

MKS INC

Moderator: Philip Deck
June 6, 2007
4:00 pm CT

Operator: Ladies and gentlemen, thank you for standing by and welcome to the MKS Fourth Quarter 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 any time during the conference you need to reach an operator, please press star-0.

As a reminder, this conference is being recorded Wednesday, June 6, 2007.

I would now like to turn the conference over to Mr. Philip Deck, Chairman and CEO for MKS, Inc.

Please go ahead, sir.

Philip Deck: Good afternoon and welcome to the MKS Fourth Quarter Conference Call.

I'm here with Michael Harris, our Chief Operating Officer, and Doug Sawatzky, our CFO in Waterloo, along with Larry Wasylishyn, our General Counsel.

I'll first turn to Larry for our legal disclaimer.

Larry?

Larry Wasylishyn: Thanks, Phil.

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 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 in 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' filings with Canadian securities regulators.

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

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

I'll now turn the call back to Phil.

Philip Deck: Thanks Larry.

Today MKS reported fiscal 2007 revenue of 48.3 million, unchanged from 2006 and a pretax loss of 2.8 million, down from a profit of 3.9 million pretax profit at 3.9 million in fiscal 2006.

The revenue split between our ALM and interoperability business was essentially unchanged.

For the quarter ended April 30, 2007, we reported fourth quarter revenue of 12.6 million, about 9% higher than the third quarter of this year and about equal to the same period last year.

We reported a loss before tax of 300,000 this quarter, a substantial improvement over the million dollar loss in the third quarter of this year.

Our legacy interoperability business reported 2.4 million in revenue in the quarter significantly above the 128 million in the third quarter and slightly below the 2.6 million in the fourth quarter of last year.

ALM license revenue increased 22% to three point - sorry, 3.9 million over the previous quarter.

Service deliveries were down about 200K from the quarter before, chiefly due to a slow start based on the sluggish licensing of the two quarters before that.

But our backlog increased substantially during the quarter with almost 2 million in ALM services sales, an all-time record.

Maintenance renewal rates were at their normally high rates. But recognition of maintenance revenues were flat due to the effects of a shorter fourth quarter than third quarter and our daily recognition policy.

Cash increased slightly to 15.3 million from the balance of January 31, 2007 of 15.1 million.

During fiscal 2007, we recorded the ALM license revenues significantly below our expectations. The gap was most acutely felt in the license sales to our largest customers. License sales to those largest all-time customers represented the entire decline in licensing compared to the prior year.

At the same time, however, service billings increased markedly over 30% from these accounts. And throughout the year, we've maintained intensive levels of activities with this key group of customers as they worked to deploy the software that they own and plan for new deployment.

In most cases, the deployment of new software is not just for more users but for different kinds of use where customers do not have nearly the internal process maturity, methodology, expertise, or interdepartmental consensus that have been the case in the more traditional seat-based deployment. This has caused a need for substantial and time-consuming efforts to develop processes, plans, consensus, efforts on the part of customer personnel and increasingly from MKS service employees and our services partners.

This expansion and scope driven primarily by the growing consensus in the industry that ALM should be addressed in far more comprehensive and

integrated manner and the improvements in MKS product capability that permit the integrated approach.

The implications on MKS' business model are likewise profound. They include the deepening of our relationship with our customers, the increasing importance of our products and the strategic platform within our customers' infrastructure and the ultimate expansion of the revenue opportunity for MKS in each customer.

In spite of lower license revenue during fiscal 2007, we saw sharply higher field expenses as we made investments in expanding the scale of our sales operations and in supporting the sharply higher levels of services that we billed in 2007.

As we start fiscal 2008, those investments represent a much higher sales capacity to grow into, additional sales personnel with significant growing pipeline, and a growing list of customers who have now made the investments in adapting their development infrastructures to accomplish far more ambitious business goals.

