opened up in Scandinavia, we're building a team there as well as likely the west coast of North America. So I would expect to see us starting to grow the team from the 34 or 35 reps steadily over the next couple of quarters anyway.

But mainly in these specific areas, less sort of scattered around the world and more in the areas of where our strength is.

Philip Deck: And that - I would say that doesn't come from the general desire to just have more reps, it comes from very much opportunistic targeting of you know certain customers groups and certain verticals and certain areas of the world.

So you know where we see a concentration of customers that we think will be appropriate in this kind of environment and this kind of economy with the kind of technical advantages that we have, then that's where we're putting sales investments.

Tom Liston: Okay. And was any of the deals above \$500 K in Asia?

Michael Harris: No.

Tom Liston: Okay. And...

Philip Deck: Well not completely, there are some international deals that included Japan in that category.

Michael Harris: In that category Japan only, no.

Tom Liston: Gotcha. And how many, I don't know if you can - if you know this number off the top of your head, but how many new customers would you have added that have potential for over 1000 feeds you know in the last six, nine months type of thing?

Would you have any of those numbers handy?

Michael Harris: How many new customers?

Tom Liston: Yeah, new customers.

Michael Harris: Well of the sort of four big customers, all of them. So those that we announced, TD, well TD wasn't new, that was a follow on, but we - you know we used to measure this a lot more closely and it was typically around 50% of our customers had more than 1000 potential users.

We don't measure that so explicitly, I mean I think as a percentage of revenue going forward the vast majority will come from customers at more than 1000 potential users.

As far as the number of accounts, I don't know, there's probably quite a few little accounts that neither of us have ever heard of that would make up a high proportion of the discreet number of customers.

But I mean...

Tom Liston: What I'm getting at is it's probably generally you're bucking the turned a bit, but generally better to sell or easier to sell into existing customers that are you know part way through a multi-year type deployment of projects rather than new customers.

You're obviously getting some new - can you talk about you know some of the plans in your - in terms of your pipeline, let's ask it that way. You know what would be you know new, expected wins versus really mining your install base.

Michael Harris: Again it's probably a little bit more mining install base. I think that the difference between the new business that we're working on from maybe 12

months ago but certainly 24 months ago is it's a lot more focused around particular markets where we've had successes.

So in the invented technology space in some financial sectors, and I think we're - our marketing campaigns and sales campaigns and ability to grow domain expertise around what our customer's specific challenges are a lot more focused than ever before.

So you know there's one particular market within embedded where we're right now talking to almost every single company in the world that builds this particular product.

So I would say most of you know our focus for the bigger accounts is deploying a lot more software, we still have a lot more software to deploy to our key accounts.

And then for the new ones, it's a lot more focused approach than more of the shotgun approach we may have had in the past.

Philip Deck: You know you can probably put customers, new customers in the three categories, there are those that are buying software because they are growing so fast and adding so many employees.

And then - and those are tough deals to find these days. And then there's those that even with a steady employee base you could define an ROI that technically would justify the sale, but it's an outlay of cash and you know in those categories and in this environment those deals aren't really getting done.

And then there are those business problems that are so serious that you really have to deal with them in order to stop your costs from ballooning or in order to make sure you can get products out the door to actually stay competitive.

And it's clearly that latter category where we think there's a lot of opportunity. The complexity of problems in software delivery and in lots of industries are really you know in a sense unrelated to the economic difficulties.

They are really ballooning out of control because the software complexity is so hard to manage. And those are places where regardless of the economic environment, those problems have to be solved and customers are going to address them.

And if you look at our you know some of the successful wins we've had in the past, some are from fairly troubled companies that are trying to you know improve their ability to compete and are investing to do so.

And that's the kind of customer we're still able to do business with today.

Tom Liston: All right, I think I know the answer to this but are you finding like in the embedded space that you're quickly sort of winning out early in the stages as the vendor of choice and it really comes down to negotiation how it works out in certain cases, in certain verticals?

Philip Deck: I think that's always been the case. I mean we are very seldom get to the end of the deal still competitive with someone else.

Tom Liston: Okay, thanks.

Operator: Our next question comes from the line of Scott Penner with TD Newcrest, please proceed with your question.

Scott Penner: Thanks, maybe I'll just start fairly simply here. Just there was a big jump in accounts payable for the quarter, if somebody could just explain that.

Michael Harris: Sure, as a part of our hedging program we've designated all the foreign exchange hedges that we've pressured into in the future as hedge transactions.

So in order to account for that properly we had to record the accrued loss on our financial statements.

So the accrued loss was about \$1.5 million is showing up in accounts payable and the offset of that is showing up through the other comprehensive income line in the equity section.

