

MKS INCORPORATED

**Moderator: Philip Deck
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4:00 pm CT**

Operator: Ladies and gentlemen thank you for standing by and welcome to the MKS Inc First Quarter Results Fiscal '07 Conference Call.

During the presentation, all participants will be in a listen-only mode. Afterwards you'll be invited to participate in the question and answer session.

At that time, if you have a question, please press the 1 followed by the 4 on your telephone. And if at anytime during the conference you need to reach an operator, please press star-0.

As a reminder, today's conference is being recorded Thursday, September 7, 2006.

I would now like to turn the conference over to Mr. Philip Deck, Chairman and Chief Executive Officer.

Please go ahead sir.

Philip Deck: Thank you and good afternoon to everyone. Welcome to our first quarter conference call.

I'll first turn to Larry Wasylshyn, our Legal Counsel for our legal disclaimer.

Larry Wasylshyn: Thanks, Phil. Good afternoon.

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

Forward-looking statements include information concerning possible or assumed future results of operations of MKS and its subsidiaries, are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict.

These statements 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' 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 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.

For the quarter ended July 31, 2006, MKS reported record first quarter revenues of 12.6 million increase from the 10.8 million recorded in the same quarter last year, based on increases on - in license, maintenance, and services in both our ALM and IO businesses.

ALM revenue was a record for the first quarter and in fact, only exceeded in any other prior quarter by the spectacular third quarter we had last year.

Sequentially, our ALM business grew 5% from the fourth quarter of last year. We did not experience the usual decline in revenue from the fourth to first quarters largely because the fourth quarter itself was a below trend quarter.

In short, our first quarter revenue was right on track.

What was unusual although not unexpected in the quarter was on the cost side where a number of factors contributed to our first operating loss in many quarters.

The main factor was the cost of the additional sales and services personnel added at the end of the fourth quarter that drove sales and marketing cost 16% higher than in the immediately preceding quarter and 35% higher than that quarter - than the first quarter of last year. Because that surge of hiring was so sudden, the disparity between cost and revenue production was quite pronounced.

Additionally, we incurred ongoing cost from our expansion into Asia, hopefully the last quarter before significant revenue production. We expect both of these factors to ease throughout the year, as our new sales and services staff build productivity.

And finally, currency rates once again worked against us amounting to an extra US\$ 400,000 expenses compared to currency rates 1 year ago.

Cash in the quarter was slightly lower to 15.4 million from 15.7 million. We were close to breakeven on EBITDA, liquidated some receivables from fourth quarter sales, paid a dividend of about \$1 million and exercised options for about 600,000.

Having successfully released our new product in May to significant acclaim, we're now focused on trumpeting its benefits to our customer-base and targets and on integrating our new sales and services staff to help them develop their pipeline.

I'll now turn to Michael Harris, our Chief Operating Office and President, for a review of Q1 operations.

Michael Harris: Thanks, Phil.

This afternoon, MKS reported record first quarter revenue driven by follow-on sales from some of our largest customers and some key wins in new account.

We continue to be encouraged by our growth in the ALM marketplace, as well as the growth that our MKS field sales and services team which will help to

ensure future success with the most demanding customers and prospects going forward.

(Full) company headcount as of July 31, 2006 was 329 or up 59, 22% from a year ago. Consistent with our previously announced contention, all of the addition to MKS staff is here will be towards product development and customer facing sales and services staff.

Late in fiscal 2006 and early fiscal 2007, we benefited from a strong surge in recruiting field sales and services personnel, with 14 new hires in the fourth quarter and a third or 14 new hires in May alone.

As expected, the addition of these new customer teams had very little impact on our Q1 results, with the vast majority of the ALM sales coming from our more tenured teams who have helped to grow the customer-base and MKS integrity deployment to where it is today.

As of July 31, 2006, our sales force included 31 direct - regional sales managers or RSM and 20 inside area account managers. Currently of the 31 ALM focused RSMs, 11 have less than 12 -- I'm sorry - 11 has less than two quarters of experience at MKS.

Consequently, one of our key challenges will be to work closely with them to ensure that they get the best possible start and allocate the time appropriately to those opportunities they can have immediate results and those that offer larger but longer term win.

We continue to expect and to reach a productive \$200,000 in sales per quarter result within the – within three to four quarters.

As of our new sales people generate momentum, we will add to their numbers modestly throughout the year.

While our new reps were busy building pipeline in the quarter, our 20 mature reps continue to improve their productivity accounting for over 19% of sales this quarter.

These came in part from repeat wins with Arrow Electronics, BNSF Railway, Campbell Soup, Daimler Chrysler, (EDS), HSBC, Industry Canada, L-3 Communications, Magna, NCR, Parker Hannifin, and Skandia Life.

In the quarter we also added (Gemalto), Overstock.com, Research in Motion, and Vertex Pharmaceuticals to our customer roster.

Our IO segment had another great result, above our expectations driving more than \$ 2.1 million in revenue.