I'll now turn to Michael Harris, our Chief Operating Officer, for a review of fourth quarter operations.

Michael Harris: Thanks Phil.

This afternoon MKS reported an increase in revenue over Q3 of 9% driven primarily by a 22% increase in quarterly ALM licensing.

ALM service revenue is down over the previous quarter but up 29% over the equivalent quarter of fiscal 2006.

Significantly, we sold 2 million dollars in services, a record total amount, and in particular, a record as a percentage of licenses.

Some of this service revenue we delivered in the past quarter but most will be delivered in the coming months as we work through the backlog.

Total company headcount as of April 30, 2007 was 323, up 4% from a year ago.

As we have detailed in the past, we made big investments to expand our sales force from 21 reps during the third quarter of 2006 to over 30 in May 2006. We have now winnowed that total down to 26 today.

Turnover among longer term tenured reps continues at the low rate that we have seen over the past few years.

Today, we stand with the largest sales force but more importantly, a longer tenured one with the surviving reps of our sales force expansion with several quarters of experience behind them.

Our total sales force also include 15 area account managers or inside sales reps, many of whom are continuing to develop their ability to manage larger and larger sales initiatives leaving the (RFMs) to focus on major accounts.

Some of the larger opportunities that we closed include repeat wins at Avon Products, Continental Automotive Systems, HSD, HSBC, Lockheed Martin Information Technology, Mitsui Knowledge Industries, NCR, St. Paul's Travelers, TRX, The TJX Companies, and Vertex Pharmaceuticals.

This past quarter was also very successful with some key new accounts being added to our roster by signing up beachheads at Continuing Care of Ontario, CQG Systems, Genesis Microchip, IKON Office Solutions, Verizon Communications, Phoenix Interactive, The Seavus Group, and Tyco Fire & Safety.

We are delighted with this addition of new accounts to our customer list as we expect for each of them to be implementing the first deployment quickly and, in some cases, already have the follow-on sales lined up for future quarters.

As mentioned, our I/O segment had a terrific finish with follow-on sales to three key customers in Toshiba Medical, Landmark Graphics, and Invensys Systems.

I/O finished the year ahead of our business plans with only a 2% decline in revenue and holding operating income essentially flat from 2006.

We continue to do an excellent job of managing the cost base of this segment and transfer headcount to ALM if appropriate opportunities arise to do so.

Over the past quarter, our global marketing team continued to generate thousands of leads for our sales reps.

Events to highlight for the fourth quarter included MKS' select sponsorship of Computerworld's Premier 100 CIO Conference, which included a joint presentation session with Ajay Waghay, Midwest CIO for Verizon Wireless, and a joint event with CM Crossroads featuring our customer Lancaster Labs which drew over 900 participants.

Our online investments in key publications like CIO Magazine, Computerworld, search engine and expert communities, such as (unintelligible), continue to drive our highest value leads which we can directly track to our largest sale leads.

Also, we secured feature coverage embedded systems journal, a case study featuring customer BNSF in technology magazine eWeek and a feature interview with Phil in IT Compliance Institute Magazine.

Our services growth year-on-year was impressive. It has been a significant focus of our sales and delivery efforts. Services growth was 23% over fiscal 2006 with the bulk of this growth coming from our larger accounts.

This service spend has been directed at the further deployment of our solution into MKS account where we see further software licensing needs on the horizon.

The most significant gating factor to strong license growth is software sold however yet to be deployed. And by focusing on delivering a return on our customer's investment, we assure more satisfied customers in subsequent follow-on sales.

Our investment in partners has played a large part in that growth and we now have a dozen third party consulting firms which we have been working with over the last year whose own business plan is dependent on the success of MKS and our joint customers. These external consultants drove 25% of our services revenue in North America alone and we expect this proportion to increase further over time.

Having these partners walking the halls of our customers is allowing them to deploy more value into the accounts and creating stronger relationships between all three parties.

