

# FINAL TRANSCRIPT

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## **WEBX - Q4 2006 WebEx Communications, Inc. Earnings Conference Call**

**Event Date/Time: Jan. 31. 2007 / 5:00PM ET**

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the fourth quarter 2006 WebEx earnings conference call. [OPERATOR INSTRUCTIONS] As a reminder this conference is being recorded for replay purposes. I would now like to turn the call over to Mr. David Farrington, Vice President and General Counsel. Please proceed, sir.

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### David Farrington - *WebEx Communications, Inc. - VP, Corp. Devel., General Counsel*

Thank you. Welcome to WebEx Communications Inc. Q4 and year end 2006 earnings call. This presentation contains forward-looking statements based on WebEx's current expectations, assumptions estimates and projections about WebEx including statements regarding our future plans, strategies, business and financial results, and other metrics relating to our business. These statements may be identified by the use of words such as expect, anticipate, intend, believe, and plan.

WebEx's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause our actual results to differ materially from those contained in the forward-looking statements can be found in WebEx's filings with the Securities and Exchange Commission. References to projections or estimates from third-party analysts do not constitute or imply any endorsement or adoption of such projections or estimates.

The presentation today and our earnings release provide financial measures for net income and earnings per share both in accordance with generally accepted accounting principles, or GAAP, and in accordance with measurements which are different than GAAP. These differ from GAAP in that they exclude expenses and the impact on our tax rate associated with the new accounting rules on equity compensation. And also exclude certain expenses from the acquisition of Intranets.com. We use these measures to help us evaluate our operational financial performance and believe that providing these non-GAAP measurements is helpful to management and to investors in comparing our quarterly results in a manner which is not influenced by nonoperational expenses and changes in accounting rules relating to equity compensation. The presentation of this additional information is not meant to be considered in isolation or as a substitute for net income or earnings per share calculated in accordance with GAAP.

An audio file of this call, together with the slides being presented today and today's press release announcing our financial results and including a reconciliation of GAAP and non-GAAP financial measures will be made available on the Investor Relations section of our website at WebEx.com. Presenting and answering questions on the call today will be Subrah Iyar, WebEx's Co-Founder, Chairman, and CEO; Michael Everett, our CFO; and Gary Griffiths, Vice President of Products. I'd now like to turn the call over to Subrah.

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### Subrah Iyar - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Thank you, David, and hello, everyone. I'm very pleased to report that Q4 2006 was an excellent and record-breaking quarter for WebEx. It was our first ever \$100 million quarter. For the full 2006 year, revenue was 380 million, which is a 23% increase over the prior year. In Q4, WebEx witnessed strength across the board in our core web collaboration business. We saw accelerating revenue growth from Q3 to Q4 driven by strong bookings and good customer retention. We also continued to see increased diversification in our revenue stream. And excellent growth in our international business. The health of our core web collaboration business was underscored by record cash flow that reached 100 million for the year. Mike Everett, our CFO, will elaborate more on these and other key metrics in his report.

In Q4, we had a record growth in new registered web collaboration users. WebEx now has 2.2 million registered users. This is the largest subscriber base in the on-demand world for on-demand applications. This large and growing user base is a significant strategic asset for our growth strategy. As we outlined in Q3, our growth strategy is to go deep into accounts with our core web collaboration services and go wide with WebEx Connect third-party services.

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I'm very pleased to report that in Q4 our execution on the WebEx Connect initiative continued to gain momentum. I will elaborate more on this later in this presentation. Now to discuss Q4 in more detail I have with me Mike Everett, our CFO, and Gary Griffiths, our Vice President of Product. Also Mike and Gary, I will close this report with some comments on our outlook for the future, then we will all take your questions. With that, I turn it over to Mike.

**Mike Everett** - *WebEx Communications, Inc. - CFO*

Thank you, Subrah. As Subrah said, WebEx finished a banner year in 2006 with our first ever \$100 million quarter. Bookings were excellent and other metrics were strong across the board, led by record cash flow. Fourth quarter revenue increased to 101.9 million, 22% higher than the 83.7 million in the same quarter a year ago. This was in the upper end of our guidance range of 99 million to 102.5 million. Importantly, year-over-year growth in core web collaboration applications -- that is, excluding Intranets -- accelerated from 19% in the third quarter to 21% in the fourth quarter.

We also closed the first few connect sales as extensions to web collaboration deals in our mid-market customer base. Subrah and Gary will say more about this later, and we will begin to report metrics on connect with the Q1 conference call.

For the full 2006 year, revenue was 380 million, a 23% increase over the prior year. We continue to diversify geographically. International revenue now represents 15% of the total, 2 points higher than the fourth quarter last year. This growth has been led by Europe which grew 54% in the fourth quarter compared to a year earlier. We expect international revenue to continue to increase as a percentage of the whole in 2007. We also continued to diversify our service offerings during the quarter. Stand-alone meeting center now represents only 30% of revenue, down 5 points from a year ago, and down 16 points from two years ago. Gary will say more about our relentless innovation in web collaboration applications in a moment.

Subscription revenue was 74% of the total in the fourth quarter, the same as a year ago. Approximately two-thirds of all direct subscription customers now enjoy the adoption-friendly named host pricing model. Indirect channels represented 17% of revenue in Q4, a percentage that has been steadily increasing throughout the year. Key channel partners, such as Verizon, AT&T, British Telecom, Premier, and Intercall are contributing substantially to this growth.

Earnings. Fourth quarter pro forma EPS of \$0.42, were 40% higher than the \$0.30 we earned a year ago, and \$0.03 above the top end of our guidance range. Fully diluted GAAP EPS of \$0.33 were \$0.04 above the top end of our guidance range. The difference of \$0.09 between GAAP and pro forma is comprised of \$0.06 of expense under the new option accounting rules, \$0.02 from an increase in the tax rate due to those rules, and \$0.01 from noncash Intranets amortization.

