

McAfee Fourth Quarter and Full Year 2008 Earnings Call

Good afternoon and thank you for joining us today. This afternoon's conference call is being recorded and will be available for replay on McAfee's investor relations home page at investor.mcafee.com.

On today's call are our Chief Executive Officer and President, Dave DeWalt ... and our Chief Operating Officer and Chief Financial Officer, Rocky Pimentel.

Dave will open the call with an overview of the year and an update on the integration of Secure Computing. Then, Rocky will provide the financial details of the quarter and guidance. Dave will close the call and we will be pleased to take your questions.

You will find, in our press release and on the investor relations section of our website, a GAAP to non-GAAP reconciliation of the fourth quarter and full year 2008 financial results discussed in this conference call. The link is: investor.mcafee.com, and our results are posted under "quarterly results." We will post our prepared remarks to the website following the conclusion of today's call.

This conference call, including the question and answer session, will contain forward-looking statements under the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements include, among others, those regarding market trends, our strategic positioning, guidance on revenue, operating income margins and earnings levels for the first quarter of 2009, the assumed tax rate for 2009, expectations regarding the

benefits of our recent acquisitions, including those regarding the contribution from, integration cost synergies, and future plans for the Secure Computing business, the expected level and scope of security threats in future periods, expectations regarding the industry shift to security suites, expected industry growth rates of the market segments in which McAfee participates, expected new and future product introductions and the revenue opportunity associated with them, expected integrations of products from our acquisition of Secure Computing and recent acquisitions with McAfee's existing product lines, expectations regarding McAfee's business momentum, market position, business segments, statements regarding future partnership opportunities and our future growth opportunities, expectations about specific growth initiatives, cost savings and cost avoidance, productivity improvements and other benefits from initiatives and strategies outlined for 2009, plans and benefits from investment in our global systems and infrastructure, and future strategic acquisitions and other uses of cash by McAfee.

Forward looking statements are based on management's current expectations and are subject to risks and uncertainties.

We caution listeners that actual results may vary, perhaps materially, from the forward-looking statements referenced in this call, including any forward-looking statements made during the question and answer session. We encourage listeners to review the risk factors contained in today's press release, as well as the Company's filings with the SEC, including the Annual Report on Form 10-K filed February 27, 2008 and most recently filed Quarterly Report on Form 10-Q filed November 7, 2008, for more detailed information on the risks and uncertainties related to the Company

and its business. We do not undertake to update any forward looking statements.

And with that, it is my pleasure to turn the call over to our CEO and President, Dave DeWalt ...

Thank you, Kelsey.

Good afternoon and welcome everyone. Thank you for joining us today.

2008 was a year of market leading results for McAfee – we delivered double-digit, year-over-year growth in key financial metrics, we increased our market share in all four quarters and we built the foundation for the future of our company.

I want to say thank you to the entire McAfee team and our worldwide partners for their commitment to our vision and their dedication to providing our customers around the world the best security solutions to protect what is important to them. We are building a best in class organization and I am proud to be a part of the team.

There are three key points I want to convey this afternoon.

First, McAfee has come a long way and 2008 was a transformational year during which we invested in our business to drive future growth and had an opportunity to enhance sales and productivity.

For 2008:

- Sales grew 20% year-over-year;
- Revenue grew 22% year-over-year to \$1.6 billion;
- Deferred revenue ended the year at \$1.3 billion, up 24% year-over-year;
- GAAP earnings per share on diluted basis reached \$1.08;
- Non-GAAP earnings per share reached \$2.01, an increase of 15% year-over-year;
- We also closed four acquisitions, enhancing our data protection, network and Web security solutions – McAfee is the market leading solution in almost every category in which we compete;
- We launched innovative new technologies, including Artemis, our always on, “in the cloud” threat prevention technology which has been deployed to tens of millions of users now;
- We invested in our go-to-market capabilities, upgrading our field sales talent and strengthening our channel relationships;
- We created the industry’s first open platform now including 40 new Strategic Innovation Alliance partners;
- We more than doubled our consumer distribution capacity. In the fourth quarter alone we had a 127% year-over-year increase in new, registered trial subscriptions, this is a leading indicator of our consumer growth strategies;
- We significantly extended our brand reach and recognition through innovative marketing actions and through new channels such as our Web security business, which generated more than 23 billion impressions of McAfee’s Secure Trust Mark in the fourth quarter alone and more than 82 billion impressions in 2008;
- And, the year culminated with our addition to the S&P 500 in late December.

But, we are not done, which takes me to my second point. Taking market share -

For seven consecutive quarters we have taken market share. And, I am convinced we can continue to do so.