As planned, our partners have also played a large part in bringing us into new accounts which may not have otherwise been aware of MKS and our capabilities.

In Q4 alone, these partner referrals led to \$1 million in sales across five specific opportunities.

Using the leverage of an extended sales team in the market is imperative for us to continue to license and sale - service sale.

And just one example, in the past quarter we signed on Seavus as a partner and customer. Headquartered in Sweden, Seavus is a provider of IT solutions, custom software development, and software products with close to 300 professionals operating Europe-wide. They have begun the deployment of MKS for internal use and are already bringing it up into their customer base.

Seavus provides development services in Scandinavia and Eastern Europe with a specialty in the telecom vertical.

They are an aggressive and high growth company which singled out MKS from all of the competition as the most logical platform from which to build an ALM practice.

The plan to use MKS Integrity as the foundation for application development for the customers promises to boost MKS' footprint in the Scandinavian marketplace.

In summary, we ended the year with quarter-on-quarter growth in our licensing and a very strong services backlog. Another solid growth in services bodes well for follow-on deployment in the customer base. Our sales team is far more experienced than it was a year ago and the traction that they are making is encouraging.

Finally, 2007 was the year where we made significant strides in developing our services partner channel. This is only the beginning and we expect to have far more MKS influencers in the market as we execute further on our partner strategy as a key component of our overall corporate strategy.

Philip Deck: Thanks Michael.

For many years, we focused on the largest companies in the world to sell to. Those organizations have demands that best fit our product capabilities and the scale that we can - and the scale that can provide us with long-term revenue opportunities and pay back the large investment that we have to make in winning them.

Until this year, we expanded our business chiefly on own steam. We've never had the services partners or channel partners to help. But as we've grown and as the amount of services that we generated per dollar of license revenue has grown, we found increasing interest from the channel.

Eighteen months ago, we launched a partner program to find, train and integrate services partners into our business, and this year we made tremendous progress in that strategy.

We now have a dozen services partners who are buying our product, training personnel, delivering services to our customers, and increasingly introducing us to their own customers at a rapidly accelerating pace.

This channel can offer us significant leverage in providing the implementation guidance that customers need, reducing the overall cost of - during the sales process, offering new capabilities, and generating new customer opportunities. It's essential to our further growth and was unavailable to us before we had proven the business model that we have over the past few years.

As we've always explained to our shareholders, we've rarely approached our customers directly through the front door as companies of our size are rarely welcome there. Instead, we always have to find an alternate route where we can use one of our unique strengths to make a strategic beachhead to expand from years ago with our iSeries platform that commonly got us through the door.

Since then we found other unique parts of our product that we can offer as ways to get through the door through world-leading requirement management capability, server deployment, and recently test management, but always with a view to finding ways to plant the seeds that will grow into major enterprise deployment.

Over the past year, we've invested over \$1 million to develop integrations that allow us to offer industry-leading ALM capabilities that were typically offered for custom application and instead for packaged application configuration.

Packaged applications like SAP and PeopleSoft require constant configuration and customization. Management of those changes has represented a major

headache for customers and the services company that typically perform those services and a major expense for both.

Our capabilities in this area now allow us to operate new unique ways to make enterprise beachheads but also contribute to our channel development strategy.

We now have an early adopter program launching with SAP and PeopleSoft customers to implement and demonstrate this capability in live production environment all in partnership with systems integrators.

In light of the recent movement of the Canadian dollar against the US dollar and the euro, we should address the currency sensitivity that we have.

Approximately, 31% of our costs are paid in Canadian dollars, about 12% in euros, about 7% in sterling, and remaining mainly in US dollars. Increases in the Canadian dollar have a large impact on our reported cost.

We have very little Canadian dollar revenue to offset that cost as many Canadian customers use our US pricelist.

We do have substantial euro revenue and so, when the euro has risen against the dollar in the past, we have a net benefit. This has not happened lately however so our exposure to the Canadian dollar has been more acute.