For the full 2006 year, EPS were \$1.43 on a pro forma basis, and \$0.97 on a fully diluted GAAP basis. Full-year 2006 pro forma EPS were 25% higher than last year. On this pro forma basis, gross margin increased to 84.4% in Q4, over a point higher than the prior quarter. Our strong gross margin is based on excellent realized pricing and a highly reliable scalable infrastructure about which Gary will say more. We expect the gross margin in 2007 to remain in the same range as the last couple of quarters.

Pro forma operating margin was 30.5% this quarter, also over a point higher than last quarter. While our fundamentals were very strong in Q4, we did benefit from a \$400,000 bad debt reserve reversal, which will not happen again in the first quarter. We are confident that we can comfortably maintain operating margins in the very high 20s during 2007 while funding our ambitious sales hiring ramp the development needed to extend our lead in web collaboration and the rollout of the connect platform.

Taxes. The pro forma tax rate, excluding the impact of the new option accounting rules, declined to 36.1% for the fourth quarter. Over 6 points lower than the third quarter. This quarter's rate included a one-time benefit for Congress' retroactive reinstatement of the federal R&D tax credit. While the Q3 rate had a one-time hit for state income tax true-ups. If the annual tax rate of 38.8% had been applied consistently each quarter throughout the year, pro forma EPS would have been \$0.02 higher in Q3, or \$0.37, and \$0.02 lower in Q4, or \$0.40. For 2007, we expect the pro forma rate to decline to 38%.

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Our GAAP tax rate for the fourth quarter was 39.9%, almost 4 points higher than the pro forma rate, due solely to the impact of the new option accounting rules on financial reporting. For the full 2006 year, the GAAP rate was 44.9%. As predicted, the impact of the new option accounting rules on the reported tax rate has begun to decline, and the GAAP rate will now gradually normalize towards the pro forma rate over the next couple of years. Fully diluted shares increased by 780,000, to 51.2 million during the quarter. This was due to three factors. The effect of a higher stock price on the treasury stock calculation, employee option exercises, and purchases under our employee stock purchase plan.

Cash flow. Cash flow from operations was a record 34 million, due to increased profitability and substantially improved DSOs. Capital expenditures were only 1.7 million in the quarter, resulting in exceptional free cash flow of 32.3 million. We expect CapEx of approximately 20 million for the full 2007 year. We have 345 million of cash and no debt on our balance sheet. In addition to powerful free cash flow, we received about 10 million from employee stock plans and did not repurchase any shares in the quarter. However, our Board has authorized management to spend up to 40 million to repurchase shares this year.

Net receivables were down from 58.5 million in the third quarter, to 53.8 million in Q4, despite strong revenue growth. DSOs improved by six days to 48 days. Investments made over the last year in finance and IT are showing results in substantially improved collections. We expect further steady gradual improvement in DSOs during 2007. Receivables remain conservatively stated with a total of 7.5 million, or 12.1% of gross receivables reserved. Details for the sales and bad debt reserves are laid out in the roll forward slide being shown now.

Metrics. Net subscription customers, or companies, increased in the quarter by approximately 1200, to 28,000. This metric, while useful, is incomplete. It does not include the now individual professional subscribers or most of our channel accounts which generally have usage-based pricing. Registered users, or individuals grew by 139,000 to 2.2 million in the quarter. This metric does include all paying users or hosts of all WebEx services on all of our direct and indirect pricing models.

As we extend our web collaboration business more widely with connect partner offerings, an increasingly important way to measure progress is to track total registered users at an average price per user. Today we have roughly 2.2 million users at an average of about \$15.50 each per month. Subscription churn was steady at 1.6% per month on a dollar or MRR loss basis, or as presented in the graph being shown, retention was 98.4%.

Based on feedback from shareholders we have returned to our former dollar method of reporting churn. Nine quarters of history are included for your reference. We expect continued strong customer retention throughout 2007. Headcount increased by 80 people to almost 2200 at quarter end. Many of the new hires were in India and China, and over 55% of our employees are now outside the U.S.

We exited December at an MRR, or monthly revenue rate, of 35.2 million. Comprised of 26 million in subscriptions and 9.2 million in average monthly usage revenue. Subscription MRR increased by 1.2 million due to excellent bookings and solid customer retention. Usage MRR grew by 0.6 million based on strong channel sales. While MRR is an important forecasting tool for us, it does exclude some revenue elements, such as customer credits, set-up fees, managed events, and professional services is.

Guidance. We are introducing Q1 revenue guidance at 105 to \$108 million, and we expect Q1 EPS of \$0.39 to \$0.41 pro forma and \$0.29 to \$0.31 on a fully diluted GAAP basis. Q4 was a fundamentally strong quarter, but EPS also benefited from some one-time items, such as the retroactive tax credit and a reserve reversal. Based on the very strong quarter just completed, we are increasing full year 2007 revenue guidance from the preliminary range of 445 to 465 million to a new range of 450 to 465 million. We see continued strong growth in our web collaboration business with a gradually accelerating contribution from connect partner extensions to WebEx offerings.

We are also increasing full year 2007 EPS guidance. On a pro forma basis, from the preliminary range of \$1.55 to \$1.65, to a new range of \$1.60 to \$1.70. And on a GAAP basis, from the preliminary range of \$1.19 to \$1.29, to a new range of \$1.24 to \$1.34. Pro forma and GAAP EPS guidance are reconciled on the slide being shown now. Gary.