Our investments resulted in full-year 2008 double-digit, year-over-year growth in sales and revenue across all of McAfee's product segments, geographies and market segments.

For example:

- Four of the largest employers in the world have now standardized with McAfee;
- We ship on over 50% of the PCs distributed by the top 10 PC OEM manufacturers;
- And, we partner with more than 200 of the best known consumer brands, a 51% increase over last year. I am also pleased to announce that this week we signed a multi-year exclusive contract with Lenovo to ship on their consumer PCs and Netbooks worldwide. This new partnership is expected to help drive growth in the emerging markets.

This is the time for McAfee to grow and to take market share. We believe we have the financial resources, the team, the product leadership, the go-to-market strategy, the partner eco-system and the global brand to compete effectively and win.

Which brings me to my third and final point, to drive growth and shareholder value by optimizing our business models. We are consciously driving growth at the same time we are focused on continuing to optimize a model that delivers sustainable shareholder value.

We delivered non-GAAP operating margins of 26.7% in the fourth quarter, excluding the impact of Secure, our best performance in almost three years. And, our guidance for the first quarter of 2009 will show that we expect a 200 basis point improvement in non-GAAP operating margins year-over-year for that core business.

In 2009 we expect to achieve continued improvement in non-GAAP operating margins by successfully executing two initiatives.

First, we invested in 2008 and 2009 is the year to harvest those investments.

- We expect to leverage our consumer model as our PC OEM relationships grow;
- We plan to take our acquisitions to the next level, leveraging revenue growth, cost synergies and expanded cross-sell and upsell opportunities;
- And, we plan to deliver our vision of an integrated security environment across the endpoint, the network and the “cloud.”

Our second initiative is to continue to improve cost efficiencies.

- We will achieve acquisition related cost savings through personnel reductions, applications of McAfee’s best in class processes and facilities consolidations;

- Employee cost savings from the actions we have already taken and plan to take, such as travel restrictions and a hiring freeze;
- And, ongoing optimization in our go-to-market model to maximize sales force yields.

We believe these initiatives are the foundation for profitable growth and market shift opportunities in 2009.

Turning to Secure Computing, I would like to provide an update on our acquisition of Secure Computing which closed in November 2008.

I want to start by formally welcoming the Secure team to McAfee. The combination of these two organizations – from the people to the technology – creates a nearly half billion dollar network security business. This is a segment that we believe is well positioned to grow significantly over the next several years.

Our product strategy emphasizes integration and the interlock between the endpoint and the network. We firmly believe that McAfee's network solutions offer the best threat detection and prevention across all protocols and products.

Fourth quarter 2008 results include a stub period for the acquisition of Secure Computing, which closed on November 18, 2008. Sales for that period were \$46 million. Revenue was \$19 million. Approximately 77% of fourth quarter revenue for Secure came off the balance sheet from prior periods. As part of the close process we completed our VSOE study of Secure's product portfolio, the results of which are accounted for in today's reported results and guidance.

The total deferred revenue write-down for Secure, derived using the fair value method in accordance with GAAP, was \$46 million, leaving a deferred revenue beginning balance of approximately \$119 million at November 18.

During the fourth quarter, Secure Computing contributed an additional net increase of \$27 million to deferred revenue, for a December 31, 2008 deferred revenue balance of \$146 million. We expect that approximately 70% of this balance will amortize into 2009 revenue.

Consistent with our expectations, Secure was \$0.01 dilutive to our fourth quarter non-GAAP results.

Integration continues to progress well and we have already realized initial cost synergies.

Plans for 2009 include a more than 50% consolidation of Secure's back office resources and integration of sales teams. At the same time we are closing more than two thirds of Secure's facilities. By the end of the second quarter, we expect to have completed the integration of sales, customer support, administrative functions and IT infrastructure.

We expect that these initiatives and many others like it will improve the profitability in the combined businesses, moving toward accretion in the back half of 2009. We continue to expect that the Secure acquisition will prove neutral to slightly accretive to full-year 2009 non-GAAP results.

And, with that, let me hand it over to Rocky for the color of the quarter and guidance.

Thank you, Dave. Good afternoon everyone.

We are very pleased to report that sales grew 20% year-over-year during the fourth quarter, even factoring in an approximately 3% negative impact from foreign currency.

Fourth quarter 2008 revenue was \$424 million, up 19% year-over-year, a record revenue quarter for McAfee and our 12th straight quarter of double-digit, year-over-year revenue growth.

Currency fluctuations negatively impacted revenue by \$11 million year-over-year and \$22 million sequentially, while Secure Computing contributed \$19 million to revenue.