All other things being equal -- even though they never are -- we would see an extra \$160,000 in annual cost for every one penny increase in the average level of the Canadian dollar over the entire year.

In the short term, we can do nothing to plan for currency movements or alleviate their effect. But over the medium to long term, we have been able to adapt and will continue to.

All of the increase in overhead cost since 2004 at MKS for instance have been in currency translation, even though our company has 40% and bigger in revenue terms.

We've achieved that cap on real cost through good design of our financial system and strict control over non-essential expenses.

This month, we will ship the newest version of MKS Integrity. Almost a year in development, the new release includes major new and unique capabilities to construct highly integrated ALM systems.

We have worked with many of our customers over the past year to make sure that the release had - addresses their objectives, many of which includes software reuse initiatives like software-oriented architectures and the software product line methodology. The platform also improves the ability for our services partners to add proprietary value and best practices, processes and methodology.

We believe that the new capabilities represent a substantial lengthening of our product advantage.

We expect that ALM license revenue will improve in 2008 from the levels of 2007, which, combined with the continued increase in maintenance and services, will result in higher total revenue for the fiscal year compared with fiscal year '07, more than offsetting expected modest decline in interoperability revenue.

We are committed to an early return to quarterly profitability and are managing our cost base with a view to sustaining current capacity while making further investments in sales capacity only when acceptable levels of profitability are reestablished.

We expect full year profitability based on increasing revenue and carefully managed cost.

Cash flow in 2007 was impacted by a variety of unusual factors. New uses of cash were a needed upgrade to our server infrastructure for \$1 million and the dividend for \$4 million.

Sources of cash included receivable liquidation from changes to maintenance collection processes, receivable liquidation due to lower licensing, and the normal buildup of deferred revenue from our growing maintenance portfolio.

We expect to maintain more than sufficient cash balances through fiscal 2008.

The combination of expected improvements in net income, reduced capital expenditures over fiscal 2007, a continuation of lower overall receivable days, and expected stock option exercises due to expiry schedule are expected to more than offset the cash needed to fund higher license sale and the maintenance of our dividend policy.

We expect that normal seasonal factors will continue to cause modest outflows of cash in the first half of the year and inflows in the second half.

In the first quarter, we have significant seasonal expenses in our global sales conference amounting to about \$400,000. This quarter, as well, will record an

additional \$400,000 in one-time severance cost that will lower the ongoing expense level in local currency.

Income tax is recorded in our financial statements going forward at the prevailing tax rate in the jurisdiction where income was generated to the extent a deferred tax asset has been recorded in that jurisdiction. The rate may be higher than the average rate we expect to pay in the future across all jurisdictions.

We expect the long-term tax rates to be approximately 35% to 36%. This will be subject to an ongoing quarterly attachment of the valuation 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 per share, US consistent with our policy to return cash not needed to fund our growth to shareholders through a regular dividend.

The Board of Directors has a great deal of confidence in the soundness of our business plan, the opportunities at hand in our changing market, and our short-term plan to reestablish growth. We're encouraged by the progress we've made in this past quarter in reestablishing that growth.

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 delighted 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-tone prompt to acknowledge your request.

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

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

One moment, please, for our first question.

And our first question comes from the line of Scott Penner of TD Newcrest.

Please go ahead, sir.

Scott Penner: Hi.

Phil, if you could spend just a minute in reviewing sort of what happened relative to your original guidance coming into this quarter. It was, you know, seen by some of us on the call last quarter as being, you know, relatively aggressive and you were quite steadfast in sticking to it, so just - some of the factors that were involved this quarter.

Philip Deck: Well clearly we had a pipeline that we thought supported the number and we didn't close enough deals - enough of the deals in it, some of them have not - now closed this quarter that we, you know, had expected last quarter. But, you know, that happens in every quarter to some degree, maybe it happened a little more this quarter than normally, you know.