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**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

Thanks, Mike. As Subrah mentioned, this has been a defining year for WebEx. I will address three years that have helped us sharpen this definition. First, we continue to innovate in our core web collaboration services, those products that drive our revenue and revenue growth today. Second, we're very proud of our execution. We've again reached new heights in reliability while delivering our services in unprecedented scales. And in another quarter of record usage, we have again lowered costs and increased margins. Operationally, we have made the competitive barriers even more formidable, and the foresight of our investment in MediaTone is increasingly evident. And third, the launch of WebEx Connect broadens our reach, allowing exciting innovations from third parties to easily connect to our web collaboration services. To sum up this year of definition we have gone deep in our core web collaboration services while going wide with WebEx Connect.

First let's talk about innovation about going deep. During this quarter, all of our web collaboration services have become richer, more powerful, easier to use. We added multipoint video to our web collaborative training services, allowing simultaneous video streams from multiple session participants. Our sales center web collaboration services benefited from new integrated applications, like WebEx AIM Pro business edition as well as exciting new WebEx Connect capabilities that I will discuss shortly.

Meanwhile, web collaborative services for IT support are now over 50% faster than previous versions. And customers like Ovex Global, an IT services provider, have found that the connection of WebEx systems management to our core services adds on-demand capabilities unavailable in competitive offerings.

In another industry first, we have introduced public key infrastructure, or PKI, as a high security option. PKI is a critical requirement for enterprise customers who want airtight identification of participants. All of our web collaboration services have had significant improvements in Voice over IP capabilities. In partnership with FaceTime, we have launched WebEx Advanced Auditor on AIM Pro Business Edition, providing enterprise class security, hygiene, and message archiving for instant messaging. Consider Ingram Micro which was evaluating enterprise instant messaging services. We closed the 10,000 seat deal for WebEx with the addition of Advanced Auditor. And we have recently launched WebEx mail, giving small and mid-size businesses a trusted and reliable partner in the fragmented web e-mail market. All of the above illustrate what I mean by going deeper in our core web collaboration services. So let's shift to execution in our operations.

In describing the scale of our operations on our last call I explained how WebEx sessions in a single quarter if run end-to-end would stretch over four centuries. I'm pleased to report that in Q4 we have upped the ante to nearly five centuries of integrated data, telephony, and video delivered real time. That is, every second of every business day a new WebEx session begins. In the short time since we started this call today, about 1500 new real-time multimedia WebEx sessions have started around the world, and some 6,000 new participants have joined these sessions. Part of the 15 million users who depend on WebEx every quarter.

Increasingly, these customers rely on WebEx to provide web collaboration services that are truly mission-critical. Customers like CNBC. I briefly mentioned our multipoint video technology. CNBC in partnership with WebEx has recently introduced face to face on their popular "Fast Money" show. In a television first, by using WebEx multipoint video, Fast Money viewers can now be part of the live show in both audio and video needing access to only a simple PC and web cam.

But delivering exciting live real-time capability like CNBC "Face to Face" does not come easily. More and more technology companies, anxious to jump on the software as a service bandwagon, are finding that running a business that must always be on, every second of every day, is a bit more complicated than simply moving a server from a customer's site to a centralized data center. On-demand means as much creativity and innovation in the infrastructure, the processes, and the discipline as it does in the application itself. And nowhere is this more true than in the real-time services delivered by WebEx every day.

WebEx continually refines and redefines this culture of service and reliability. For every day our MediaTone Network is setting new records for scalability and reliability and reaching new heights of productivity. Despite breaking the \$100 million revenue barrier, despite record usage, and the continued expansion of our network, we have decreased our cost of delivery, adding

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another point to our gross margin for the second consecutive quarter. In short, with each passing quarter, the operational and technological leverage of the MediaTone becomes increasingly evident.

I have talked about going deep. Let me explain how WebEx Connect takes us wide. To do this, let me take a moment to first help you understand the relationship between WebEx Connect and the core web collaboration services I have been discussing. As you have heard me say before, the real benefit of Connect is in extending our core web collaboration services. That is, you should not think of Connect as a product. Our customers will not buy WebEx Connect, but they will be buying richer, more powerful WebEx web collaboration services, services enhanced by the capability and flexibility of WebEx Connect but powered by the imagination of our WebEx Connect partners. These enhancements provide additional value to our customers while increasing our revenue on a per-product and per-customer basis.

Let me illustrate this with a couple of examples. First, Bridgeport Ventures, a Florida-based preconstruction syndication. They needed both real time collaboration and sales force automation. They liked the way Sugar CRM, one of our early WebEx Connect partners merged seamlessly with the realtime collaboration capabilities of our sales center. Bridgeport found the merger of Sugar CRM and WebEx web collaboration services as a natural combination and a more efficient way to close their sales prospects. And then there was One Communications, a longtime WebEx customer, who was ready to expand to a comprehensive learning management system, or LMS. Enter WebEx Connect partner GeoLearning. When connected to the WebEx collaborative training services One Communications now enjoys new LMS features, including a library of training resources, a training track, advanced registration systems, and others, all fully integrated with WebEx realtime collaboration and all delivered on-demand.

In both of these examples our customers received additional value while avoiding the cost of software licenses, servers, support staff, and the time of integration. And in both cases, WebEx enjoyed additional revenue and more reasons to deploy our products. Deeper web collaboration and wider capability powered by third-party innovation.

So to wrap it up, we have completed another quarter that has defined excellence in software to service products and operations. No other company has consistently delivered web collaboration services on-demand at the scale, the cost, and the reliability that WebEx has achieved. We continue to increase our depth in our core collaborative services while showing how we will leverage third party innovation to widen our reach. So to tell you more about diving deeper and reaching wider I'll turn it back to Subrah.