Of the \$424 million in revenue during the quarter, \$209 million was service and support, up 18% year-over-year, and \$170 million was subscription, up 13% year-over-year. This equates to \$379 million - just over 89% of total revenue for the quarter.

North American revenue was \$233 million, an increase of 25% from last year's fourth quarter, and accounted for 55% of the business. This was a record revenue quarter for North America.

International revenue was \$191 million, an increase of 12% from last year's fourth quarter, and accounted for 45% of the business. We had double-digit revenue growth across each of our international segments in

local currencies. As reported in U.S. dollars, revenue grew in all international geographies:

- Up 1% in Europe, the Middle East and Africa – even where the intra-quarter strengthening of the dollar most negatively impacted year-over-year results;
- Up 49% in Asia Pacific;
- Up 39% in Latin America;
- And, up 26% in Japan.

This is our 12th straight quarter of double-digit, year-over-year growth in international revenue.

For the fourth quarter, 76% of total revenue came from deferred revenue off the balance sheet. Sequentially we saw a slight decrease in the percentage of revenue off the balance sheet due to the impact of foreign exchange, a shift in product mix favoring our network solutions and improving in-period revenue realization related to our systems business.

During the fourth quarter we closed 576 deals having a value greater than \$100,000, 66 deals over \$500,000 and 28 deals over \$1 million. This represents an increase of 69% quarter-over-quarter and 27% year-over-year for deals over \$100,000.

Corporate revenue was \$261 million, up 21% year-over-year, and another record revenue quarter. We had double-digit, year-over-year revenue growth in each of our corporate product segments.

Highlights from our fourth quarter corporate business include:

- Record sales of Total Protection or ToPS. Sales of ToPS grew 11% year-over-year, driving many of our large deals over \$1 million and many new license sales and competitive displacements.
- Sales of our Data Protection solutions grew more than 70% year-over-year.
- Finally, we had a very strong quarter in Risk & Compliance where we closed three deals exceeding \$1 million, including the largest Risk & Compliance deal in McAfee's history. Risk & Compliance sales grew more than 60% year-over-year.

On the consumer side, revenue grew 16% year-over-year for the fourth quarter to \$163 million. This was a record quarter for our consumer business.

Additional highlights from our fourth quarter consumer business include:

- We signed or extended 22 new consumer partnerships and launched 51 new or enhanced online partnerships during the quarter.
- We recorded the highest overall addition of online net new subscribers in more than 11 quarters.
- Our results reflected record worldwide sales for both our direct and partner consumer businesses.
- During the fourth quarter, Total Protection remained our fastest growing consumer product where sales of Total Protection grew approximately 80% year-over-year.

- We added approximately 3,000 new McAfee Secure customers in the fourth quarter, bringing the total number of customers who trust McAfee with their Web site certification to approximately 14,000.

Full year 2008 revenue of \$1.6 billion was up 22% over 2007. This total reflected double-digit, year-over-year growth across all geographies.

For the full year 2008, we closed 85 deals exceeding one million dollars and 1,533 deals over \$100,000, compared with 39 deals exceeding \$1 million and 1,216 deals over \$100,000 in 2007.

Reviewing the rest of the income statement, GAAP gross profit margin for the fourth quarter was 75.2%, compared with the third quarter 2008 of 76.0% and fourth quarter 2007 of 75.8%. Non-GAAP gross profit margin for the fourth quarter was 79.3%, compared with last quarter's 79.6%, and a year-ago quarter gross profit margin of 79.0%.

Total GAAP operating expenses in the fourth quarter 2008 were \$286 million, compared with \$237 million for fourth quarter 2007. Total operating expenses, on a non-GAAP basis, in the fourth quarter 2008 were \$229 million, compared with \$195 million for the fourth quarter 2007 and \$230 million for the third quarter of 2008.

GAAP sales and marketing expenses for the fourth quarter 2008 were \$142 million. Sales and marketing expenses, on a non-GAAP basis, in the fourth quarter 2008 were \$132 million, or 31.0% of revenue. This was an increase of \$4 million sequentially on a non-GAAP basis and was driven primarily by the acquisition of Secure Computing.

Fourth quarter 2008 GAAP research and development costs were \$67 million. Fourth quarter 2008 research and development costs on a non-GAAP basis were \$61 million, or 14.4% of revenue, compared to \$57 million for the third quarter, reflecting additional headcount from Secure Computing. We were granted 7 new patents in the fourth quarter, bringing our total to 420.

GAAP general and administrative expenses for the fourth quarter of 2008 were \$43 million. On a non-GAAP basis, G&A expenses for the fourth quarter were \$36 million, or 8.5% of revenue, compared to \$46 million for the third quarter. This sequential decrease on a non-GAAP basis was primarily associated with reduced legal expenses during the quarter.