But again, we've - we experienced the same things we've experienced through the year where we have some great projects and we're trying to move them along and they're not moving along as fast as we would like.

Scott Penner: So were these, again, of the larger variety with existing customers?

Philip Deck: All kinds. I mean, I think that the problem that we've experienced with the biggest kind of delays in our expected revenue are with existing customers and they tend to be fairly large involved projects that were associated with some of the deals that we would have liked to close last quarter and now have, you know, our new customers, so most of the schedule problems or timing problems that we've experienced in the last year are from existing customers.

Scott Penner: And these existing customers that are taking a little bit longer to deploy, are you aware of any that have gone away from MKS as you've been talking to them, a competitive loss or are they just taking longer rollout?

Philip Deck: No, I mean, you know, when we look at our top, you know, 20-25 customers, we know them all pretty intimately. Most of them we have ongoing services projects with. Most of them we have ongoing sales initiatives with and are planning for deployment.

I can think of one where I'm concerned about losing the business, although it would be a couple of years out. But just based on the politics of that one account, I can see a risk there. I can't think of any others in that group. And again, they're customers that we have pretty close relationships with.

Scott Penner: Okay.

What - I just - if we can address also the services side of things to try to get a reconciliation of some of these numbers. I was a little bit surprised to see the ALM service revenue as recognized dip quarter over quarter. I know you've mentioned strong bookings and I also noticed that the margin looks quite weak on the services side for the ALM business.

So, is this a case where the bookings came in and they've stacked up but the revenue is just, you know, still to be recognized?

Philip Deck: Well, we have so much fixed capacity in services so if the bookings are down then the margins are always going to be down because our cost level is mainly fixed in the services group.

The reason for this - the lighter delivery was that we really had a slow start in the first few weeks of the quarter really because we had such poor licensing in the second and third quarter, we didn't have the (unintelligible) we needed in services.

So, while the percentage of services to licenses has been growing very steadily and even though the percentage was pretty high in the third quarter, it just wasn't very high license numbers but the backlog in services was great. By the time we started signing up a lot more services in the quarter, you know, we're already a month or six weeks into it.

So, you know, in a reasonably fixed capacity business like services if you get a slow start and you have some holes in your bookings certainly in the quarter, you have to make it up.

So, the actual bookings we did were a high number both in the absolute number and in terms of percentage of overall sales, over 50% now relative to

what we would have seen say, two years ago of around 20%. But most of that backlog is being delivered this quarter.

Scott Penner: And that backlog is now more so leading-edge type services revenue not the implementation side?

Philip Deck: Yeah. All the growth - and we kind of categorize it into basic implementation which would be, you know, someone setting up a server and migrating a code base and, you know, establishing basic processes and doing training. That's the kind of stuff that we've always done and there's not much growth in terms of the percentage of licensing that we do on that.

All the growth is in consulting services, whether it's process consulting or, you know, designing the data model that someone's going to use.

If someone's going to use our system across many departments, then you have to design the different processes that will apply to each kind of information that's being modeled and how the different kinds of information will relate to each other, what kind of reports you're going to generate, what kind of metrics have to be generated.

And there's a fair bit of consulting where just in, you know, trying to figure out what kinds of things need to be tracked as well as, as we've discussed, in big companies, you know, where there's fairly broad deployment, the level of expertise among our customers in the processes outside of core development processes is often quite low, whether it's requirement, management expertise and the methodologies around that or test management or deployment management.

So these are processes where, you know, our customers haven't been very well developed in the way they've done things. And so, it's not just installing software, it's actually helping them to develop processes around these activities which is really important.

And so that's where the growth has been and in fact that's the part of the growth that we're really trying to offer to services partners as a way to entice them in to working with us, getting to know our platform so that we can expand the services partnerships we have.