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**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Thank you, Gary. Again, Q4 was a great finish, to a strong year for WebEx. Now let's look to the future. To reiterate, our strategy for the future is based on a two-pronged approach. First, go deep with web collaboration, and second, go wide with WebEx Connect. I'm pleased to say that we enter 2007 firmly in the leadership position in the web collaboration market.

One of the major accomplishments over the last year was the managed shift in our core business to the named host pricing model. Today almost two-thirds of our corporate customers are on the new pricing model. They are now geared to accelerate the execution of our strategy. This means going deeper into customer organizations with our continually expanding web collaboration suite, and it means going wider with our WebEx Connect platform and partner ecosystem. This positions us well for two converging mega growth streams. Web collaboration and software as a service.

According to the research from Gartner Group the on demand software accounted for 5% of new software sales in 2006. Over the next five years this is expected to climb to 25%. That translates to 25 billion to \$30 billion in sales annually. In the on-demand software business today, WebEx is the Company with the longest history. WebEx is the Company with the largest subscriber base. WebEx is the Company with the proven scalable financial model, and WebEx is a company with a unique delivery platform, MediaTone. Thus we're extremely optimistic about our future in the on demand software business.

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Our core team in the on demand software business is web collaboration. In the last ten years we witnessed a significant shift in the global economy. Success is no longer based on company size and scale. Competing in a flat world is about speed, agility and reach. Our web collaboration services are all about helping our customers do business in this flat and fast world. And that means helping businesses collaborate across geographic boundaries, collaborate across organizational boundaries, and collaborate across platform boundaries. And most importantly, it means enabling them to collaborate in realtime. With this focus I'm pleased to note that we have enabled a whole generation of multinational SMBs. SMBs who collaborate and compete globally every day with our web collaboration services. In fact, 80% of companies on Business Week magazine's 2006 list of innovative companies are our web collaboration customers. Similarly 90% of Wired Magazine's 2006 most wired companies are WebEx customers.

Even as we go deep to web collaboration our strategy for going wide is through direct connect. With the WebEx Connect initiative we are creating an ecosystem of ISV partners. These ISV partners will enable us to extend our core web collaboration services. They will enable us to deliver a rich suite of complementary to collaborative business applications. They will help us go wide in the match-up of mix of services we can offer.

As I indicated earlier, I am pleased to note that in Q4 we made significant progress in executing on our WebEx Connect initiative. Our partners have begun actively building connections to the WebEx Connect platform. In fact, in Q4 we were able to launch a market test with our sales organizations with two early WebEx Connect services. The first service is an on-demand learning management service from GeoLearning. The second service is an on demand CRM service by Sugar CRM. I am very pleased to note that the results of these tests were very positive. We launched these services well into the quarter in mid-November, and given the timing, there was minimal support for the sales organization. Yet we closed a dozen Connect transactions in the quarter. These tests provide us an early validation of our strategy. They give us a lot of confidence for the market success of WebEx Connect.

In summary, our strategy for growth in the on demand software world is in place and we are in execution mode, our team is aligned to go deep with the collaboration and go wide with direct connect services. 2007 promises to be a very exciting year for WebEx. At this point Mike, Gary, and I will take your questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. [OPERATOR INSTRUCTIONS] And your first question will come from the line of Thomas Ernst of Deutsche Bank.

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### Juven Matte - Deutsche Bank - Analyst

Hi, Subrah. Congrats on the quarter. Thank you. This is [Juven Matte] on behalf of Thomas Ernst from Deutsche Bank. We'd like to get more color on the success of WebEx Connect. Is it material from a revenue standpoint yet? Do we have a WebEx Connect and the employee numbers factored into your guidance? Can you break out those numbers?

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### Subrah Iyar - WebEx Communications, Inc. - Co-Founder, Chairman, CEO

Why don't I have Mike answer that question.

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**Mike Everett** - *WebEx Communications, Inc. - CFO*

Revenue is not material yet. We booked some deals in Q4, but we didn't recognize any revenue because they were late in the quarter and it takes a few days to provision. In terms of our forward-looking guidance we do have revenue baked in for 2007, but it's very, very modest.

**Juven Matte** - *Deutsche Bank - Analyst*

Okay. So the application in your guidance finally comes from the core business?

**Mike Everett** - *WebEx Communications, Inc. - CFO*

Correct.

**Juven Matte** - *Deutsche Bank - Analyst*

If I may, one more question. Can you talk about the pricing environment? Has increased services from LOB or Citrix impacted pricing?

**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

This is Gary. I think as you know our competitive position continues to strengthen. And while we see certainly competition from both of those it hasn't materially impacted our pricing, and I think it would just be from our results. We continue to be positioned very strongly competitively.

**Operator**

Your next question will come from the line of Kash Rangan of Merrill Lynch.

**Kash Rangan** - *Merrill Lynch - Analyst*

Just a couple clarifications if you could. Mike, for you, so if I back out the normalized -- if I include the fact of the -- if I exclude the effective tax rate and back out the impact from the reserves I get \$0.39. So just -- which is at the high end of your guidance. Is that -- am I doing the math correct there?

**Mike Everett** - *WebEx Communications, Inc. - CFO*

Yes, I think it actually works out to \$0.40, it rounds to \$0.40.

**Kash Rangan** - *Merrill Lynch - Analyst*

It's a high \$0.39, call it \$0.40. So just want to clarify that. And secondly, looks like the core business, X the Intranets acquisition grew 21% in the quarter. When I look at the midpoint of your guidance for fiscal 2007 it's right around 20% if I'm not mistaken. Are you implying a similar growth rate for your core business in 2007, or is there a mix shift that we should be looking at? Thanks. And I have one more question.

