

McAfee Second Quarter 2009 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.

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

Dave will open this afternoon's call with a high level review of the quarter and a strategic discussion. Then, Rocky will provide financial details and guidance for the third quarter 2009. Dave will close 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 second quarter 2009 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.

During this conference call and the question and answer session we will make forward-looking statements regarding future events and the future performance of the Company, including our guidance on revenue, operating income margins and earnings levels for the third quarter of 2009, the assumed tax rate for 2009 we used in estimating our guidance, our strategies and opportunities, trends in the security market, our competitive position and momentum, the anticipated benefits of our current, new and

future products, and the anticipated benefits of our acquisitions, partnerships and alliances .

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 made during this call and the question and answer session this afternoon. 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 Form 10-Q filed May 7, 2009, 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.

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

Thank you, Brandie.

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

In the second quarter of 2009 our momentum continued with another exceptional quarter for McAfee with records set in most of the key metrics of the business.

In addition, we are pleased to announce another strong acquisition of MX Logic, the leader in cloud-based security. This will help McAfee drive additional growth in the small and mid-market segments and creates the industry's most comprehensive Security-as-a-Service portfolio.

For the second quarter of 2009 we're proud to report quarterly records in revenue, deferred revenue, non-GAAP operating income and non-GAAP net income.

- Revenue reached a record \$469 million, up 18% year-over-year, and our 14th consecutive quarter of double-digit, year-over-year revenue growth;
- Deferred revenue reached a record \$1.31 billion, up 20% over the same period last year
- Sales, which are orders received during the quarter, grew 22% year-over-year during the second quarter, even factoring in an approximately 6% negative impact from foreign currency. Excluding the impact of foreign exchange, we had double-digit, year-over-year and sequential organic growth in sales during the second quarter
- Moreover, our corporate and consumer businesses delivered record revenue; and, our North America and international geographies also delivered record revenue.
- Finally, due to our sales momentum, we had a substantial increase in our product backlog, setting us up for an excellent start in the third quarter.

In addition to strong top line growth, we also had strong operating results as exemplified by:

- Record non-GAAP operating income of \$125 million, up 23% year-over-year; and
- We continue to leverage our cost structure. Second quarter non-GAAP operating margin was 26.7%. This was a 100 basis point improvement compared to last year's second quarter non-GAAP operating margins.
- Non-GAAP earnings per share of \$0.60, up 15% year-over-year, a new record

Our balance sheet is strong, with \$886 million in cash and marketable securities, up \$85 million quarter over quarter, which includes a \$32 million payment for our Solidcore Systems acquisition in June.

For the six months ended June 30, 2009, McAfee generated \$199 million in cash flow from operations, compared to \$151 million in the same period last year. Cash flow from operations for the second quarter of 2009 was \$53 million which includes increased investments in working capital and a total of \$20 million of payments to clean-up prior years' matters. Rocky will provide more color later.

Our results and market share gains continue to demonstrate that security is a must-have technology and that McAfee is a company in the right place at the right time. Customers and partners choose McAfee for security leadership and improved returns.

I am very pleased with our corporate performance that resulted in more large deals and an increase of overall contract durations of 10% year-over-year, dwarfing our competition.

In the second quarter we closed 424 deals greater than \$100,000 in value, including 57 deals greater than \$500,000 and 28 deals valued over \$1 million, matching our record for million dollar plus deals and compared to 21 deals over \$1 million a year ago and 16 in the first quarter of this year.

Our momentum continues to accelerate and we continue to win market share. 83 of the Fortune 100 now use McAfee technologies. This includes some of the world's largest financial institutions, telecommunications companies, governments and technology companies. With 100 deals over \$1 million in the last four quarters, this represents standardization decisions and confidence in McAfee's strategy among customers.

Turning to the mid-market, this segment recorded yet another double-digit, year-over-year growth quarter.

Our Total Protection Suites in the mid-market continue to gain popularity with 29 percent growth in sales over last year. Our sales outside the traditional anti-malware space organically grew 25 percent year-over-year with our newly introduced McAfee UTM, or Unified Threat Management product.

