MKS

Moderator: Philip Deck
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6:00 pm CT

Operator: Ladies and gentlemen, thank you for standing by and welcome to the MKS Fiscal 2008 Third Quarter Results Conference Call.

During the presentation, all participants will be in a listen-only mode.

Afterward, 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 do need to reach an operator, simply press the star followed by the 0.

As a reminder, this conference is being recorded today, Tuesday, March 4 of 2008.

It is now my pleasure to turn the conference over to Mr. Philip Deck, CEO. Please go ahead sir.

Philip Deck: Thank you. Good afternoon, and welcome to the MKS Third Quarter Conference Call. I'm here with Michael Harris, the President and Chief

Operating Officer, and Doug Sawatzky, our Chief Financial Officer in Waterloo.

But I will first turn to Larry Wasylishyn, our legal counsel, for the legal disclaimer.

Larry Wasylishyn: 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,” (“estimate,”) 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 fact but instead represent only our current expectations, estimates, and projections regarding future events.

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

MKS does not undertake any obligation to update or release any revision 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.

Today MKS reported quarterly revenues of $12.8 million, up 11% from the results in the comparable period in the previous year, led by ALM revenues of $11 million, up 13% from the same period last year. We achieved that result with record maintenance revenue and very strong service results.

License revenue was about $3.1 million, about the same as a year ago.

Our interoperability business showed declines consistent with our expectations but we continue to manage cost well to achieve normal profit contribution.

In our ALM business we continued to do a large number of transactions this quarter but no particularly large ones with the largest license transaction being less than $200,000.

Our maintenance revenue set another all-time record at $6.6 million and an ALM net maintenance record at $5.8 million. Maintenance revenue continued to show the effect of very high renewal rates of about 90% overall with the top half of our maintenance revenue base renewing at about 97%.

Service revenue of $2.1 million equaled the record level of last quarter, and 31% higher over the year ago result with excellent utilization and margin.

Our services business continues to grow in absolute terms and relative to our license level consistent with our strategy to ensure that customers are (deriving) as much value that they can from our product. Our customers continue to utilize our expertise in increasing amounts to plan and implement more complex and comprehensive ALM implementations.

Our closing cash balance at January 31, 2008 was $10.6 million, up from $9.9 million at October 31, 2007. Our cash grew primarily due to normal maintenance renewal seasonality.

MKS is substantially impacted by changes in exchange rates between the U.S. dollar, our reporting currency, and our other primary operating currencies, the Canadian dollar, the Euro, and the Pound. The chief impact of currency changes this year have been to significantly increase the expenses that we pay in Canadian dollars and modestly increase the net margins that we earn in Euros and Pounds. The entire amount of $900,000 of increased cost this Q3 over last year was currency-related alone.

The average cost of Canadian dollars expense in the quarter was $1.01 U.S.

For the first time in many quarters we've entered the new quarter with lower Canadian dollar values relative to the U.S. dollar than we'd experienced in the quarter before. This means that if current conditions persist through the balance of the year we will not show any additional currency-related costs increases from the immediate quarter before, a welcome change from the past year.

The recent rapid changes, particularly in the Canadian dollar in the last six months, have somewhat delayed our pace to return to higher profitability levels but we've largely overcome the higher rates and at currently sustainable rates of licensing we should have no trouble in posting profitable quarters going forward.

I will now turn to Michael Harris for a view of Q4 operations.

Michael Harris: Thank you Phil.

We were pleased to report higher year-to-date results based mainly on higher services and maintenance revenue. The growth of these critical components of our business are attributable to our success in building our ALM business over the past few years but we all recognize that license revenue is a leading indicator of our long-term success and will lead to even more growth in services and maintenance.

While our overall ALM business has now grown to almost $50 million in annualized revenue, so too has the size of the deals we are chasing and we continue to see volatile license revenue performance on a quarter-to-quarter basis.

Often the most important beachhead wins come from small initial deployment that lead to much larger deployment later on.

In the third quarter our largest single transaction was less than $200,000.

In that light, the $3.1 million in license revenue in the quarter showed good progress in small to mid-size transactions.

Already we are seeing better activity in larger transactions this quarter which gives us comfort in reasserting our full year guidance for profitability.

In spite of the lack of large deals we did make excellent progress in accounts which hold great long-term promise and include among others, Ameren, Daito Trust, Emerson, Fortis Banque, Inergi, Lloyds TSB, and New Horizon Systems Solutions. We're excited about each of these new names as all of them will involve follow-on business in the coming quarters as the first deployments are made successful.