The external services providers don't really want to take on the code migration and server setup, that's actually stuff that we're much better doing internally. What they want is a higher level of consulting services and that's exactly what we're offering up to them and virtually guaranteeing a quota of outsourced services for many of them on a quarter-to-quarter basis.

Scott Penner: And thanks for that.

And what was the 400k of severance that you had talked about, what does that relate to?

Philip Deck: Well, it relates to terminating people. It's not anything very specific, I guess, but it's probably on higher level of terminations than we've typically done in any one quarter than that.

Scott Penner: Okay. Does this relate to the sales of - the RSM count to being 30 down to 26?

Philip Deck: No. Typically, when we experience turnover in salespeople they're very short-tenured salespeople and the severance cost for those is extremely low so it wasn't anyone in the sales force.

Scott Penner: Okay. I'll pass it on. Thank you.

Philip Deck: Sure.

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

Please go ahead.

Lawrence Rhee: Hi guys.

Can you - I guess, looking back and seeing fiscal 2007 as a tough year for you, can you just outline some of the things that you've done in terms of, I guess, sales execution strategy that have given us comfort that things are kind of on the up-and-up kind of going forward?

Philip Deck: Well, I mean I think at this point results are going to have to speak for themselves. You know, we've kind of detailed the parts of the strategy that we're very much committed to and maintaining our focus on and, you know, the overall strategy of course that we've articulated over the last couple of years, we haven't diverted from one bit.

You know, I think the things that we've done that really are in response to the disappointing numbers are, you know, first of all, to address the issues that really have caused it, which is try and make sure there's enough services attention and sales attention and deployment attention on large customers to get their project moving along.

But also, you know, frankly, to take a pause in the addition to any new sales capacity until we can improve the results. You know, we're very committed to being a profitable company and so, we're - we've built a bunch of sales capacity in the company that we'll grow in to but we won't add to it until we start seeing the results from them.

You know, I think that the best evidence is always going to be in the numbers and those are going to - we're going to have to prove that in historical numbers obviously.

Lawrence Rhee: And just looking back in terms of the history and sort of financials and reaching an ALM license revenue of 6.5 million about six quarters ago. Is that - does your pipeline kind of offer that potential sometime next fiscal year or do you think that's kind of further out?

Philip Deck: Well, we are very, you know, we described the nature of that quarter extremely precisely when it happened and we described it as a very lumpy quarter and we explained that to achieve 6.6 million, we had a \$2.2 million license deal that contributed to it.

So, you know, the question is, I suppose, when are you going to have some more lumpy deals and, you know, we often focus on that ourselves. It's very hard to predict. And sometimes the largest deals and the lumpiest deals are the ones where the timing is very hard to predict.

But certainly the, you know, as we make better deployments in the large customers, the prospects of larger deals are there. It's just not something that's very easy to forecast and we've proved that.

Lawrence Rhee: And with respect to, I think, last quarter, I think you, commented about increased competition as the reason for some of the weak results last quarter. How do you address that - continue this quarter?

Philip Deck: I'm quite sure that I didn't actually point to increased competition as any reason for problems last quarter. In fact, I'd state that while we did experience some competitive losses earlier in the year, we really have seen very little of that particularly in the last quarter. So I can't think of any significant deal that we lost to competition in the last quarter and I don't think we made that comment.

Lawrence Rhee: I just think - I think it was the term "fiercer competition," sorry, during the conference call and I think I just alluded to that just as increased competition, so...

Philip Deck: Yeah. I mean I think when - what's clear is that when we're competing for, you know, at a very high level in the customer organization, you know, our brand is not as effective as very large companies. And so, we have to find another way to get around them.

There's lots of large companies that only want to deal with large suppliers, and fortunately, there's lots that, you know, that are exceptions to that.

And the best way to get into those accounts is find somewhat a smaller beachhead and work it. You know, we've got 67 big Fortune 500 companies where we've made that progress and shown that if you can find a way to wedge yourself in then you can get to the CIO level and you can get some very strategic deployment there.