As has repeatedly been demonstrated through - although declining in revenue over the longer term, this team can and has added much needed revenue and profitability to MKS as a whole to provide the fuel for ALM growth.

Further, as this revenue declines, we have been able to steadily manage the profit and in many cases, transition the employee successfully to the ALM team.

The first quarter was another busy quarter for MKS and the PR department. Beginning with MKS' sponsor level participation at Gartner flagship event, ITxpo, a symposium in San Francisco and Barcelona.

During these shows, we were pleased to host presentations by senior executives from Verizon Wireless, NCR, and Tele Atlas, where we had a great turnout of potential prospects excited to hear directly from our customers about the solutions that we have implemented.

Recordings of these sessions are available on our home page for those of you who are interested in learning more. We also launched a brand new look and feel to our Web site and in total content structure overhaul.

Press coverage continued through the quarter, resulting in (feature) coverage of our customer Lufthansa and Computerworld and a major compliance feature in CIO Canada Magazine featuring Philip Deck, Deloitte, and one of our customers, Navtech.

As witnessed by our 19% year-in-year growth over Q1 fiscal 2006, our focus around one single platform and sales execution towards our current customer base, and new global 1,000 target accounts is allowing us to steal away market share.

Although competition for businesses is always heated, we continue to prevail in the type of accounts where we are focused. Those accounts with globally distributed development teams, multiple platforms and look into automated processes which will allow them to improve productivity and quality and visibility into application development.

Our most recently introduced MKS 2006 version bringing to the market the first ever ALM platform complete with fully integrated application portfolio management capabilities.

This new capability and feature set is allowing us to - not only to consider for new opportunities, but more importantly giving our current customers more reason to deploy MKS iIntegrity companywide.

With companies that are looking to measure and manage their development activities more closely and to gain an understanding of the total cost of their vast inventory of applications which often numbers in the thousand, this capability is key.

As the use of MKS Integrity propagates through the IT departments of our significant customer base, the value to the enterprise thereby improve exponentially.

As we focus on following our first (beachhead) with further deployments of MKS Integrity, the visibility to the CIOs and CTOs within our customer base towards MKS increases as does the awareness of the value that we bring.

We continue to be encouraged by the increasing number of customers providing recurring business through finding and delivering continual value into our customer base.

The importance of a truly integrated ALM platform continues to grow in the assessment of industry analysts. In Forrester's recent report, the changing face of application lifecycle management, Carey Schwaber talks about the three pillars of ALM being; first traceability of relationships between artifacts;

Second automation of high-level process;

And third, providing visibility into the programs of development efforts.

She goes on to say that the majority of today's ALM solutions have grown through attrition rather than through purposeful design. As a result, the dominant structure of today's ALM solutions is tool-to-tool integration and this integration is never as deep or as resilient as advertised.

She further identifies MKS and Microsoft as the only two companies with a single vendor - single repository ALM platform.

This continues to be one of the most important decision criteria for our customers when choosing MKS, whether it be for the initial purchase or for follow-on sales.

This combined with our ever growing and delighted customer base and outstanding execution at the field level, to clearly understand the challenges facing our customers and how we can address these challenges head on is a winning combination.

We're looking forward to continuing our growth and the share of the ALM market by remaining steadfast on our mission to ensure our customers' success with the management of their application lifecycle and driving visibility into their IT asset base.

Back to you, Phil.

Philip Deck: Thanks, Michael.

Having just released our new product, I wanted to comment on some of the aspects of our research and development process.

The release of Integrity 2006 included a major upgrade to our software deployment capability, a feature that's known as MKS Deploy.

This capability ensures that software deployed onto production servers hosting the mission critical internal and external applications that keep our major customers in business has been properly authorized, tested, and reviewed.

It can prevent some of the most catastrophic IT failures and offers a significant contribution to IT compliance.

This is a successor to the former NKS Build and Deploy and represents the culmination of over a year of work with major customers to understand how to best meet their software deployment needs.

We're delighted with the response to this new capability and are working with customers to plan upgrades throughout our markets.

We have found that releasing a version 1 capability that leverages mainly on the powerful workflow and the process management capabilities of the MKS Integrity platform, followed up by intensive consultations with major customers to refine the domain specific features, ensures that we can best solve the critical business issues that our customers face.

And as we begin the new product release cycle following the release of MKS Integrity 2006, the largest investment we will make is in the upgrade of our MKS Requirements feature set.

When we first released our first version of MKS Requirement in May of 2005, we seriously underestimated the impact that it would have on our marketing strategy.

We thought then that its chief appeal would be among existing MKS Integrity users who wanted to extend their application lifecycle management processes into the Requirements domain.

And we were right about that. Many of our customers have rolled out requirements or in the planning stage of roll outs.

Where we underestimated our impact was in the demand for requirements management as a standalone product and that's where we're seeing some of our biggest opportunities today.

In the past year, we have won numerous Requirements management mandates from major companies who are new to MKS, but are seeking to deal with further problems that our Requirements management solution can uniquely solve.

And among them, some of the largest electronics companies in the world.