Many of the customers which we have deployed MKS Integrity into the past also provided follow-on business in accounts such as BNSF Railway, Cincinnati Financial, Magna Electronics, Motorola, Ontario Hydro, RWE Systems, TeleAtlas, and Textron Systems.

Our IO division revenue was unchanged from the same quarter last year and from the prior quarter with revenue of $1.8 million and operating income of $400,000, adding to another solid performance.

As with the ALM division, there were no notably large toolkit transactions completed.

We continue to manage headcount against the headwind of the Canadian dollar and finished the quarter with a total of 306 employees, a 4% decline from the equivalent period in fiscal 2007.

ALM sales (rep) headcount was flat from the prior quarter at 40. Q3 in turn showed a significant improvement in sales productivity of 28% from a year ago to $151,000 per (rep).

Our year-on-year services revenue growth of 31% was dominated by large projects with (a strategic account) and much of the services business is focused directly at deploying more licenses to fuel follow-on sales in these accounts.

We continue to depend on the services delivery partners to deliver close to 1/3 of our services revenue. This in turn allows our customers to access a diverse range of implementation and process skills while building the community of MKS-trained services personnel and allows us to direct our efforts to sell and deploy MKS Integrity licenses.

During the third quarter marketing efforts were primarily focused on promoting our requirements management capabilities following the release of Forrester Research's report on requirements management tools landscape. MKS was the only vendor in the report to fully satisfy Forrester's criteria for a requirements management system and we're working very hard to ensure that the market gets the message.

As part of a month-long webinar series on solving the requirements challenge Forrester Research analyst (Peter Sturk) joined us in a webcast to provide their research insight. The webcast was sponsored through CM Crossroads, an online community for development managers, and drew nearly 1,000 viewers.

MKS continued to position itself as a thought leader in the areas of requirements management and requirements reuse gaining media coverage on IT sites such as Gantthead.com, (fdtimes), and CM Crossroads where MKS launched and is sponsoring a requirements management zone providing a library of resources and information on software requirements definition, management, testing, and reuse.

Based on all of this activity, the market demand for requirements management solutions continued to grow in the past quarter and our extremely high rankings in industry papers fueled yet more pipeline building.

MKS Integrity's unique requirements management capabilities continue to allow us to raise the bar for technology in this marketplace. We're extremely pleased that in two short years we have catapulted to the forefront of requirements management technology and now we are focused on market leadership. Over and over again we continue to prove during selection competitions that we beat the market leaders and have defined the space - that have defined the space for the past ten years.

In fact, already this month MKS beat out the competition from several rivals for the requirements management business at Research In Motion, and we expect to have their global software engineering team managing the requirements using MKS Integrity by the end of 2008. Ultimately we were chosen as the best technology in the marketplace with the capability to deliver on RIM's needs.

On the topic of industry recommendations, Gartner released its first-ever Magic Quadrant for the software change and configuration management market and positioned MKS as a leader with the most complete vision out of all the - out of all the vendors including IBM and Microsoft among others. This announcement has very quickly put us on the watch list of target accounts who might otherwise not have known of MKS's successes, more evidence of our building momentum.

In summary, we're going into the last quarter of the year ahead of where we were a year ago with respect to ALM licenses.

We have carved out a dominant position in requirements engineering and been formally applauded by Gartner as the company with the most complete vision in the software change and configuration management market.

We have spent much of FY08 developing opportunities in our key accounts and are looking forward to a strong finish in the coming three months as we execute on our goal of MKS revenue growth driven by ALM license growth.

Back to you Phil.

Philip Deck: In the application lifecycle management market, we have identified three key disciplines: software change and configuration management, or SCCM; requirements management; and test management. When we launched MKS Integrity in 2001 we could claim technology leadership in only one, SCCM. And we’re still in the lead. Our leadership was affirmed just this past quarter with Gartner Group’s Magic Quadrant study that ranked MKS in the leadership category for SCCM.

When we decided to enter the requirements management market our chief goal was to bring all the capabilities that made us a leader in configuring source code to the configuration of requirements. We worked with several major customers to understand how they wanted to work with the technology and built new capabilities throughout our platform. That has put us in the driver seat now in requirements management too.

Forrester Research affirmed this position in the past quarter as Michael described and we’re finding amazing technical competitiveness in this market today.