Scott Penner: Okay. And then Phil just when you - who is the main competition these days that you see and especially on the requirements management side and just an extension to that, what is the level of aggressiveness of I guess IBM and then HP to a lesser extent?

Philip Deck: Well we divide the competition, the main competition is really Word and Excel. Where you know proudly a majority of customers are using those tools to manage requirements and need to do a lot better than that.

The incumbents in the marketplace are of course DOORS and Requirements Pro both going by IBM and so we see both of them separately coming up and Caliber from Borland and the (On Time) HP kind of marketing their quality center program or product with some requirements capability.

So we see those from time to time. You know I guess of the incumbent products, DOORS is the most well deployed.

So it would probably come up most competitive, but again we're - I would say the majority of the accounts we're in we've become selected fairly early in the process and end up spending most of the sales cycle pretty much as the selected vendor.

Scott Penner: Okay. The sales number of 34 down 3 in the quarter, just why would it be down in the quarter given the enthusiasm is probably a pretty simple answer.

Michael Harris: Well we lost I don't know who the three were that left, I think they might have all left, I'm not sure - I have one of them. Yeah, one of them we let go, the other ones, one did not leave and another one left on her own.

So we've been looking for reps pretty hard for the last three or four months. We've actually just - there's three people starting, three reps starting in the next two weeks.

So we've really just have been diverting more energies to hiring new reps probably over the last sort of three or four months. And it just takes that long to find people.

So I think that's....

Philip Deck: And I think it's important to note that reps are not interchangeable, they're of very different skills and very different geographies and very different verticals. So as our business kind of moves and changes mix a bit between large deals and small deals and between different customer sectors then it also requires changes in the people that we have going after them.

So that causes a little bit of turnover, but again the turnover in our sales force continues to be very light.

Scott Penner: Right. Mike, where would you like to see the per rep sales? You mentioned \$255K, what would be a number that you'd be - consider to be optimal?

Michael Harris: I mean you know optimal would be you know anywhere more than \$1 million per year, if you get up to \$1.5 million a year I think as the whole team is concerned you're doing okay.

Remember that the numbers that we're talking about, those include the - what we call the inside sales reps as well. So those are the much lower quota carrying, lower cost reps that we have that stay in the office and dial the phone.

And they represent about a third of the team. So the overall quota carrying direct reps who out there knocking on doors, those - that productivity level would be closer to about \$1.2, \$1.3 million.

So it's getting there. I would suggest that of the new hires that we're making, the percentage of the direct reps, the outside reps knocking on doors will be higher going forward than most of our growth will be towards those type of reps as we go after a lot more targeted strategic accounts.

So I would expect over time to see that number you know get up to the million and a half dollar a year level.

Scott Penner: Okay. Still just lastly the - if we were to look back into the last major release of Integrity, you know I think a very complicated release and you were obviously hiring a lot of sales people during that time.

There certainly was a - I think arguably a bit of a discontinuity in the license revenue after that release as people got used to the complexity of it. I don't know if you'd agree to that but if so, I mean what is different about this release that also seems to have a lot of new functionality?

Philip Deck: I don't think that the timing of our release makes that much difference. The - because in fact a lot of customers won't immediately upgrade to it, they'll wait a bit of time.

What's important about getting close to the release is that we can start demoing the capabilities of it. And I think the big difference in this case is that when we released Integrity 2007 which was the last release, although we went out with the headline saying what we've added is requirements management capability, what we had really added was the ability to configure non-code artifacts.

And we were using requirements as one of those non-code artifacts that we could configure in a really sophisticated way. And so we had to get our customers used to the idea of configuring non-code artifacts and linking them and you know reusing them and branching them and doing all the sophisticated things to them that took a while for them to get their minds around.

As we released test management, there's very little you know what we've kind of refined some of those capabilities, but all the capabilities that we released two years ago for requirements management pretty much are used to

create our test management capability. There's actually not that much capability that's unique to test management.

We've just allowed you to extend that idea of managing and configuring non-code artifacts to test management. So to some degree a lot of customers look at test management as just the other side of the coin of requirements management.

When you create a requirement then you want to create a test plan and a test artifact and you want to create tests that pass the requirements.

And so you want the linkage between the two and so for anyone who's rolled out implementation of requirements management, then the addition of test management will be pretty smooth because it's all the underlying concepts that are the same.

Now a lot of the things that we've done over the last two years are just to strengthen those capabilities, make them easier to deploy, make them easier to configure.

In fact we've ended up doing a lot of scalability work to make sure that we can scale to much larger customers and a lot of that infrastructure work isn't so much flashy features, it's the fact that we can now support thousands and thousands of developers on a single server where you know in some cases they would have run into scalability problems before.