For MKS Integrity 2007, we're working with some of these major customers to create substantial new capability, including a document-centric Requirements view, the biggest single feature gap from the 2006 version.

In its first year, MKS Requirements generated almost 3 million in new sale, mainly through our largest customers. But much more importantly is exposed us to a whole new set of customers that we've only started to tap, that will ultimately result in even more sales of the non-Requirements aspects of MKS Integrity.

And finally, it continues to generate considerable new interest among the most senior ranks of our customers, an essential part of creating enterprise-wide deployment for the MKS Integrity platform as a whole.

As Michael has indicated, we're very excited about the year ahead of us based on a great response to our new products and based on the building pipelines of our new sales staff.

Consequently, we're comfortable with our guidance even though the expected pace of productivity improvement will likely produce profits that are more backend loaded than in years past.

We expect that the trend of revenue growth experienced over the last three fiscal years will continue throughout fiscal 2007, as ALM licensing opportunities develop through expansion of existing customer relationships and through targeting of Global 1000 companies worldwide.

We believe that the anticipated growth in ALM revenue will lead to annual fiscal 2007 revenue in the range of 57 million to 60 million, an income from operations before tax in the range of 4 million to 6 million, unchanged from the outlook given last quarter.

The material factors and assumptions applied by MKS in arriving at these ranges are the ability of the company to successfully expand our ALM sales and services staff and to generate higher revenue in the ALM segment, our ability to make increased marketing expenditures, increased ALM research and development expenditures, and to ensure that we maintain our technical leadership in the ALM market.

We will incur increased cost relating to the expensing of stock compensation charges and we expect that our interoperability business will decline on an annual basis, approximately 10% over the course of the next year.

Income tax expense will be recorded in our financial statements going forward as the prevailing tax rate in the jurisdiction where the income was generated, to the extent of a deferred tax asset that is being recorded in that jurisdiction.

That rate maybe higher than the average rate that we expect to pay in the future across all jurisdictions.

We expect our long-term tax rate to be approximately 35% and this will be subject to ongoing quarterly assessment of valuation allowance by jurisdiction which may give rise to further increases or decreases to the existing tax asset.

We appreciate the support and confidence of all our shareholders and look forward to seeing as many as possible at our shareholder meeting this fall.

We have divided the normal annual meeting into the official parts, the election of Directors and appointment of Auditors on September 26 in Waterloo and the management presentation to be held the following week on October 4 in Toronto.

I look forward to seeing as many shareholders as possible at either or both.

And I'll now be delighted to take any questions from analysts which can be directed to Michael, myself or Doug Sawatzky, our CFO, who's with us on the call.

Operator: 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, simply press the 1 followed by the 3.

If you're using a speakerphone, we ask that if possible please lift your handset before entering your request.

One moment please for the first question.

Our first question comes from the line of Susan Streeter at Sprott Securities.

Please proceed with your question.

Susan Streeter: Thanks. Good afternoon.

Philip Deck: Hi, Sue.

Susan Streeter: Hi.

I'm just wondering if you can go through briefly the hiring in the quarter again. If I understood correctly, you had 31 direct sales managers...

Philip Deck: Uh-huh.

Susan Streeter: ...and - but - and there were 14 new hires in the quarter?

Philip Deck: There were - the 14 new hires in the quarter we're referring to the whole field team.

So we - the net change in RSMs at the end of July from the previous quarter was from 26 to 31 for regional sales manager.

Susan Streeter: Twenty-six to thirty one.

And what is your goal in terms of absolute numbers at this point?

Philip Deck: You know, we're at - I think we're at 33 as of today.

And we want to spend a lot of time assimilating this group into the rest of the team, into the rest of the region. So I think going forward for the next couple of quarters anyway, before adding one or two per quarter, that would be probably about right.

Susan Streeter: Okay. So a bit of a pause in terms of the numbers then.

Michael Harris: You know, we've got - close to 40% of the RSMs have been here last (four or five) months. So we want to spend a lot of time getting those people up to speed first.

Susan Streeter: Okay.

Philip Deck: I think it's fair to say that it's not our intention to be hiring in surges.

Man: Right.

Philip Deck: The surge happened as a result of our lack of success in finding the right kind of people out here.

So because it turned out to be a surge, you know, I suppose maybe not a pause, but certainly a reduction in the pace of new sales people for the next quarter or two...

Man: Right.

Philip Deck: ...and then we'll assess our revenue growth rate at that point.

Clearly to the extent that we're doing better than we think, then we typically take some budget and apply it to new sales people.

Susan Streeter: Okay.

And the - you mentioned that your hope was to see that some of these new RSMs hit a quota of about 200,000 over the next couple of quarters?

Michael Harris: We - our expectations are that they hit that run rate within three to four quarters. So most of these people are past their first quarter, we don't expect much contribution but certainly more than in the first quarter, in the second quarter which is our Q2.

And then we'd start to see them get much more closer towards, but their full rate productivity should be in Q3, in Q4.

Philip Deck: For instance the - of the 20 seasoned reps -- and by season we mean that have been with us for more than 6 months -- virtually all of them hit their \$200,000 or better in their...