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**Mike Everett** - *WebEx Communications, Inc. - CFO*

We actually saw our core business growth rate accelerate from Q3 to Q4, and based on that strength, increased our guidance for the year.

**Kash Rangan** - *Merrill Lynch - Analyst*

Got it. So your growth rate in the core business is probably the same that would you expect in 2007 as you saw in Q4, or is it the same growth rate in 2006 that you are projecting in 2007?

**Mike Everett** - *WebEx Communications, Inc. - CFO*

You can do the math, Kash. What we have done is taken increasing strength in the business and then projected a higher growth rate going forward.

**Kash Rangan** - *Merrill Lynch - Analyst*

Got it. Okay.

**Mike Everett** - *WebEx Communications, Inc. - CFO*

We'll adjust that each quarter as we go.

**Kash Rangan** - *Merrill Lynch - Analyst*

Got it. Sounds like -- so the strategy with Connect is to really get into customers that might have not looked at web conferencing more seriously and also to perhaps lock in the barriers to exit and improve the stickiness of the product, right? So we should not be thinking of Connect as a material revenue driver in 2007? Is that the right way to characterize it?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Well, one of the advantages is, of course, more stickiness, but it's about, as I said, our core value proposition, our web collaboration, we want to get deeper and deeper into it and WebEx Connect, as the name suggests itself is to connect web collaboration into the various third party applications so that we can't develop all, and we have the web is really about creating a community of solutions, right? So in the short term, of course, given that we have recurring revenue business and you can see how that flows, the impact of WebEx Connect revenue in and of itself will grow over time. So to expect to have a benefit, what shall I say, impact in the early quarters is unrealistic but it just builds up over time.

**Kash Rangan** - *Merrill Lynch - Analyst*

Got it. And just finally, very quickly, number of new customers, if I got the number right, was 1,200. That's sequentially down, any seasonality in your business that you did not anticipate that caught you by surprise or am I looking at it the wrong way? That's about it. Thanks.

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**Mike Everett** - *WebEx Communications, Inc. - CFO*

1,200 is the right number. And it's not really a result of seasonality. We did some account clean-up in terms of bringing Intranets on to the WebEx accounting systems and just cleaned up some of the metrics in doing that. But overall, it was really as strong as last quarter.

**Kash Rangan** - *Merrill Lynch - Analyst*

Great.

**Operator**

And your next question will come from the line of George Sutton of Craig-Hallum Capital.

**George Sutton** - *Craig-Hallum Capital - Analyst*

Congratulations on the quarter. I'm sure there are a lot of smiles around the table. I wanted to ask a question I think I've asked several times in the past few years, and that relates to the building cash position that you have and acquisition interest, particularly as you talk about going wider. And my assumption would be that's the way you might think of making acquisitions?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Yes. Obviously our cash position puts us in a good strong position to invest in the [Inaudible] for the business. We contemplate acquisitions as well as investments, so to speak, which can help us get faster in the market. So yes, we are actively looking at ways we could accelerate the business and have made some minor investments in small companies as well to help them build complementary solutions to WebEx Connect.

**George Sutton** - *Craig-Hallum Capital - Analyst*

Am I thinking about it too simplistically when I look at partners on the WebEx Connect network ultimately being a potential farm team for acquisitions?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

I missed the last part. Potential what?

**David Farrington** - *WebEx Communications, Inc. - VP, Corp. Devel., General Counsel*

Farm team.

**George Sutton** - *Craig-Hallum Capital - Analyst*

That's a baseball term.

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**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

I understand. Yes, it could be, but obviously we want to be careful. We have to pick the areas we want to go deep, right, and build partnerships, because, we want to be best of breed in web collaboration, and spawn best of breed in various complementary areas and based on that, yes, it's an opportunity for us in the picture.

**George Sutton** - *Craig-Hallum Capital - Analyst*

One other thing if I could, AOL, the AOL program, IM program, can you just give us any updates there?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

The high level of data is going very well. It continues to gather momentum and we have actually had sales into accounts who have upgraded to more enterprise class services, and Gary, if you want to add to that.

**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

I would just reiterate it's going very well. There have been some number, well over a million registered users on AIM Pro, so we're very happy as we believe AOL is also with the results.

**George Sutton** - *Craig-Hallum Capital - Analyst*

Thanks, guys.

**Operator**

And your next question will come from the line of Sarah Friar of Goldman Sachs.

**Sarah Friar** - *Goldman Sachs - Analyst*

Good quarter. Just to go back to Connect, obviously the thing everyone wants to talk about, as you've added these new partners what do you typically see around first of all the R&D investment? Is there a new R&D every time you have to add a partner? Or have you effectively begun to streamline it so now you know exactly what needs to get done so we shouldn't expect R&D expense to grow all that rapidly in '07?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

No. The whole idea of the WebEx Connect platform is to make the addition of new partners seamless, easy, really fast, and, in fact be able to be done even by -- over time by ordinary business users. That's the focus. So the investment is, first, it is actually I would say version 2 or version 3 of our API program we've always had. We've always had this concept of connecting the WebEx core collaboration services to other partners. So it sort of in that continuum that we have just taken to whole new level with all the learnings we've had. Our sales and also what we see going on in the market. So from an investment perspective, it is factored into our -- already into the R&D expense but over time the expense will not be in the fact of adding more partners, but in of course, making the platform more robust, richer. Gary, you want to add?

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**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

Yes, I would -- Sara, I would add to that, as Subrah says, the whole idea of Connect is for us to take that whole world of innovation from third parties and easily connect it to our world of web collaboration. So just I think as you have seen in the fourth quarter as we have launched WebEx Connect, you haven't seen any increase in R&D expenses, you haven't seen any increase in our cost of operations. So it's fulfilling our belief that WebEx Connect actually simplifies life for us here, and frankly allows us, from an R&D point of view, to spend other people's money.