While we still have a few things to add we believe that we have set a whole new standard in (RMK)'s ability that allows us to win RM-only mandates, not just in connection with full ALM deals. Requirements management is now the driving force for many of our exciting ALM opportunities today.

And no we're working again in close cooperation with our customers to define how we can take our world-class configuration technology to provide fully featured, test management technologies. You'll be hearing more about that in the quarters ahead.

It seems that everywhere we turn at MKS we see signs of increasing momentum. We have over the past few years been challenged by efforts to move customers past simple version management to much more complex configuration and end-to-end change management.

We've been faced with the Canadian dollar value changes that forced us to make tough adjustments to our expense balances.

Throughout these transitions, we've been benefiting from the steady gains in service and maintenance revenue that have been driven by the loyalty of our customers who have deployed MKS Integrity and are steadily working with us to (drive) even more value from it.

As many of those challenges increasingly seem behind us we're gratified by the momentum we seem to be building in the marketplace. The combination of our increasing size, the disappearance of many our competitors, the increasing number of reference installations, have helped the analyst community speak out more forcefully about the technology leadership we have shown for some time.

And that confidence is translating into lead generation growth in quality and in quantity.

While we can't promise, nor do we even hope, that quarterly license variability will end we are confident that we can show annual results with consistent revenue growth and higher levels of profitability.

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

We expect significantly higher license revenue in the fourth quarter compared to third quarter leading to full year profitability for fiscal 2008.

We are limiting the expansion of our sales and marketing capacity to ensure that profitability can be expected throughout our planning horizon.

The average cost of the Canadian dollar during the third quarter of 2008 was $1.01 U.S. As a result we do not expect further currency-related cost increases assuming stable Canadian dollar rates during the balance of the year.

We expect to maintain more than sufficient cash balances through fiscal 2008 through the combination of expected improvements in net income, reduced capital expenditures over those in fiscal 2007, and an expected continuation of lower overall receivables days net of current dividend policy.

We expect that seasonal factors will continue to cause inflows of cash in the second half of the fiscal year as our maintenance renewals are more heavily weighted to the last two quarters of the year.

Our board of directors yesterday approved our regular dividend of 2 cents per share U.S., consistent with our policy to return cash not needed to fund growth to shareholders through regular a dividend.

The board of directors has a great deal of confidence in the soundness of our business plan, the opportunities at hand, and our changing markets as well as our short-term plans for profitable growth.

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

We would now be delighted to answer any questions from analysts.

Operator, over to you.

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

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

We ask that if you're using a speakerphone to please lift your handset before entering your request.

One moment please for the first question.

Our first question comes from the line of Scott Penner with TD Newcrest. Please go ahead.

Scott Penner: Thanks. So just first of all I guess on the deal with Research in Motion which seems like a fantastic opportunity, what is the deployment timeline and I guess license recognition that you'd expect?

Philip Deck: Well we'll have to - we haven't disclosed any financial details and we'll have to talk to RIM about whether they want to. So, I can't really give you any specifics. (But) it's certainly a project that we expect to move quickly ahead.

Scott Penner: Okay. When Michael said the end of 2008, that's the calendar year I assume?

Philip Deck: Yeah, that's an implementation timeline, yeah, so it's calendar.

Scott Penner: Okay. And the - on the services business in general, you mentioned the improved margins and they've been running at what looks like about 30% now, is that a - is that a reasonably stable level going forward?

Philip Deck: It seems to be. Of course it's mainly capacity related so the fact that we've been running fairly high capacity the last two quarters has really helped us. So, if we had a quarter where we didn't or we couldn't book customers as closely together as we have been or if there was some kind of reason that some deployments got delayed then we would show it in our margin. But, you know, services look pretty good moving forward. So, hopefully we can continue to do the same kind of numbers.

Scott Penner: Okay. Does somebody have the number of $100,000 deals?

Philip Deck: Douglas, do you want to give that?

Douglas Sawatzky: Sure. This quarter we had 18 deals over $100,000.

Scott Penner: And how many of those were services only?

Philip Deck: Not many but a lot of them were maintenance renewal only.

Scott Penner: Okay.

Philip Deck: So, I'm not sure if Doug has the non-maintenance renewal ones. I don't think we calculated that.

Douglas Sawatzky: No we don't have that readily available.

Scott Penner: Okay. On the requirements management business in general, what has been the experience - because you seem to be getting quite a bit of traction in what may be RM-only deals at this point, what's been your experience about the ability of taking RM-only deals and transition them into more of your full product suite?