Michael Harris: Yeah.

Philip Deck: ...first quarter.

Michael Harris: Yeah.

Susan Streeter: Okay.

And for the more mature reps, does that average - does that quota expectation sort of scale up along with seniority?

Michael Harris: Oh, absolutely. And with territory and with accounts that they're assigned.

Susan Streeter: Okay.

So 200,000 sort of the minimum once they are assimilated.

Michael Harris: Yeah. I mean, it'll start in the order of a - up to \$1 million and then go up to more than \$2 million depending how seasoned they are.

Philip Deck: Annually.

Michael Harris: Annually.

Susan Streeter: Annually. Okay.

And - just moving on in terms of expenses, you mentioned in your MD&A that that was about 500K related to Asia, is that something that is going to be

linear over the next couple of quarters or do you see that tracking down once the initial start up costs are behind you?

Michael Harris: No. I mean, that's the full run rate now with the cost that we have in Asia, with the headcount that we've hired and we're holding that now steady at least for the next couple of quarters.

We have the team in place and you know, we expect to see them start contributing soon. Certainly not negative contribution as they did in this past quarter.

But that team of seven or eight headcount plus all the partners that we have and travel expenses, that's the rate you're going to see going forward for the next couple of quarters.

Susan Streeter: Okay, okay.

And then just lastly, you have - you mentioned a deal over 0.5 million, I'm just wondering if you - was that from an existing customer or was that a new customer win?

Philip Deck: No, it's a follow on for an existing customer. In fact - yeah, I think that's all I can say about that.

Michael Harris: Yes, it is.

Susan Streeter: And then would that be the largest - one of the largest contracts to date on the ALM side?

Philip Deck: Maybe sixth or seventh.

Michael Harris: Yes.

Philip Deck: We've - I can think of probably - yeah probably that are \$6 million deals.

Michael Harris: Yeah.

Susan Streeter: Okay, great.

I'll pass the line. Thank you.

Michael Harris: Thanks, Susan.

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

Please proceed with your questions.

Lawrence Rhee: Hi guys.

Just wondering in terms of your headcount hiring, where are you finding most of the sales staff, are they primarily from some of the recent M&A activity in the space?

Michael Harris: No. I think we talked last - on the last call Lawrence that, we've sort of gone through and hired all of the market reps that we were looking for from the competition.

And we're starting to expand beyond into other enterprise sales of portfolio management and even in ERP, mainly because of the fact that our product suite is expanding.

So in fact, the person that we hired who has a very much a project portfolio background is doing very, very well in the UK, as is somebody we hired recently from SAP.

So we're finding that a blend of having, you know, relatively generic enterprise software sales background as opposed to pure ALM and the ALM teams together is proving out to be very successful.

So I would see the new group, a lot of the big players are going to come out in this quarter and the next quarter, won't have necessarily an ALM background.

Lawrence Rhee: And are you finding that it's taking them longer to get up to speed because of their background or what's your – I know it's only been a few months I guess so far, but...

Michael Harris: No. I think – well - no, I don't it is taking them any longer to get out to speed. I mean, everyone still starts with, you know, a new territory and a new set of customers and you know, we spend a lot of time, you know, they have their account executives or their application engineers with them, helping them through this.

So, you know, these are, you know, no one problem is the same and in fact, you know as we're moving - as we've moved away from sort of core SCM to more broad range in ALM, we're solving bigger business issues, none of which are the same.

So no, I don't think they're any slower at all. They're just not able to be as conversant in more of the detail potentially in some of the accounts, but I don't think it's (cause to say) anything at all.

Philip Deck: I - Lawrence, I think it's fair to say that the nature of our sales and deployment is changing as our platform changes. So as we've added deployment capability and requirements capability and now portfolio management, there's a lot more software to integrate, there's a lot more support of customer deployments needed.

And one of the reasons we like people from places like the ERP sector is they're more familiar with larger scale deployments of somewhat more complex problems that typically may require more services and more consulting who actually manage deployments and you know, take more care of the customers after the fact.

You know, years ago when it was simply versioning in workflow and defect tracking and feature planning, that's pretty straightforward for most of our customers to implement.

Once we enter Requirements management and portfolio management, then there's a more heavy consulting component and we have to have sales people who can manage a lot more different services activities through the deployment.

Lawrence Rhee: Just on now, would you - are you expecting the services line item to services revenue item to become a bigger proportion of your overall business in the near term?

Philip Deck: Yeah, I think we do. I don't think we have a specific target for it, but I note that we sold more than \$2 million worth of services last quarter, even though our - the service delivery was around a 1.5 million.

So we are building backlog in services and I wouldn't be surprised if that continued.

Lawrence Rhee: Got you.

And just – if you give us some color on the competitive landscape, how things have changed, if any specifically, if you've seen less of Serena I think was the trend last quarter and Borland as well would be great.

Philip Deck: I don't think I can - I was actually asking Michael out this afternoon to try and figure out whether they should make any comments on it. We couldn't think of any particular changes that we've really encountered.