GAAP operating income for the fourth quarter was \$33 million - resulting in a GAAP operating margin for the period of 7.7%. The year-over-year decrease in GAAP operating margin percentage is driven primarily by the acquisitions of Secure Computing and SafeBoot.

Operating income on a non-GAAP basis for the fourth quarter was \$107 million, the highest we have reported in three years, resulting in a non-GAAP operating margin of 25.3%. Excluding the effect of the Secure Computing acquisition, McAfee's core non-GAAP operating margin was 26.7% for the fourth quarter.

For the full year 2008 we finished with a non-GAAP operating margin of 24%, reflecting the dilution of initiatives designed to drive future growth, including acquisitions and investments made in PC OEM partnerships.

GAAP other income for the quarter was \$2 million. This GAAP figure includes a \$4 million impairment loss on our marketable securities portfolio resulting primarily from the recent credit market crisis. By policy we invest in high quality, investment grade securities.

Non-GAAP other income was \$6 million, compared with \$17 million in the third quarter 2008 and \$16 million in the fourth quarter 2007. This decrease in other income reflected lower foreign currency exchange gains as compared to the third quarter and lost interest income associated with use of cash for our acquisitions.

Total employee headcount at the end of the quarter increased to 5,563. The sequential increase was driven primarily by the acquisition of Secure Computing.

For the quarter we had a GAAP tax benefit of 31%. As noted when we announced third quarter results, the GAAP tax benefit reflects the impact of receiving administrative relief for incremental taxes previously accrued related to certain acquisition integration activities. On a non-GAAP basis, our tax rate was unchanged from a year ago at 27%.

In the fourth quarter of 2008 we reported net income, on a GAAP basis, of \$45 million, or \$0.29 per share on a diluted basis.

For the year, GAAP net income was \$172 million, or \$1.08 per share on a diluted basis. This compares with our 2007 result of \$167 million, or \$1.02 per share on a diluted basis.

Our fourth quarter net income, on a non-GAAP basis, was \$83 million, or \$0.53 per diluted share, up 17% year-over-year. This includes approximately \$0.01 non-GAAP earnings per share dilution from the acquisition of Secure Computing.

Full year net income on a non-GAAP basis, was \$320 million and non-GAAP earnings per share, on a diluted basis, was \$2.01. This compares with our 2007 result of \$287 million, or \$1.75 per share, an increase in full year earnings per share of 15%.

Investors and potential investors are encouraged to review the complete reconciliation of GAAP to non-GAAP financial measures set forth in the attachment to our press release issued this afternoon.

Turning to the balance sheet, our net accounts receivable balance at the end of the fourth quarter 2008 was \$323 million compared with \$232 million for the same period last year. Days sales outstanding were 69 days for the fourth quarter 2008, compared to 59 days for the fourth quarter of last year. Nine days of the increase in days sales outstanding is related to the acquisition of Secure Computing's accounts receivable without offsetting full-period revenue.

Deferred revenue at the end of the fourth quarter 2008 was \$1.293 billion, up 24% year-over-year, and included deferred revenue of \$146 million related to Secure Computing.

We ended the fourth quarter with \$989 million in short-term deferred revenue, up \$171 million when compared with the third quarter 2008. Long-term deferred revenue was up by \$65 million in the fourth quarter

compared to the third quarter 2008, ending the quarter at \$304 million. We did not see unusual contract extensions during the quarter or unusual discounting.

We ended the quarter with cash and marketable securities of \$594 million. Please note that this total reflected a net cash outlay of \$447 million for the acquisition of Secure Computing which closed in November 2008.

At the end of December 2008 McAfee announced that we entered into a credit agreement providing for a \$100 million unsecured term loan and a \$100 million unsecured revolving credit facility. The term loan was drawn down in early January and provides for extra financial flexibility.

We have \$250 million in stock repurchase authorization remaining through July of 2009.

In the fourth quarter 2008, we generated a total GAAP operating cash flow of \$70 million. Operating cash flow was down compared to last year due to the use of cash for a one-time non-US tax payment of approximately \$30 million related to 2004 and 2005 which we highlighted earlier this year. During the first quarter of 2009, we expect to make a payment of approximately \$14 million related to our recently concluded derivative lawsuit.

Now I would like to discuss guidance.

We will be providing guidance for the first quarter of 2009. But first, I would like to give you a sense of how we are managing the business in

this challenging macro environment. We are pursuing operational efficiencies and have initiated numerous actions to keep operating expenses in line.