Philip Deck: Well, the roll out of RM-only deals is still pretty early so we've now got a few customers that are fully deployed. There's a lot of customers that are in kind of mid-deployment now. So it's difficult to tell exactly what the difference in rate is going to be.

But I think anecdotally we feel that customers see that it's much more obvious that you would move forward through the development cycle from requirements into development (into) test than it has been obvious that just because you use us for source code configuration and change management you should use us for requirements and/or test.

So, the transition hasn't been as strong as we would have liked going from the SCCM sector into the other two but in requirements management, you know, I think it's generally accepted in the marketplace that requirements management and test management are two sides of the same coin and that the ability to trace requirements through to test and the ability, you know, I think in a secondary way, to trace them through software development and change management is really key to some of the attraction we have.

Now, it's important that we're able and we're proving that we can win requirements management deals ignoring test management and ignoring software change and configuration management. So, when it's just the requirements management capability that's being assessed we can win those deals by itself.

But I think the linkage between requirements and test is much stronger in the minds of customers than it has been in the past for us.

Scott Penner: Right. Okay. No, thanks for that.

And the strength in the services business again, to go back on that, is that something that in looking at the kind of deals that you're doing that you still view as sort of a promising leading indicator of license revenue within (the) existing customers?

Philip Deck: Yeah, I guess what's the most promising indicator is not so much the size of our services business but the number of services that we're throwing against implementations where there's, you know, a good expectation of follow-on licenses. And that's very much the case.

When you look at the services we're doing we really aren't trying to build the services business for the sake of building a services business even though the margins have been okay. We're really strategically trying to focus our services revenues on places where we can get more licenses. So, we're very much committed and focused to being a license driven company, or I should say maybe more accurately, license and maintenance driven company, and services are a way to make sure that customers are so happy with the product that they'll buy more and be loyal to it.

So, we're pretty focused internally on making sure that our what are somewhat scarce services resources get applied to companies that can use them best.

Scott Penner: And you mentioned better, or Mike I think mentioned, better activity on large deals this quarter, can you just share anything you can about, I guess, you know, quantitatively what the pipeline looks like and why you would say there was better activity this quarter than I guess in the past?

Philip Deck: Well I guess all I can say is we've already done a few deals this quarter that are bigger than our biggest from last quarter. And so we've got a good start and we don't have a lack of significant kind of medium size to large deals. And so, you know, I think unfortunately it's going to be difficult for us to achieve really smooth license results from quarter-to-quarter because, you know, you can have a fantastic customer opportunity long term and they may choose to start with a $100,000 or they may choose to start with $1 million worth of software. It doesn't make a whole lot of difference in the overall life of that implementation. But it makes a big difference in the actual quarter you start at.

And so, you know, whatever the customer decides whatever's right for the customer is going to be what we book in that quarter because that's the amount they're going to buy. And so some quarters we're going to be light on that as we were in the quarter before.

We're actually pretty pleased with the license result given that there weren't too many big opportunities because the production on the small to medium size deals was really good. So, we're off to a good start. We've got some bigger deals in the hopper already and fourth quarter looks a lot better than third quarter.

Scott Penner: Okay. I'll pass along, thanks.

Operator: Thank you. Our next question comes from the line of Sameet Kanade with Blackmont Capital. Please go ahead.

Sameet Kanade: Yes hi. Thanks for taking my call. I've got a couple of questions from (unintelligible). One thing, looking ahead, how do you guys track license performance in terms of how you compare it to (the) (unintelligible)? And, any color that you can provide on this would be fantastic.

Philip Deck: You mean, how do we track how our competitors are doing?

Sameet Kanade: No. How do you track how you're doing with the competitors? There's little guidance being provided beyond April '08, I'm just trying to understand what factors you look at in the industry to see how far - how your performance is tracking.

Man: Market share (unintelligible).

Philip Deck: Yeah, I mean, it's difficult to measure much about the market because the market encompasses a lot of different businesses within it so you have to take all the development workflow kind of tools and the requirements tools and the test management tools and the - you know, there's some smaller sectors that are not the key three disciplines that we would have to lump into it too. So it might be a few billion dollars.

And in that context it's very difficult to measure anyone's market share because most of our competitors are not ALM companies. Most of them are, you know, major software companies. Of course, Microsoft, HP, IBM don't really breakout their ALM revenues externally.