I don't know Michael, if you have any comments.

Michael Harris: No, I mean, you know, the only changes in competition was Mercury's acquisition, but we never - we didn't really face them very often and we're always successful when we did.

So it tends to be the same players that's, you know, normally it's us Rational and Serena, and normally us and Rational in the final two.

Lawrence Rhee: Got you.

Okay, thanks guys.

Michael Harris: Thanks Lawrence.

Operator: Our next question comes from Duncan Stewart at Orion Securities.

Please proceed with your question.

Duncan Stewart: Good afternoon guys.

Philip Deck: Hi, Duncan.

Duncan Stewart: One thing that's sort of - I don't know, I think I'm going out on a little bit of a limb with this one, but it sort of makes sense to me, maintenance of course is a trailing indicator of license - previous license revenue.

Does series revenue in any way act as a predictive indicator of license? Like do you guys sometimes end up doing sort of, you know, having - I just kind of look as I go back over, I guess it's eight, nine quarters, sort of the quarter or two before you have a very strong license revenue quarter, it looks like there's been a blip in service, does that make any kind of sense?

Philip Deck: I think there's a general increase in services. I don't think you could correlate the two enough, because there's a lot of big services jobs that would tend to frustrate that, and the timing of that are a little bit unpredictable as well.

So, no, I don't think that's a terribly effective measure.

Michael Harris: Although I would say that the more services are driving, will definitely drive more licenses. This wouldn't necessarily be in the following quarter.

Philip Deck: Right.

Duncan Stewart: But certainly, broadly, I mean one of the things as I - I mean, as I look at it, you know, you did quite a bit better on service than I was looking for at least and I guess I'm sort of saying, you know, is that irrelevant to me or is that actually maybe a good thing? And I guess the answer is maybe a good thing.

Philip Deck: It's a highly desirable thing and a necessary thing, an important thing, because, you know, the kind of projects that tend to be services heavy are exactly the kind of complex, large scale, you know, really significant value add projects that we love to be part of.

And so, you know, our services revenue is significantly skewed to the biggest customers in our portfolio and it represents major implementation projects. So - and projects where customers are implementing much broader set of the features that the platform offers.

So whenever there's a large services component going on with the sale is a good thing.

Furthermore, there are lots of customers that decide that they don't really need many of our services and they'd like to rely on their own people. And typically those deployments run into some problems.

And later on, we then have to, you know, go in and make sure that processes are implemented the way that optimizes, the way the platform works. So obviously, we know a lot more about our software than our customers do and we can implement it better.

Duncan Stewart: Right.

Philip Deck: And so, we're really much happier if we can, you know, do a big services project along with the implementation.

Duncan Stewart: Right. That makes sense.

In terms of the cost side, the sales and marketing and R&D levels, they are sort of - we certainly would have expected to see them climb to more or less these levels, but we should not expect them to climb as a percentage of sales going through Q2, Q3, Q4, correct?

Philip Deck: That's exactly correct.

Duncan Stewart: Okay. Just clarifying.

IO obviously at -- what was it? -- one, three or whatever on the license side, that's the highest it's been in quite some time I believe. Any comment on that?

Michael Harris: Q4 is a lot better actually.

((Crosstalk))

Duncan Stewart: Oh, sorry. Not accounting the Q4.

Michael Harris: ...1.7 if my memory serves me.

Duncan Stewart: No, no, you are right. But Q4 is sort of always been a big one for that number. But I mean sort of - in the sort of Q1 through 3, this seems like a high number, any comment on sort of - is that just lumpiness or should draw any implication from that?

Michael Harris: Probably in (QN) - Q1, it was modestly above the trend and the trend being a declining trend.

But, you know, there is some volatility and there's some lumpiness in it, so, you know, sometimes it's good, and sometimes it's not.

Duncan Stewart: Right. Okay.

Final question and this is sort of a big picture one. Not too long ago, I guess would be about five, six quarters ago, your trailing 12 months ALM license growth was sort of I think 67%, we've kind of seen it drop sequentially.

Any comments on that? You know, was MKS sort of in a particular sweet spot that allowed much higher than average growth? Is the market maturing? Landscape getting more competitive?

If I remember that 60% number, you guys were posting that during when IBM and Rational were merging and you know, causing a lot of turmoil. Any kind of color on what does appear to be a deteriorating trailing 12-month ALM license growth trend?

Douglas Sawatzky: I think that the trend you're looking at is, you know, our business plan was to add sales people throughout last year. And for all the reasons we've talked about the last couple of quarters that didn't happen.

And so we really plateaued out our sales force through last year and the only growth we could get was through productivity growth.

Duncan Stewart: Right.

Philip Deck: So, you know, we caught up and hired a lot of sales people and the results of that have not come through yet.

We're still skating on the productivity growth of our more mature people. So our (unintelligible) are to add sales people in a very, very steady way. You know, it'd be great if we could just add three sales people every quarter and then we could maintain a lot more consistency in our license growth.