We execute a disciplined forecasting process. At the heart of this are frequent intra-quarter forecast cycles, where we review and interrogate each geography and sub-region's pipeline, deal structures and sales close plans. We believe our process provides us the ability to dynamically align those resources necessary to assist our field sales representatives in securing orders and closing deals.

At the same time we are scrutinizing the cost profile of our business, as Dave said, balancing investments to grow with prudent expense management.

In the short term, we have effectively imposed a hiring freeze keeping headcount flat, we have instituted mandatory time off, we have frozen salaries and we are suspending certain compensation benefits. We have imposed business travel restrictions – limiting the team to primarily customer facing travel – and cut discretionary marketing spend. We also have integration plans in place to deliver cost synergies from the Secure Computing acquisition.

Additionally, we are making progress on longer term expense levers. We are consolidating facilities associated with acquired companies, as well as rationalizing our current facilities profile. At the same time we are upgrading our infrastructure, enhancing our systems to maximize productivity of the sales team and create efficiency in other functional organizations involved in those related sales processes.

The company anticipates these initiatives will result in more than \$50 million in savings and cost avoidance over the course of 2009.

The following updated guidance replaces and supersedes any previous guidance with respect to future periods and is valid as of today only. I would like to remind our listeners that guidance is based upon management's current judgments and that actual results may vary, perhaps materially, from those results anticipated in this guidance. Please see the footnotes to our press release for further details.

For the first quarter of 2009:

- We expect a revenue range of \$440 million to \$460 million.
- We expect a GAAP operating income margin of 5.0% to 9.0%.
- We expect an operating income margin, on a non-GAAP basis, of 20.5% to 22.5%.
- We expect a diluted share count in the range of 156 to 158 million shares.
- We assume an annual 8% GAAP tax rate and a non-GAAP tax rate of 24% for 2009.

Also, for the first quarter of 2009:

- We expect GAAP earnings per share of between \$0.20 and \$0.24 per share on a diluted basis.
- On a non-GAAP basis, we expect earnings per share in a range from \$0.46 to \$0.50 per share on a diluted basis.

Our expectations for the first quarter include double-digit, year-over-year revenue growth for the core McAfee business. In addition, we expect approximately 70% of the revenue contribution from Secure Computing in the first quarter to come from the balance sheet. This guidance also includes \$0.05 to \$0.07 dilution to non-GAAP earnings per share related to the Secure Computing acquisition. We continue to expect the transaction to be neutral to slightly accretive for the full year 2009 results with profitability improving as we progress throughout the year.

Non-GAAP operating margin guidance for the first quarter, excluding the dilutive impact of Secure, is expected to be between 23.5% to 25.5%

In addition, guidance does not include any impact from future stock repurchases.

At this point I will turn the call back over to Dave.

Thank you, Rocky.

As evidenced by the results you just heard from Rocky, our strategy is working.

While no company is recession proof, we believe that a challenging macro-economic environment presents well-positioned companies like ours with opportunities to grow.

Our customers are focused on cost reduction, better resource utilization and business optimization as they struggle to manage the increasing level

of security threats. There has been an exponential growth in cybercrime over the last few years – in 2008 alone we saw more than 5 times the amount of malware we saw in 2007. In addition, organizations worldwide are coping with increased compliance and reporting requirements.

This complexity is driving buying trends, consolidation of vendors, a focus on efficiency, the necessity of integration and management, all of which trend in favor of McAfee.

At the same time, security is becoming increasingly ubiquitous. In today's world of sophisticated malware, targeted threats, and multi-stage attacks, security needs to be everywhere – in the silicon; in the operating system, including virtual environments; in the data base; in storage and on all endpoint devices, including mobile phones. Our business – once limited to a focus on operating systems and anti-virus – today secures virtually all layers of the IT stack, as well as our customers' digital lifestyle.

So, to conclude, challenging times create opportunities for companies that are positioned to take advantage of them. And, as we enter 2009, we believe McAfee is very well positioned.

We have been growing our business and taking market share and we expect this trend will continue.

Thank you for joining us this afternoon. We look forward to answering your questions in a moment.

Now, I will turn it back over to Kelsey.

Thank you, Dave and Rocky. As the operator polls for questions, I would like to inform you that McAfee plans to attend the Goldman Sachs Conference on Thursday, February 26th and the Morgan Stanley Conference on Tuesday, March 3rd.

In addition, please mark your calendar for McAfee's Investor Day on Friday, May 15. Investor Day this year will be held at the Grand Hyatt in New York City. This is an invitation only event and information will be forthcoming.

Operator, please poll for questions. In the interest of time, please limit yourself to one question per person. Thank you.