Most of the ones that do publish ALM numbers, Borland, Serena, formerly Telelogic but not anymore as they've been acquired, seem to be showing not very good trends in distributed licensing. Certainly Borland and Serena, if I'm not mistaken, in the last couple of reports in each case have shown negative growth in distributed licensing. I think IBM showed better results overall but I think analysts were commenting on the fact that that was mainly currency effects. But it's difficult to tell with a business as big as IBM.

So, it's difficult to track it in a statistical way or a very complete way. But certainly we follow our own win rates pretty closely and we look at our competitiveness against different customers. In the past we've had pretty high win rates on a technical basis but clearly we haven't been in a lot of the deals that we should have been in. That's starting to change a bit I think because as the market gets more consolidated we tend to stand out more.

It's a lot harder now to exclude us in a three company short list from an analyst in (unintelligible) partly because there aren't as many companies, partly because we're now bigger and so we don't get excluded on a size basis as often, and partly because our record of successful deployments is getting analysts more comfort in recommending us.

So, you know, anecdotally what really excites us about requirements management is that we've really introduced capabilities into that market that were never available in that market. These are capabilities that we offered in our source code and configuration management business but in the requirements management business when it came to traceability and some kinds of requirements reuse they've just never heard of that kind of thing in that market.

So, we find that our competitiveness in going up against the competitors in large scale engineering opportunities, places where you need to do component reuse, where you need traceability and to test, where you need connections into the software development area, we really have things that no one else has.

I don't know if that's answered your question.

Sameet Kanade: No, that's good. Thanks. Thank you.

Operator: Thank you. Our next question comes from the line of Dave Taylor with GMP Securities. Please go ahead.

Dave Taylor: Hi guys. Most of my questions have been answered. I was just hoping to get a breakdown of the IO revenue, the license and the maintenance.

Man: Do you have it Douglas?

Douglas Sawatzky: Yeah. So, for the quarter our IO total revenue was $1.8 million. Of that, licensing was around $950,000 and maintenance was $780,000.

Dave Taylor: Great. Thank you.

Man: You’re welcome.

Operator: Thank you. Our next question comes from the line of Thanos Moschopoulos from BMO Capital Markets. Please go ahead.

Thanos Moschopoulos: Hi. Just on the RIM RM deal, just to clarify, they were not previously an existing customer for you guys for other products?

Philip Deck: They were an existing customer in a small way for requirements management so they’ve been using the system for about a year.

Thanos Moschopoulos: Okay. But none of the SCM (sic) stuff?

Man: No.

Thanos Moschopoulos: Okay.

Philip Deck: And they’re not - and they haven’t selected us for SCCM.

Thanos Moschopoulos: Right. Okay. As far as the deals we had in this quarter, can you provide a bit more color as far as, you know, sort of the mix between, you know, new accounts versus your larger house accounts? You know, what’s been the activity there? Is it mostly a question as you said where a lot of the services work is focused on pushing some of the existing customers along so, you know, with a lot of what we saw this quarter, just, you know, other customers, some new business that drove the license number this quarter, or?

Michael Harris: Yeah. I mean, the bigger deals that are for this quarter actually came from new customers so we planted some pretty good seeds as far as the new license deals are concerned. We did about 70% of our business with our current base which is about normal. And I would say that the vast majority of our services revenue in this quarter was for our bigger main accounts. So it was a slightly different spread. Our bigger accounts didn't pay off as far as licenses this quarter in any big way but they did for services. So, for us the exciting part is that we did get four or five pretty good new names here started with, you know, a sizable transaction to get started. And those are most of our bigger deals.

Thanos Moschopoulos: Okay. And then as far as your optimism for Q4, is that just I guess the traction you're expecting as far as further new account wins or is it that you're seeing some of the existing customers starting to (pull the trigger) on some of the deals?

Michael Harris: Yeah, it's mainly existing customers but we're also got some new names coming in. I mean, as Phil said, we've already got a couple of transactions in the first five weeks of the quarter that are bigger than the biggest one we did last quarter as far as Q3 is concerned.

So I would expect most of our bigger transactions in the fourth quarter to come from our current customer base, the ones that - the larger customers, the more strategic ones, that didn't pay off too well in this quarter and somewhat in Q2 and that we're going to be realizing some of that pent up demand in Q4.

Philip Deck: And …

Thanos Moschopoulos: Okay.