The acquisition we announced today of MX Logic is expected to further accelerate our growth in the mid-market segment, This acquisition continues a string of small and medium-sized acquisitions that allow us to broaden our product portfolio.

Today MX Logic has about 40,000 customers in the small and medium business segments. McAfee intends to extend MX Logic's business around the world and into the large enterprise as well as cross-sell and up-sell current McAfee offerings into the MX Logic customer base. Additionally, McAfee's future offerings will be enhanced by MX Logic's expertise in SaaS sales and support.

The acquisition of MX Logic reinforces our position as a leader in Security-as-a-Service and brings world class email and Web defense, including archiving and business continuity services, extending our proven expertise in providing cloud-based services to our customers. MX Logic aligns with the McAfee vision to lead Security SaaS by bringing industry leading technologies and a strong partner ecosystem.

Following completion of the proposed acquisition, McAfee will offer the most comprehensive and dedicated security portfolio in the market. This approach will give businesses in all market segments the flexibility to purchase these solutions as stand alone offerings or to mix and match these deployment choices to meet their exact needs.

We are paying \$140 million for MX Logic, funded by cash from our balance sheet with an additional \$30 million in the future if certain performance targets are met. The acquisition is expected to close in the third quarter of 2009.

On the consumer side. Defying seasonal trends and the weak macro consumer environment, our revenue grew 13% year-over-year in the second quarter to \$177 million, a new record.

- This is the sixth quarter where we have had consecutive double digit year-over-year growth in consumer revenue
- It is the ninth consecutive quarter of sequential growth in consumer revenue.
- In addition, our strategy to expand and diversify the distribution capacity of our consumer products resulted in many new strategic agreements. These include:
 - One of the largest telecommunications providers
 - The largest retailer on earth
 - One of the largest banks in the United States
 - One of the world's largest and most diversified software companies
- In continuing our strategy of a balanced partner portfolio, we signed or extended 24 new consumer partnerships and launched 63 new or enhanced online partnerships during the quarter. We now have more than 200 partners around the world, allowing us to take additional share in the consumer market. These partnerships are prime examples of why we continue to gain market share in the consumer space – we have taken a portfolio approach that is balanced by both segment and geography.
- Furthermore, our new trial subscribers worldwide grew more than 140% year-over-year.
- And our online sales of Total Protection, our high-end consumer security suite, grew 128% year-over-year.

We have won approximately 100 awards for our consumer products over the last few years including some of the most prestigious awards, showing that we have the best consumer security products.

- This includes awards for one of the most exciting new products in our consumer segment, launched in June -- Family Protection. This timely product has been very well-received by the media and by customers looking to protect their families. It features protection elements that address the most current issues we face, such as social networking management, time limits and user reporting functionality.

Significant work has also been done on alliances and partnerships on the corporate side of our business.

- We now have about 70 Security Innovation Alliance partners committed to helping customers drive savings with McAfee Compatible products. The Security Innovation Alliance is the only open security platform in the industry and it is seen as a clear differentiator and advantage for McAfee by leading industry analysts.
- We have over 18,000 channel partners worldwide and continue to expand our network. With MX Logic we also acquired a partner network with 1,800 members.
- Over 80 OEM partners in the corporate segment now embedding McAfee security technologies to protect the offerings and solutions that they produce and sell to businesses of all sizes, with 15 new OEM design wins this year aimed at increasing our market share in the corporate segment.

Turning to the product side. We continue to lead the industry. Prime examples of key product announcements that can drive future growth include:

- Our next generation release of ePolicy Orchestrator platform, ePO 4.5 -- a major milestone for the company that allows for lower switching costs from competitors and further streamlines security operations for our customers. ePO provides real time visibility for our customers into the security of their IT environment and is the glue for our platform to provide optimized security.
- On the network side we officially announced our Network Security Business Unit and new products including McAfee Total Protection for Internet Gateways, allowing customers to make one purchase to acquire Web, mail and network DLP protection to be deployed on McAfee appliances. This provides industry leading threat protection with acquisition cost savings of 50 percent or more.
- In June we also announced an upgrade to our enterprise firewall products with next generation capabilities that help customers increase network security and lower their compliance and operational costs. The products, McAfee Firewall Enterprise, McAfee Firewall Enterprise Control Center and McAfee Firewall Enterprise Profiler also feature streamlined management through integration with ePolicy Orchestrator and leverage McAfee global threat intelligence to provide world class protection.
- Later this year, we will launch an online backup product for consumers that will be offered as a stand alone product and also be offered through our 2010 suite products. The stand alone product will provide unlimited storage at a \$59.99 price point, and be available in 26 languages.