**Sarah Friar** - *Goldman Sachs - Analyst*

Got it. And then as you think about it for '07 I kind of want to think about it, because people often compare it to the sales force op exchange. I think of you guys as going much deeper so you have started off here with seven partners. All of whom, particularly the big guys, like the [Inaudible] are really material ISVs to work with. What's kind of the goal as we think through the year as 7 goes to 20 partners, 30 partners, or I would assume it's not like ApExchange where you go to thousands of developers over time.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Well, I think that there's no shortage of partners who would like access to the 2.2 million registered users. Let's face it, from the partner's perspective, not just our perspective, right?

**Sarah Friar** - *Goldman Sachs - Analyst*

Sure.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Partners are looking for distribution into the on-demand world, and essentially a channel, and a cost effective channel to get -- obviously because of price points and the delivery vehicle is completely different, right?

**Sarah Friar** - *Goldman Sachs - Analyst*

Sure.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

That's the goal. If you take that as the backdrop, I would say that our focus is -- there's no shortage of adding partners but really is about working the entire process, not just signing the partners, integrating it, but then taking them to market and proving that we can actually create a business for the partners and in the process make money for ourselves and them. If you look at -- if you go to ApExchange and you look at -- again, these are early attempts, it's easier to sign up partners than make sure that the partners are successful and actually making money. So I would say the 2007 focus is obviously to add a critical mass of partners to keep this going but even more so ensuring that it's a successful ecosystem where people are driving business. And then over time be able to scale it in 2008 and 2009. Yes, it is conceivably possible that it will go in thousands, but volume self is not the bigger challenge. Ensuring that the successful ecosystem is the bigger challenge.

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**Sarah Friar** - *Goldman Sachs - Analyst*

Got it. And at some point -- final question on this one. At some point are there some of these applications you might want to own yourself because you get to try before you buy by seeing how well they are doing as part of your ecosystem, or do you not want to muddy the waters on that front?

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Well, okay, that's a good question. We'll have to play it as we go. Again, if you think of it as from a perspective of a distribution channel you have to be careful of what you -- what your role is and what your partner's role is. But again, as traditional distribution channel you have a house brand as well as other brands, right?

**Sarah Friar** - *Goldman Sachs - Analyst*

Yes.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

So I think there will be opportunity at the right time to see and some of those house brands may be OEMs. I don't see this as that different from what happens in the traditional world in distribution, right? So the cutting time our focus obviously as I say is to be able to work the entire process and create successful partners, success being determined by success in the marketplace, and them being able to generate profits.

**Sarah Friar** - *Goldman Sachs - Analyst*

Okay, great. Thanks a lot.

**Operator**

And your next question will come from the line of Peter Goldmacher of Cowen and Company.

**Peter Goldmacher** - *Cowen and Company - Analyst*

Just a question on the other 100% of your business. Can you talk a little bit about churn in the quarter? I'm very glad you're breaking out revenue turn out. Looks like it was flat. Are we at a point where we're still sort of trying to either base before we continue to improve or your sense there, and I have a follow-up after that.

**Mike Everett** - *WebEx Communications, Inc. - CFO*

Okay, Peter. You're right, churn was essentially flat in the quarter in dollar terms, and down pretty substantially as you can see, down, I think, 0.7 of a point from a year ago. So we have made a lot of progress. Our operating plans do call for us to continue to improve in the current year. We'll see.

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**Peter Goldmacher** - Cowen and Company - Analyst

Another quick question. I know you're investing heavily in sales and marketing and a lot of that is going offshore. Can you help us understand the impact on coverage and your ability to address a broader swath of the market? Is that part of the success in Europe? Can you help us understand that?

**Mike Everett** - WebEx Communications, Inc. - CFO

Let me see if I get this right. But in Europe we have built a sales -- a set of sales channels that very much mirror the ones we have in the U.S. So the heart and soul is our corporate business unit or mid market channel, and then we have enterprise reps in the key countries as well as channel partners like Telefonica or British Telecom. So we have been bulking up all of those, and then are also building out similar capabilities in India and China as well, although we're somewhat earlier in the learning process there.

**Peter Goldmacher** - Cowen and Company - Analyst

But Mike, I thought part of the buildout in India and China was to be technical support for some of the domestic and European sales efforts. Is that -- am I mistaken?

**Subrah Iyar** - WebEx Communications, Inc. - Co-Founder, Chairman, CEO

Yes, Peter, this is Subrah. Yes, one of the unique characteristics of WebEx and in fact all successful on demand software companies is the -- what I call the web touch model, which is actually enabled by web collaboration. That means having a distributed sales organization complemented with local sales people and subject matter experts located in geographically different locations in places like India. We have successfully tested that model, it's going really well and we actually have growing actively in Europe, and to your point, that is something -- that is actually one of the, I would say formal areas of success and that's working really well.

**Operator**

Your next question will come from the line of Tavis McCourt of Morgan Keegan.

**Tavis McCourt** - Morgan Keegan - Analyst

Great quarter. Mike, special congratulations on the DSOs. Most of my questions have been answered. I just had a couple of follow-ups on guidance for '07. You talked about a non-GAAP tax rate, Mike. You know what you would expect for GAAP tax rate for '07?

**Mike Everett** - WebEx Communications, Inc. - CFO

We don't really have as good information on that. We are looking at about 38% for non-GAAP and for the GAAP rate it depends a lot on which options get exercised, ones being granted more recently flow through the rate, the deduction flows through the rate, where as if it's earlier options that get exercised it doesn't, so it's a bit harder for us to predict.