But I think the metric you're probably driving for is that there is a significant lagging -- sorry - leading indicator in our RSM growth. There's a big lag to the productivity and if we don't hire sales people for sometime, while the growth may not slow immediately, eventually it will start to slow and it won't speed up until the new sales people we hire get on track.

And that's...

Duncan Stewart: (Would take) that three to four quarters.

Philip Deck: ...why the integration of new sales people is so important this year to get those growth rates back to where they were a year, two ago.

Duncan Stewart: Right. So it's nothing to do with slowing marketplace or competition or anything else. It's just your ability feet on the street sort of thing.

Philip Deck: Exactly.

Duncan Stewart: I'm going to push on just as a little because I want to drilldown at (touch ville) and I guess, you know, certainly, you know, Mike can take us (unintelligible) this as well.

You guys talk about Requirements management being sort of, you know, it was great in the existing customer base, but it was an unexpected hit outside of that and that added -- I think you said -- an additional almost \$2 million to \$3 million of license revenues.

Philip Deck: I was all our (unintelligible) license revenues. So that included our existing customers.

Duncan Stewart: Oh, okay. But some portion.

I guess what I'm getting at, is you guys, you know, you have let's say arbitrarily five products within MKS and Integrity or ALM 2 years ago and there's now seven or eight products.

Is it that if, you know, giving 20 sales reps more products even unexpected hits like RM, doesn't actually give you as much leverage as you would think.

One sales guy can only sell so many dollars worth, and even if they got more products on a shelf, even if it's an unexpectedly good product, that only sort of subtracts the weight from something else.

Philip Deck: That is true to some extent. And the win you get though, is that when you have a more comprehensive platform, you position yourself for much larger large-scale deployment.

Duncan Stewart: Right.

Philip Deck: You get a much more business critical use of your product within large customers. So the key to the revenue growth formula for MKS and the

profitability formula is to be able to tap into very large customers and get a lot of, you know, regular license revenue wins as you get large-scale deployments.

And then long-term to have, you know, significant dependency and - on the product by customers and you only get that when you're - you have very broad functionality.

So it is true that if you - if a sales person is following up a Requirements only mandate for a quarter million dollars, that means that he can't follow up on a versioning Requirement or versioning mandate for a quarter million dollars.

The question is, which sale is going to tap you into a large company that can then give you ongoing follow-on business?

And what we very much believe is that when you create a comprehensive platform that includes very broad functionality, then you have a much more compelling business case to get into the very large companies.

There's no - there's not a very good business model to selling small deals that is, you know, \$100,000 or \$200,000 to medium-size companies and then having to continue to repeat that sales process.

And that's what happens if you simply try and expand the sales force for an existing product that has fairly narrow functionality or narrow reach.

What we want to do is become a mission critical platform for the largest companies in the world and to do that, you have to have a broader platform.

So yeah, there will be some cannibalization of your sales efforts when you introduce new products, but it puts you into a whole different category of vendor.

Duncan Stewart: Ask a long question, get a long answer. Thanks, Phil.

Nobody ever asked Doug anything, so I'll give it a shot. Doug, what exactly was the - in the cash flow statement, you actually spent cash on a purchase of intangibles?

Douglas Sawatzky: Yes.

One of the things that we're continually doing is looking to develop our product, and one of the areas where we're focusing is in the Japan market.

And one of the things that we needed to do in order to facilitate our (unintelligible) development team was investing some intangible assets in the - in Japanese (space).

I gave them the ability to produce a product compatible with the Japanese market.

Duncan Stewart: And that's an intangible?

Philip Deck: And all our error messages translate into Japanese.

Duncan Stewart: (You know) a blue screen in appropriate colors.

Okay, I wouldn't have thought that would count as an intangible, but okay that - but it's part of the Asian build-out.

Philip Deck: Yes.

Duncan Stewart: Okay, thanks.

Operator: Our next question comes from the line of David Shore at Desjardin Securities. Please proceed with your question.

David Shore: Thanks. Most of my questions actually answered.

But Phil, just if you could talk a little bit about the MKS 1000 kind of in qualitative terms and how you're progressing there and I don't know if you mentioned how many kind of house accounts you're up to at this point?

Philip Deck: We think we're around 62 and we typically add 2 or 3 a quarter. You know, once in a while we'll decide one really is an MKS 1000 account or we decide we've stalled in there, so there's sometimes some deletions from the list, so not very often.

And I guess qualitatively we're - we continue to refine our customer account management process so that we can get a lot more further deployments into these accounts.

And every time we deploy new functionality, we get an opportunity to become a much more important platform and a more important vendor in those customers.

And so, you know, we're very happy with the strategy. It hasn't change in a couple of years. We're delighted with a lot of the plans that are in place and house accounts to rollout our new features and you know, it's still the key to

our long term growth is to successfully manage those accounts so that they buy a lot of software.

David Shore: Okay. And then just...

Philip Deck: That answer your question or...

David Shore: Yeah.

And then just on the financials, CAPEX came in a little higher than I was thinking for this quarter, is that related to the Asian build-out, and would you expect to kind of trend down from here?