Philip Deck: … I think, you know, for an example in the case of RIM, although they are an existing customer, they ran a process that completely ignored that existing install base. This was very much a look at the market from a blank sheet of paper. So, it would be hard to consider it a follow-on transaction even though they have been using software for a while.

Thanos Moschopoulos: Right. Okay. At this juncture what are your customers telling you about, I guess, the outlook going forward? Any signs of a possible slowdown (of pending plans)? You know, just trying to think about the overall macro environment in the U.S. particularly and whether you see any signs from that perspective?

Philip Deck: I'd say that there's a couple of customers where we see some micro disruption so that they have issues in their own businesses that might be affecting our ability to sell to them. But we've seen very little that we could consider kind of a macro slowdown, kind of a ,you know, "Oh, we're just going to freeze spending for the hell of it." So, we have yet to see that. We certainly are watching carefully for it but it's not showing up yet.

Thanos Moschopoulos: Okay. All right thanks guys. I'll pass the line.

Philip Deck: Thanks Thanos.

Man: Thanks.

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

We do have a follow-up question from Scott Penner with TD Newcrest. Please go ahead.

Scott Penner: Yeah, sorry. Just on the measure that you say for full year profitability, that is pre-tax profit?

Philip Deck: Yes.

Scott Penner: Okay.

Philip Deck: We never know what's going to happen with taxes.

Scott Penner: Yeah, exactly. And just, any update on when the next version of Integrity is coming out and what are sort of the key features that are worth calling out?

Philip Deck: It will come out in the fall. It will be called Integrity 2008. And some of the key features will be that we're entirely, or have, entirely rebuilt our Web interface which was a bit of an old part of the platform.

We've done a lot of things to enhance the stability of the platform at high capacity so we've been spending a lot of time focusing on how companies with thousands of engineers can make sure they can use it effectively and happily. So, there's a bunch of kind of internal platform improvements we're making along those lines.

There's two key integrations for us. Those are integrations with IDE so the .NET and Eclipse IDE both being entirely rebuilt. We've actually released now, or are about to release, the Eclipse one and the .NET will come out in the fall with the rest of the release. So those are two integrations that are very important for our business.

And then just a host of other changes to smooth out the capabilities that we've improved in a host of areas across the entire platform. But I think those are the main things of note.

Scott Penner: And is there any update on availability of functionality with packaged software?

Philip Deck: We're still in the process - we've rolled it out kind of on a very very limited basis. We're still doing a lot of technical work on it. There's a release coming at the end of March that will be the full PeopleSoft implementation. So at that point we can start rolling out a little more aggressively.

We spent - while the SAP capability is pretty complete and in use at a couple of customers, the PeopleSoft one we had to spend a lot more time on to make sure that it's ready and so that'll be done at the end of March.

Scott Penner: Okay. And, Doug, maybe just maybe one quick one for you and that is the sales and marketing expense was fairly flat quarter-over-quarter this quarter despite obviously the weaker license number, is that a function of currency?

Douglas Sawatzky: There's a small impact of currency. We do have sales forces in Europe that have had an increase cost base with the strength in euro and pound. But, yeah, there's really nothing else of note going through there.

Scott Penner: Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Tom Liston with Versant Partners. Please go ahead.

Tom Liston: Hi. Thanks. Good afternoon. Just, not to beat this question to death, but with regard to your being fairly (bullish) going into Q4 and on, can you give us some type of a number in terms of deals in last two quarters? I think the last two quarters (that) all were under 250K deals. What type of deals were maybe 50 or 100K that would be MKS 1,000 as it was previously (find) type of customers? And what does give you that confidence (unintelligible) this quarter whereas the last few quarters, you know, why weren't those large deals closing?

Philip Deck: So the first part of the question is, which deals have we done in the last couple of quarters that we would consider MKS 1,000?

Tom Liston: Yeah. So how many deals that are kind of 50 to 100K that would be, you know, that could hit up above 500K deals?

Philip Deck: Okay. In the last quarter?

Tom Liston: No in the last few quarters. There obviously have been two quarters where there hasn't been, you know, any deals over 250K …

Philip Deck: Yeah.

Tom Liston: … correct me if I'm wrong, but …

Philip Deck: Yeah.

Tom Liston: … why wasn't there? And more importantly, if there are a whole bunch of sort of 100K deals that look like they're going to be over 500K, you know, what would that number look like, roughly?