Fierce competition is what happens when, you know, when you go straight at a company in a broad-based way, and we have to be a bit sneakier than that but we proved that we know how to do that.

And in fact, you know, the problems we experienced in fiscal year 2007 really had nothing to do with the competition. They had, you know, we - most of the disappointment in licenses came from our most important longstanding customers where competition isn't a factor at all.

Lawrence Rhee: Got you. And sorry, last question, just in terms of beachhead-type accounts, what's the customer count right now?

Philip Deck: Lawrence, it's in the order of 70. We have - you mean house account, I guess?

Lawrence Rhee: Sure, yes, house account.

Philip Deck: It's in the order of 70. We added a few more this quarter.

Lawrence Rhee: Okay, great. Thanks guys.

Philip Deck: Sure. Bye.

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

Please go ahead.

Susan Streeter: Thanks. Good afternoon.

Philip Deck: Hi Susan.

Susan Streeter: Hi Phil.

I'm just wondering if you could - most of my questions that I see you've touched on already, but can you elaborate on what you would anticipate in terms of a decline in the interoperability revenue this coming year?

I mean, I know 10% sort of annual decline has been a number you sort of talked about, obviously you did a lot better than that this year. Is there something that you're seeing a bit of a resurgence or is it just...

Philip Deck: No, I think they just did a really great job. I still think 10% is probably a good number.

Susan Streeter: Okay.

Philip Deck: And, you know, maybe there's even a catch-up to that rate this year.

I don't think that the great performance they had this year is necessarily indicative that the trend is reversing. You know, we're trying a bunch of new ideas and new products in that division, albeit without a huge investment in them and you know, maybe that can stabilize the revenue, but I don't think we're at a point where we can forecast that.

Susan Streeter: Okay, okay.

And then, you talked a bit about bringing on some of the third party consultants as sort of an indirect channel. As a percentage of your overall business, where would that stand right now?

Philip Deck: Well, we don't - we're not bringing them on as resellers, so we're not contemplating the creation of an indirect channel. What we're trying to do is establish partnerships to service this company, who will work with us as customers.

So, there's no contemplation that we're going to start selling to some kind of distributors or borrowers or resellers that we'll then take the product to customers that we don't know well, that's not part of it at all.

So, I think Michael indicated that about \$1 million of our revenue in the fourth quarter license, revenue came from leads or relationships that started with channel partners. I think that actually was \$1 million in total sales in license.

But none of those were indirect so those were all customers where, you know, we were either chiefly or mainly or at least heavily involved in the sales process and it would have been assisted by one of our partners who had a services relationship and that partner probably would have done services in the account. But we're not setting up an indirect channel.

Susan Streeter: Okay. Okay, thanks.

And then just lastly, I might have missed it on the call, did I - what was the RSM count at the end of the quarter? Twenty-six? Did I understand that correctly?

Philip Deck: That's correct, Susan.

Man: Twenty-six, yes.

Susan Streeter: Okay, okay. Thank you. That's it.

Philip Deck: You're welcome.

Operator: Ladies and gentlemen, as a reminder, to queue up for a question, it is the 1 followed by the 4.

Our next question is a follow-up question from the line of Lawrence Rhee.

Please go ahead.

Lawrence Rhee: Sorry. Just one more quick question.

You mentioned that you closed some of those deals that you expected to close in Q4, I guess, now in Q1. Can we expect that the traditional seasonal decline in revenues in Q1 may not be as apparent this time around because of that?

Philip Deck: Well, I guess, the quarter would be a combination of some - a little bit of bounce back and a little bit of seasonality, so I - you know, I can't really give you much indication that way and, you know, we haven't put out any guidance for the first quarter.

You know, unfortunately, normally, business - let's just push out other business because the reps working on that business slipped, they are busy on it.