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**Tavis McCourt** - *Morgan Keegan - Analyst*

I understand. Then on the gross margin guidance, having been up for two consecutive quarters pretty meaningfully and you mentioned continuation into '07. Was that continuation from the percentage you saw in Q4 or kind of the overall percentage from '06?

**Mike Everett** - *WebEx Communications, Inc. - CFO*

I think I was intentionally mushy there. But I think it would be fair to say that really we think we can say that we don't know if we'll repeat what we did this quarter but we can stay in the range we've been the last couple of quarters of '06.

**Operator**

As a reminder, ladies and gentlemen, please limit yourself to one question. And your next question will come from the line of Nate Swanson of ThinkEquity. Please proceed.

**Nate Swanson** - *ThinkEquity - Analyst*

Hi. Thanks for taking my question. Couple questions around the Connect product. First, in terms of the metrics that you said you would provide in Q1 should we think about you breaking out revenue separately or would those be more around customer wins and partners and maybe users?

**Mike Everett** - *WebEx Communications, Inc. - CFO*

Well, we haven't really formalized what we're going to do, Nate, but it will be some combination of visibility on the partner community and visibility on our customers and whether we do that in terms of customer count or dollars we haven't fully debated through internally yet.

**Operator**

And your next question will come from the line of Brent Thill of Citigroup.

**Brent Thill** - *Citigroup - Analyst*

Can you just talk through what steps need to be implemented still to ease the migration for your partners to join in the Connect platform and make a more seamless process, whether it's the training or new tools? What are the milestones that you are looking for in the first half of this year to ease that step?

**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

Brent, this is Gary. The real work in Connect given that it's a development platform is in the APIs and the software development kits that our team is working on now and expects to have the first release out to the public later this quarter. That's really where the bulk of the R&D effort comes down, making it simple for third parties to get on the platform.

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**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Simultaneously, as we said, with the early partners we are working closely and working on taking them to market through our sales force. As I talked about the tests we had, and so there's a whole operational element of bringing them more on board on our platform and then more importantly bringing them to the market and being able to create demand and fulfill that demand in a cost-effective manner where there's money going on for partners and ourselves.

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**Operator**

And your next question will come from the line of Bill Benton of William Blair. Please proceed.

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**Bill Benton** - *William Blair - Analyst*

Good afternoon, guys. Congratulations. Just -- I might be watching the wrong channels here, but I have been seeing a lot of advertising on go to meeting, and I'm just curious if you guys could talk to any sort of impact that you guys are seeing as a result of that, and is it impacted kind of your thoughts on where you're going to put your spending going forward?

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**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

Bill this is Gary. Let me take that one. As I mentioned earlier we continued to strengthen our competitive position. We have been for the past few years. Citrix is filling that low-end niche that's been around for a long time. When it was Raindance, there was Latitude, there was Centra. But specific to your point, it's actually kind of nice to have a company like Citrix to consolidate that low end and frankly, put some marketing dollars into the space that's really raising the level of awareness in this whole category. So we don't -- we don't see Citrix as a significant threat to our business. They are in the horizontal basic meeting services, and as we have been saying, our business is all about web collaborative services. But we do see the benefit of their marketing.

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**Operator**

And your next question will come from the line of Ari Moses of Kaufman Brothers.

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**Ari Moses** - *Kaufman Brothers - Analyst*

Good afternoon. Just continuing that competitive question, on the Connect side of the business as you grow this ecosystem has the question of exclusivity come up as far as when you add an ISV into your ecosystem are they exclusive to WebEx for delivering their on demand solutions? Are they web enabling perhaps with another party and then joining into the Connect platform as well? Being distributed through multiple platforms? How does that relationship evolve and do you have a preference of what the relationship is?

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**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Well, the question of exclusive comes out but that's not our philosophy. I think it's an open platform, as the web has proven over time. I think it is a natural way for companies to collaborate with each other and the best of breed solution emerge on a web 2.0 kind of model. So our philosophy in that is we will be the best web collaboration service provider. The best and we believe that the killer app in that collaboration is real-time meetings and we have a formidable competitive advantage with respect to that. Then around that we are building complementary services, some ourselves and some from third parties, and in a sense, if you really get into it, we don't find companies saying that they want to do A or B. Most of the small companies are

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looking for a channel, and a cost effective channel, and, of course, many of our partners are already on [Inaudible] for example, but they see it as complementary. It's another way to get to market.

Just like, for some solutions sort of added on to the way sales force comment, the focus around sales force automation we are about web collaboration. And as a result, people look for multiple avenues, and we are very fine with that. We think it actually helps the market.

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**Operator**

And your next question will come from the line of Brad Whitt of RBC Capital Markets.

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**Brad Whitt** - RBC Capital Markets - Analyst

Thanks for taking my question. Can you -- I've got a Quick clarification for Gary, then a question. Gary, did you say that Ingram Micro now has purchased 10,000 seats of AIM Business Pro? Did I hear you correctly on that?

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**Gary Griffiths** - WebEx Communications, Inc. - VP, Products

You did hear me correctly, Brad, yes, sir.

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**Brad Whitt** - RBC Capital Markets - Analyst

Is that your largest deal to date on that?

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**Gary Griffiths** - WebEx Communications, Inc. - VP, Products

I didn't say that.

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**Brad Whitt** - RBC Capital Markets - Analyst

You guys seem to be pretty bullish on international. Seems to be growing much faster than the overall business which is good. Do you think that's sustainable into '07, and can you give us a little color as far as where you're strong now and what areas you may be expanding into as we move throughout the year?