Philip Deck: The right metric is probably new hiring times the cost of a laptop.

David Shore: Okay.

So being as you're not going to be adding a whole lot to the headcount, it would certainly come down.

Philip Deck: Yeah. (It'll flatten out a bit).

David Shore: Yeah. Okay. Thanks a lot.

Philip Deck: Sure.

Operator: Ladies and gentlemen as a reminder to register a question, you may press 1-4.

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

Please proceed with your question.

Tom Liston: Thank you and good afternoon.

Certainly a lot of questions but just a few short ones. Just on - with MKS Integrity 2006, I assume there's a price increase. Can you talk about if there is one in fact and what that does your maintenance space, if they will - had to come along at the higher levels of price increases?

Douglas Sawatzky: Yes.

I mean the price increases that we had for this release weren't as substantial as in the past. I think it's across the board. Different features (have) different amounts, but I think it's in the order of 8% blended if you can blend all the products.

And so all the maintenance will be increasing by that amount too as well and there hasn't been any pushback on that in the least.

Tom Liston: And sort of a follow-on from another question, but in a different way, with the new release and it has a lot new features with Deploy and certainly deepening the Requirements management feature set.

Does that ever extend many sales cycles given that perhaps someone's looking mainly at Requirements management, then maybe backs off and says, hey let's look at the whole feature set of Integrity 2006? Does that change the sales cycle in anyway?

Philip Deck: I haven't seen that happen. I think some customers -- believe it or not -- delayed purchases because they wanted to see what was in the release and tested out.

And even though they get it as a free upgrade if they buy the product, they still wanted to delay in, you know, in case it wasn't what they were expecting and decided they didn't like it and I don't think anyone decided they didn't like it.

So sometimes they can extend it that way.

You know, there's a regular issue with customers where they say all this stuff is so great. I love the portfolio management idea. I'd really like to do Requirements, deployment, that sounds great. But what do I do first and how do I schedule this implementation and there's a lot of stuff to kind of do.

And so we have to help them try and figure out which things should be implemented first and what makes sense for a rollout through their organization.

So I suppose depending on what they decide is most important that may extend or shorten implementations. But I haven't heard of any of the delays that you've described.

Man: No, it's pretty well-known upfront what problem we're in there to solve. So it's not as if sort of 6 months through the cycle, they find out that we've got Requirements as well. If they do, we're doing a fairly poor job.

So right at the bat we know what we're there for, and we go for it and it's the salesmanship to manage it if Requirements isn't one of the things they're looking for, but it does come up as a requirement (one).

Throughout the sales cycle then, it's up to us to decide whether or not we want to trying to push that of and win the business on its own and we go for the requirements later, or if we think it's a competitive advantage that the rest that we have to delay.

Tom Liston: Sure.

And remind me on the eight reps that you hired in Q4, I thought the majority were from competitors. Is that correct or no?

Douglas Sawatzky: Probably...

Man: Five...

Douglas Sawatzky: ...half - more from competitors, but not...

Philip Deck: I think might have been five competitors, three not.

Tom Liston: And were they potentially - I mean, you don't want to model this in, but they potentially coming to (see faster) since we hope they have a fair bit of relationship, they probably know your product a little bit, given that they're probably were (unintelligible) situations with it.

Do they come up the curve any faster given that they do have some of the relationships in place?

Philip Deck: Well, we can't use the customer information that they have from other competitors because they're not allowed to use it, but they do have familiarity with the product space and they have familiarity with the kind of problems that ALM is trying to solve, so that's quite helpful.

I think the limitation that we find is that for many of them, they're really not selling in an enterprise way. I mean, there's the bulk of sales by our competitors are not really enterprise sales. They're, you know, kind of point product sales and they're not very extensive and they're not broad-based and they're, you know, they're just product sales.

So - well, certainly there is – there are sales people in those companies that understand how to do a much more involved and higher level sale and those are the ones that we try and hire.

The more - majority don't, and that's why we have to start looking outside of our competitors for people who understand how to do, you know, larger scale integrated deployments.

Tom Liston: A bit of a difficult question to answer, but I'll try it anyway. Sixty-two house accounts, you're never going to get fully penetrated with any account, I would imagine, but is there a natural sort of limit there and what would you guess, is it still in the kind of single digit type of penetration and do you see kind of a natural limit of where you probably get to in anyone organization?

Is there a way to measure that as we sit here currently?

Philip Deck: I think that it is true that the average penetration we have is likely still in the single digits or at least low, you know, very low teens. But, you know, we

typically find that whenever we think where we sold most of the software into an account, there's at least twice as much to sell.

And that's not just through upgrading the product. You know, as the intensity of use of the products goes up, there's typically more capacity needed and people find more (user) support.

So certainly the number of - the amount of feature availability is going up much faster than we're selling it, so I feel like there's a backlog in that sense.

Tom Liston: And maybe another way, if you look in your - in terms of your growth plan for the next 18-24 months, how much could you get just from (maybe the existing) base versus having to go out and add to that core account base?