So, you hardly ever get the benefit of a delayed deal really affecting in the quarter. But, you know, it certainly helps deals coming earlier in the quarter and that's always helpful in putting a quarter together.

Lawrence Rhee: Got you. Great. Thanks guys.

Philip Deck: Sure.

Operator: And our next question comes from the line of Tom Liston of Versant Partners.

Please go ahead.

Tom Liston: Yeah, just a follow-on to those questions.

Is there anything you're doing in terms of sales methodology or even how they're sort of estimating these deals to have some better visibility on, you know, what the pipe looks like and when is it going to land so you can sort of better attune staffing levels to the current reality?

Philip Deck: You know, I think that we tend to spend 95% of our time on trying to help them bring deals in instead of trying to help them estimate them better. You're just never going to be - I think it's just very difficult to predict a lot of the time. And the quarters where we've been beaten our numbers, in the past, we've tended to beat them in a way that we didn't predict and so, you know, I don't know what that implies for our methodology.

Certainly that, you know, managing a pipeline is important just to manage the sales force and the activities and things like that, but I think the bulk of our activities are just really focusing hard with our salespeople on how to move things along.

And for many salespeople it's somewhat new territory and having to, you know, sell services, manage implementation, do things that are much more in the nature of, you know, things like ERP sales and real integrated application

sales where we're certainly way out of the development tools business where we are, we're selling enterprise applications.

And interestingly enough that, you know, we hired a lot of salespeople, as people know, in the last year and the ones that didn't make it were almost all the ones that came from our industry who are just way too focused at trying to sell point products, you know, thinking in terms of development tools and not thinking about enterprise sales process and, you know, integrating a big team to go after larger enterprise deployments.

And the ones that came from people are companies like SAP and other enterprise players have tended to be much more successful in the sales force. And so, we're, you know, looking much more skeptically at salespeople from our industry because we have to make sure they understand how to sell enterprise.

So I think that's where our focus is. You know, if we can generate better results just from, you know, managing people's activities better than the forecasting of how long is it as well.

Tom Liston: Did Michael give the sales productivity metrics and deals over 50K, et cetera?

((Crosstalk))

Michael Harris: No, I didn't give it, Tom, but I will.

They are - help me out here, Doug, over 100,000, there were 19 deals, 16 of which were ALM and our per RSM sales were 252,000.

Tom Liston: Okay. And it sounds like there's not many hirings of any further RSMs during the year.

What - where do you think your capacity is? I'm not only interested in sales reps but maybe the organization as a whole, (unintelligible) your current personnel of that. What capacity could go to your organization just on current personnel?

Philip Deck: Well, when - I guess, in 2006, we had about 350 or a little over that in RSM productivity, so, you know, the 250 that we just had is an indication of excess capacity, I suppose.

But I think the other factor is that our inside salespeople are tending to increase their capacity as well because they're doing somewhat bigger deals -- to some degree that the distinction between an outside salesperson and an inside salesperson is blurring a little bit in our company because some of the inside salespeople are starting to do significantly larger deals.

So, I think there's a fair bit of capacity in where we are and, you know, we could certainly grow 30% or 40%, you know, with the current kind of sales force size.

And, you know, we're not - we don't completely exclude the possibility of hiring any salespeople. If we find someone that, you know, offers us a résumé and a personality and an approach that we just can't turn down, then we'll add them to the sales force but it's not primarily with a view to expanding our capacity.

Tom Liston: Okay. Just on the severance, can you highlight roughly the number of people and areas that they were in?

Philip Deck: It was a few mainly in the marketing side of their company.

Tom Liston: Okay. That's it for me.

Thank you.

Philip Deck: Sure.

Operator: And there are no more questions at this time.

Philip Deck: Great.

Well, thank you everyone for joining us on the call. We look forward to updating you further in the months to come.

Operator: Ladies and gentlemen, that does conclude the conference call for today.

We thank you for participating and ask that you please disconnect your lines.

END