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**Gary Griffiths** - WebEx Communications, Inc. - VP, Products

Sure, I'll take that Brad. We do think that it can sustain and even accelerate into '07. We have spent a lot of time building up marketing programs and putting leadership in place in Europe, and so we still -- we still can see a lot of benefit from that going forward, and we have a very, very good team in India that we acquired with a small acquisition a couple years ago, and again, are bringing them into our web touch sales model as we see the ability to grow quite rapidly there as well.

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**Operator**

And your next question will come from the line of Steve Koenig of Jefferies.

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**Steve Koenig** - *Jefferies - Analyst*

Thanks for taking my question. Quick question about Connect. Just interested in getting any color on any progress in getting team work space out. Is it being deployed with AIM Pro yet? Are you deploying it with Business Edition? Is Ingram Micro using it/ And then just a follow-up on Connect related to that.

**Gary Griffiths** - *WebEx Communications, Inc. - VP, Products*

Steve, this is Gary. We're, as we said, we're in the early stages of this and really it will be later this quarter when we see Connect with the full team work space capabilities and the degree of data sharing that we can expect. As Subrah mentioned, this was a great chance for us to test all the processes to see everything from the development process right through bringing it to the market, selling it, the billing, the revenue sharing, and you will see as we go through the successive quarters continued progress in the sophistication of that interface and the operations behind it.

**Operator**

Your next question will come from the line of Sri Anantha from CIBC World Markets. Please proceed.

**Sri Anantha** - *CIBC World Markets - Analyst*

Thanks for taking my question. Just two questions. One, Subrah, as you lay out your strategy for 2007 and going forward, do you think at some point for WebEx a strategic relationship, either with an infrastructure vendor or some other IT services integrator makes sense, especially we are seeing some announcements from salesforce.com and Citrix. And the second one, Mike, CapEx was unusually low this quarter. Was there anything, a one-time issue, or if you could give any color on that? Thank you.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Yes. As we get to that, to answer your first question, if you mean system integrators, like Deloitte, et cetera that you are talking about, as we get broader into the business process arena, yes, there will be opportunities. Where as we have been much more turnkey collaborative solution in the past there's not been that much opportunity, you would say. But, yes, there would be an opportunity for us to build those kinds of relationships as we roll out Connect and some of the more heavy-duty business process work flow kinds of solutions and traditionally salesforce has been more in that area. So we should see that.

**Mike Everett** - *WebEx Communications, Inc. - CFO*

In terms of CapEx, you're right, it was just a couple million dollars this quarter, and we're projecting it to average about 5 million a quarter next year, although it will bounce around a little bit. We -- if you look at our CapEx during 2006, actually the last couple of years, it's pretty spiky quarter to quarter, so there's nothing special going on there. We made investments in the second and third quarter, and didn't need to add as much capacity in the fourth quarter.

**Operator**

And your next question will come from the line of Philip Rueppel of Wachovia Securities.

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**Philip Rueppel** - Wachovia Securities - Analyst

Good afternoon. Quick question on sort of AIM Pro or the client side of Connect. I think at the analyst meeting AOL talked about pushing that out to its business users in waves. Has that occurred, and is the million registered users sort of a result of that, or do you see that number going up significantly over the course of the next quarter or so, and if not, or if so, do you expect users -- or Connect users to come and actually have to go and download the client?

**Gary Griffiths** - WebEx Communications, Inc. - VP, Products

Philip, we have seen pretty steady adoption of the AIM Pro client, so I wouldn't attribute it to any single event. As we continue to roll out WebEx Connect through this year we will be taking actions on our own to make sure that there is sufficient penetration of the AIM Pro client.

**Subrah Iyar** - WebEx Communications, Inc. - Co-Founder, Chairman, CEO

What we have heard is from the AOL side there will be rolling thunder, so to speak, as we keep enhancing and adding, but we do see our own activities of supporting that. One will feed off the other.

**Operator**

And your next question will come from the line of Rod Ratliff of Stanford Group.

**Rod Ratliff** - Stanford Group - Analyst

Congratulations again, guys. Very nice quarter. Mike, a couple of modeling questions. Everything else I had has pretty much been asked and answered. But can you give us an idea about where stock compensation is going to go next year? Looked like it dropped off a cliff in the fourth quarter compared to where it had been in previous quarters this year.

**Mike Everett** - WebEx Communications, Inc. - CFO

It is gradually coming down some, Rod, as we manage our equity comp programs that way. It was about 24 or 5 million this year for the year as a whole, and we're projecting in 2007 for it to be about 20 million. And that should reconcile out to the GAAP to EPS guidance.

**Operator**

And ladies and gentlemen, our last question will come from the line of Scott McCabe of Lehman Brothers. Please proceed.

**Scott McCabe** - Lehman Brothers - Analyst

Hey, guys. Most of my questions have also been answered, but just hoping that you could give us more color on gross margins, how we could think about it? Any comments along the mix to help us understand how it might be sustainable going forward? Seems like they're increasing steady going forward.

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**Mike Everett** - *WebEx Communications, Inc. - CFO*

Well, we're -- Scott, we're projecting gross margins sort of in the lower half of the 80s, and that, as you can see, is where they have been consistently for the last several years. They have strengthened over the last couple of quarters largely due to greater efficiencies that Gary and his team have introduced in the operations of the network. We also benefit from economies of scale, as we do more and more business, we're able to leverage some of the infrastructure that we have put in place.

**Operator**

And that does conclude our question-and-answer session. I will turn it back to management for any closing remarks.

**Subrah Iyar** - *WebEx Communications, Inc. - Co-Founder, Chairman, CEO*

Thank you all for attending our call today. We look forward to your attendance on our next call in April. Bye-bye.

**Operator**

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the presentation, and you may now disconnect your lines. Everybody have a great day.

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