Michael Harris: Maybe this can answer the question, Tom. What was unique about this quarter, I think, is that we signed up more new accounts than ever before in the sort of 50 to 100 and $150,000 range where almost every single one of them we can see the follow-on. So, it was fairly unique to have, you know, a half a dozen or more accounts where we know what's next. In fact, one of the ones we signed late in the quarter for the first deal on the order of $100,000-$200,000 should be coming in (for) four or five times that in the coming days.

So, that was what was unique about Q3 whereas in prior quarters most of the smaller deals that we were doing that might have been it and they were sold more from an inside sales point of view. So I think that's the part that we're, I think, mostly excited about is that most of the - a much higher proportion of the deals we did in Q3, even the smaller ones, we can see the follow-on transaction or transactions.

Scott Penner: So the most part, they have a very clear plan on roll out?

Michael Harris: Yes.

Tom Liston: Okay.

Michael Harris: (Unintelligible). Yes.

Tom Liston: Okay. And just on the, with the requirements management you're getting a lot of momentum with the industry analyst and what have you, are you finding with (the) Telelogic if that ever does close, I don't think it's officially closed yet, but when that acquisition closes, are any of those customers concerned about what happens if that becomes part of IBM and their development plans and the rest? Is it obviously good timing in that sense that you might be winning some of those customers where they're, you know, a bit unsure on what's going to happen?

Michael Harris: I think, yeah, they're not - some of them are unpleased and somewhat worried. I wouldn't say it's the tipping point for us winning the business. I think where we're winning the business and where we're winning the (nods) is purely on technology. You know, we hear rumblings about some of the customers worried about this and what this will mean, you know, are they going to stick with the DOORS offering or the (repro) offering, are they going to have two, how are they going to manage it going forward, but I don't know if it has much of a impact on the decision. We're still winning sort of straight up on these opportunities with or without that.

Philip Deck: Yeah. You know, there are some customers that are going to be - that would prefer having IBM as the owner and some customers that will be disappointed to have IBM and would prefer not. And, you know, those, you know, that probably is an orthogonal distribution against, you know, what kind of companies they are and how big they are and all those kind of things. Some people like dealing with IBM more than others.

But I think the important thing is that DOORS is a very high market share product but it's pretty old technology and it's built on a technology basis that is completely different from ours. And, you know, the reason that we're beating them in the market is not because we have a couple of fancy features that they don't. They're a much more mature product. They've been around forever. It's a very smooth, you know, good looking product. But, we offer fundamental capabilities that just aren't possible with a product that's built like DOORS and that's why we're winning.

So I don't think IBM's going to change that because, you know, the first thing that they'll do is try and, you know, align the sales and marketing capabilities, I would guess. But you're not going to see much change in the technology for a long time and, you know, I think they as well as the other incumbents in the requirements management space are selling the same technology they have been for a long time. We've come in and said, "No no no. You can do this completely differently with a completely different approach and look at all the benefits you can get from that," and that's what's winning the business for us.

Tom Liston: Okay. And I'm not sure if I missed it but could you comment on any geographic trends in the ALM license business? Anything going on that could be highlighted in terms of Europe doing well, or?

Philip Deck: (Unintelligible).

Tom Liston: Pardon me?

Philip Deck: Well, Europe's doing a little bit better partly because of the currency because they have money that's worth more to us these days than our …

Tom Liston: Sure.

Philip Deck: … American customers.

Tom Liston: But otherwise still fairly balanced?

Philip Deck: Fairly balanced otherwise.

Tom Liston: And this finally on IO, it seems to be hanging in there better than most of us would have thought. Any foresight if we might get to more 10% type declines rather than the sort of flattish numbers you've been looking at or do you think it might have a chance of hanging in?

Philip Deck: Well speak for yourself Tom. Yeah, no, you're right. They're pretty much on track. And, no, I'm guessing that we're going to see the same kind of trend next year as we saw this year. We don't see any dramatic changes. But, you know, over time it's still going to decline.

Tom Liston: Okay.

Philip Deck: Hopefully it won't be at the 10% level that we kind of plan against but it's not going to be far from it I don't think.

Tom Liston: Sure. Okay. Thanks. That's it.

Philip Deck: Thanks Tom.

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

One moment please for the next question.

There are no further questions at this time.

Philip Deck: Then thank you everyone for your attendance on the call. We look forward to updating you further in the quarter ahead.

Operator: Ladies and gentlemen that does conclude today's conference call. We thank you very much for your participation and we ask that you please disconnect your lines.

END