Can you meet your expectation?

Philip Deck: I guess we think that the healthy balance is about 50-50, that if we could get half our business from our existing accounts and half from the penetration of new accounts, that's the right base.

If it's higher than half on new accounts and it means we're not developing our existing ones very well. And if it's only - if it's really coming to much from our existing account, then it means we're not delineating new opportunities well enough.

So I think we want to stay in that kind of balance, and we're quite often pretty close to the 50-50 mark and not too much - not far from it either way.

But I don't think the limitation is the amount that can be deployed in the customer. The limitation is for sure that the rate at which we can organize

deployments. And there's a certain, you know, internal cost to our customers to deploying things.

It takes effort. They have to schedule it. They have to plan it. They have to test it. They have to involve people. They have to train people.

So, you know, that is by far the much bigger limitation to our sales. You know, the ultimate amount of software that could be sold in those accounts is way, way past what we can actually manage.

Tom Liston: And one final question and it will be - ask you to speculate a bit, but Mercury while not a direct competitor, probably was in my mind, your biggest threat and potentially seeing the traction of what you're doing in terms of entering that sector and going sort of backwards into the ALM cycle, do you think that changes with the acquisition of HP or at least certainly probably (delay thing)?

Philip Deck: Well, there will undoubtedly be some disruption I guess through that acquisition.

I guess my assessment is that, you know, that Mercury will change the least by ownership by HP than almost any other company they could've afforded to buy them.

So, you know, HP doesn't have a very big software business outside of Mercury now. Mercury I think represents probably almost half of the - their software business now that it's part of it.

So HP doesn't have as much to add to Mercury. It doesn't have as much synergy. It doesn't have as much kind of strategic relationships or customer relationships.

So, you know, I could think of half a dozen other possible acquires for that business where, you know, we would sit back and say, you know, look at the changes that are going to happen now.

I'm not sure that's the case of HP. I think they'll pretty much run us the way it was being run.

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

Operator: Our next question comes from the line of Scott Penner at TD Newcrest.

Please proceed with your question.

Scott Penner: Phil, just one thing and that is, if you could comment on the role of industry analysts such as Gartner as, you know, as advisers at your customers, you know, as this industry has become a little bit more complex and more strategic, do you see people like Gartner more as a – as sort of lead-ins for your sales force and you know, if there's anybody else other than Gartner that you really work closely with?

Philip Deck: No. Well we see the role of industry analyst as extremely important and extremely influential. Maybe, you know, it was when we started the strategy and maybe it's even grown since then.

We've always had a very strong relationship with Gartner, although, it's only now really starting to blossom to kind of multiple areas within Gartner. So, you know, even within any one firm, you may have four or five different analysts that, you know, that deal with your space.

For instance, at Gartner there's a different person who deals with Requirements management and deals with kind of traditional SCM.

So we have to have more than one relationship. And that relationship with Gartner is expanding very nicely as we add different feature sets and expand into different areas.

But there's lots of other important analysts as well. Forrester is very important for us and IDC is important to us, and there's a number of other somewhat more regional analyst firms that are very important to us.

So no, it's a critical part of our business and you know, and an expensive part. We invest a fair bit in these relationships, and when we go and present at conferences and do Webinars and go on tours, you know, analyst time is not cheap, but it's very important to us, and I think we have a really good, consistent, referral rate and certainly with Gartner has been good for a while and the other analysts I think it's increasing in quality pretty steadily.

Scott Penner: And just - thanks for that.

Just to - a couple of other things, the - you sort of talked about the long term tax rate and the fact that, you know, it may or may not be around that in the next few quarters, you know, should we be using that 35% or 36% to, you know, to the extent that it's material? Is that a good number?

Philip Deck: The 35% is the number we record with all due respect to our CFO, I think you should ignore as complete fiction.

The rate that we show as a tax rate only applies to the jurisdictions that we've created tax assets for. And so it is a non-cash number and you know, the

percentage of our - the tax we show relative to our pretax is, you know, it's only coincidentally going to be close to, you know, a tax rate that you might find normalized.

So it's 35% rate that we think is the appropriate long term tax rate to use.

Scott Penner: Okay. No, that's fine. And just to - Phil, have you ever talked about the IO margin assumptions that are embedded within your guidance?

Philip Deck: I don't believe I have.

We don't see any big changes to the kind of margins we're having. So, you know, we've given guidance of 10% long term decline, and I would say that the cost will decline at least that rate as well.

You know, and some of the cost decline in IO has come not because we wanted to reduce costs at IO, but some of the people at IO were so fantastic, we want them working on the ALM business.

So we've been (pilfering) people at IO and that's reduced their cost and amazingly hasn't seemed to affect their ability to generate pretty good results.

Scott Penner: Right. Okay. Thank you.

Operator: There are no further questions at this time.

I'll turn the conference back over to you, Mr. Deck.

Philip Deck: Thank you very much. Let me just thank everyone for listening on the call, and we look forward to seeing people at our meetings this fall.

Thanks.

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

Thank you and have a good day.

END