So there's been a lot of infrastructure renewal. And we've actually released a lot of product through service packs because we didn't have a major release and that includes some major overhauls to some of our IDE integrations along the way.

So it's - we don't think it's going to be a terribly disruptive release from a customer point of view, in fact it's kind of completing the job that we started with requirements management by adding the flip side to it.

Scott Penner: Okay, thank, I appreciate it.

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

Lawrence Rhee: Hi guys. With respect to the opex side of things, you guys have done a great job in kind of managing your costs I guess this quarter down sequentially from Q1.

Notwithstanding the benefits you're getting from the Canadian dollar, but is this level of operating kind of cost something you believe you can maintain going into the latter half of this year?

Philip Deck: Well just to be clear, we haven't really started benefiting that much from the Canadian dollar because this quarter we effectively averaged 96 cents US in Canadian dollar terms.

So and that's partly a result of the dollar only coming down late in the quarter and partly a result of the hedges. So if you actually priced out last quarter at the prevailing rates today, you'd be about you know 20% better.

So in fact that amount of additional savings you know if all other things were equal which they never are, you know would make our quarter a lot better than we reported.

So a lot of those currency benefits are still to come and you know I mean costs go up and down a bit but we're not planning any major expansion of costs, you know we want to make opportunistic hires in sales and marketing where we think there's good capability to expand.

We are adding modestly to our engineering force, but you know we're not planning any significant changes in our kind of corporate capacity over the next little while.

Lawrence Rhee: Okay great. And just on the testing side, looking into your customer base, is there a way of kind of quantifying the opportunity there amongst your customer bases, would many of your existing customers have a testing capability from a competitor or somehow developed in house?

Or would it represent kind of a green field opportunity for you?

Philip Deck: Well I think like all areas of ALM, I mean testing has lots of tools that are out there. But none really linked within a larger ALM framework, right, some would claim.

But I mean you know Borland would say it's part of their integrated framework and I guess so would IBM, but I don't think many customers would actually use it that way and it's not very useful that way.

So really we're looking at selling against incumbent point products, and one of the things we really learned about requirements management is if you're going to go sell against incumbent point products, you'd better be very competitive as a point product yourself.

So when we go and compete in requirements management, it's essential to us and essential to our strategy and the way we market our product and sell our product that we can beat someone in the requirements management space just on requirements management capability.

Not by saying oh but you can link it to all these other things and there's all these things outside of requirements management that you can benefit from as well.

And it's the same with test management, what we think we can deliver in test management can be competitive in the test management market alone without relying on any other parts of ALM.

Now for people who already use us for other parts of ALM, the benefits are much, much greater. But we still think we can be competitive and the reason for that is that the sophistication of configuration management in general that's available to us from MKS Integrity brings a lot of benefits to test management that just aren't there in those products today.

And in the same way bringing the you know what we would say, the power of MKS Integrity to the requirements management market put us to the top rankings of requirements management technology within I guess under two years.

We think those same benefits apply to test management and it's not so much that we're building all these great test management features, it's the fact that when we bring MKS Integrity configuration management to that area, you get a great capability for managing test results.

So it's - you know it's taking expertise we already have and bringing it into an area that doesn't have it now. And so the first - you know we build out our business case based on being able to expand our customer's implementations into test.

So we think there's a great opportunity for doing test management only implementations as well. And roughly I'd say you know for most software development departments, the QA department is going to be at least 25%, 30% of it.

So there's a tremendous amount of seat expansion available for us there.

Lawrence Rhee: Great. And last question, just obviously with respect to the global economic weakness and how are you guys kind of managing or how are you guys hunkering down and positioning yourselves to brace for the weakness expected to come over the next couple quarters?

Are you seeing extended sales cycles and - as a result are you doing more kind of video conferences as opposed to travel to maintain costs? Just give us an idea of what you guys are doing internally to brace for you know potential weakness in the next couple quarters.

Philip Deck: Well I mean it's hard to prepare for you know eventualities that you can't define. And none of us know what's happening in the economy over the next quarter or two. And if anyone does I hope they call me.

So we don't know either. What we can say is that most of the effects that we're seeing in our business have been in place for a few quarters, and that is a significant slowdown in the business we get from banks, insurance companies, you know brokerage firms, other financial institutions.

That kind of a spending you know significantly declined quite a while ago. And there - you know we continue to have those companies in our pipeline but they represent a smaller amount.

And we've made that up with very targeted, focused efforts in manufacturing and that's really the way we see we can keep our strength through this period is go to the firms that absolutely need to accomplish certain things in spite of what the economy is doing.

And there's lots of companies in our customer base that you know have been having a tough time but still need to do things in their business that are important and enable them to get products out faster.

So you know we're being very careful, we're being very cautious, we're you know adding to our capability modestly and carefully and in a focused way and that's what we're going to keep doing.

And you know so far so good, we haven't seen any other impacts than the ones I've noticed or ones I've noticed.

Lawrence Rhee: That's great. Thanks guys and great quarter.

Operator: Our next question comes from the line of (Janner Boskopolous) with BMA Capital markets. Please proceed with you question.

(Janner Boskopolous): Hi good afternoon, just yet another macro question to follow up on Lawrence's. To what extent if any has there been an impact on customer roll out plans or deal sizes from the environment?

And what I mean for example is the large deal this quarter, were they originally slated to be the size that they were or were some of the originally let's say seven figure deals but then customers may have looked at and said you know we only need x many licenses up front and let's defer some of the deployment plans later on.

Is any of that going on or not really in the segments you're targeting?

Michael Harris: No, none of that. I mean I think the - I mean for the deals that we closed in October, all the big ones were mainly October, those were the things configured as in they knew in fact how much software they needed.

Probably in August or September time frame and it went into purchasing you know some time in October and so that never changed the whole way through.

And of the - all the sort of the key big deals we're looking at for the coming two quarters, none of them are really changing size or configuration at all.

We haven't seen any of that. I would say that if - quite the contrary I would say in fact a couple of our deals are actually growing right now, the bigger ones.

But we haven't seen any of that. I think the only sign that I might see is just from the approvals point of view it seems that we're being asked to get more internal approvals and the sign off has changed a little bit and been a bit more strict at lower levels.

But it doesn't really - hasn't really caused the deals to slow down all that much. So we just haven't seen anything yet.

Philip Deck: You know our sense is that some of the smaller deals that represent capacity expansion should slow down. And we have seen some decline in our deals under \$100 grand and then made up by deals over \$100 grand.

But those declines aren't really a trend yet and they're really within the demands of statistical insignificance. So although we're thinking there almost should be a trend and we're thinking, we're expecting to be a bit of a trend down, we cant really say that we've really seen it definitively yet.

So we're - certainly an area we're looking at.

(Janner Boskopolous): And that's because those deals would be the most important to headcount, right? That's why they show up there?

Philip Deck: Yep.

(Janner Boskopoelous): Okay. Since this involves (unintelligible) change rate, would you have a constant currency revenue growth number for the quarter?

Philip Deck: Not that I can calculate in my head.

(Janner Boskopoelous): Okay, no, just wanted to know if you had it handy or not.

Philip Deck: You know where you see the impact of the currency mostly in our - you know it's almost impossible to calculate for licenses revenue because you never really know if your discount might end up being a bit different or if your negotiation might have been different under a different currency assumption.

Where you do see it is that we are down sequentially in our maintenance revenue and that's 100% currency related.

But the other parts of revenue, you know it's very hard to measure what it would have been otherwise.

(Janner Boskopoelous): Okay, fair enough. And just further on your comments regarding the shifting of the customer base towards the advance manufacturing sector, would you have any sort of guesstimate or approximation as to what the split would look like as far as IT focused customers versus manufacturing type customers at this point?

Philip Deck: Well of course it gets complicated because some of those are IT departments in manufacturing companies and so then you have to you know there's kind of sub categories within that.

But I think broadly you know we're probably at least at two thirds kind of one third in terms of manufacturing versus IT departments.

But it's hard to classify some of them.

(Janner Boskopoelous): And what is your guess as to what that might have looked like a year ago let's say?

Philip Deck: Fifty fifty.

(Janner Boskopoelous): Okay. And finally on the competitive front, you made some comments there and during VHM you'd shared your thoughts regarding Rational Jazz, any update on that front? Is it creating any (fudd) at all amongst your prospective customers or are they sort of smart enough to know that's it's really an expensive product still early stage at this point?

Philip Deck: Yeah, well we have pretty smart customers. We also - but we define intelligence by people who by MKS Integrity, so...

Michael Harris: They're all smart.

Philip Deck: We haven't seen a ton of talk about IMB Jazz. We're probably more obsessed with it than our customers are.

Michael Harris: Yeah, no (fudd). It's not causing any delays to deals getting closed.

(Janner Boskopelous): Okay. Great, thanks guys.

Philip Deck: Thanks (Janner).

Operator: Ladies and gentlemen, as a reminder, to register for a question please press the 1 followed by the 4. We have no further questions at this time, I'll turn the call back to you.

Philip Deck: Thank you, I'd just like to thank everyone for joining us on the call today and we look forward to reporting on our results in the quarters ahead.

END