In short, our strategy is working. We have a growing opportunity to expand our security footprint on almost every layer of the technology stack. We have the products, the partnerships, the momentum and the macro conditions continue to be strong.

The need for security is everywhere. The threat landscape continues to elevate and regulatory compliance requirements worldwide are on the rise. Also, cybersecurity is a key priority for the government at the highest level, as underscored by President Barack Obama when he presented his administration's cybersecurity review in late May.

All of this means one thing -- security is more important than ever, for protecting countries from cyber-terrorism and cyber-warfare; for keeping companies operating; and for making consumers digital lives safe. We believe McAfee is perfectly positioned for the future.

With that, let me hand it over to Rocky for a financial review of the quarter and guidance.

Thank you, Dave. Good afternoon everyone.

This quarter last year was my first earnings call with McAfee and I'm proud to say the team has come a long way. For the second quarter of 2009, we are pleased to report record, balanced revenue growth and operating margin expansion that lead to record non-GAAP net income.

Our 2009 strategic operating imperatives included driving operational efficiency, improving our business model, improving sales productivity, and

successful integration of our acquisitions, to ensure we are positioned for 2010 and beyond.

Our strategic agenda includes upgrading the infrastructure. I am pleased to report we are on track with this initiative and it includes more than 70 key projects such as our customer relationship management initiative, extending and enhancing our dot-com and web infrastructure, improving our ERP system, enhancing our supply chain processes, and improving our acquisition integration capabilities. These are critical in preparing us to take advantage of future growth opportunities in front of us.

In addition to investing in these projects, we're investing in our people. We've added to our team with new leadership in Information Technology, Finance and Supply Chain Management from other leading technology companies.

Moving on to the financials, second quarter 2009 revenue was \$469 million, up 18% year-over-year. Foreign currency had a negative impact on revenue of approximately \$22 million year-over-year and was not significant sequentially.

North America revenue was \$265 million, an increase of 30% from last year's second quarter, and accounted for 57% of the business. This was another record revenue quarter for North America, reflecting the impact of the acquisition of Secure Computing, strong performance in the core McAfee portfolio and highlighted by numerous competitive displacements in both our network and endpoint businesses.

International revenue reached a record \$203 million, an increase of 6% when compared to the same period last year, and accounted for 43% of the business. As reported in U.S. dollars, revenue in our international geographies, compared to the second quarter of 2008, showed:

- Europe, the Middle East and Africa declined 2%
- Asia Pacific grew 18%;
- Latin America grew 36%;
- And, Japan grew 20%

Excluding the impact of foreign currency, international revenue grew 17% year-over-year and grew double-digit in each theatre worldwide as follows:

- Europe, the Middle East and Africa grew 12%;
- Asia Pacific grew 35%;
- Latin America grew 36%;
- And, Japan grew 15%

For the second quarter, approximately 79% of total revenue came from deferred revenue off the balance sheet. And, as Dave mentioned, we had 28 deals over \$1 million.

Approximately 50% of total revenue this quarter came from service and support and 41% from subscriptions – with approximately 91% of total second quarter recurring.

We were also particularly pleased with our product revenue which grew both year-over-year and quarter-over-quarter -- further evidence that we

continue to make progress in new business growth. Product revenues include both software license and hardware sales.

Corporate revenue was \$291 million, up 21% year-over-year. This was another record revenue quarter for our corporate business.

Corporate highlights include: another strong quarter in our Mid-market business as Dave noted. In addition to Total Protection, sales of our new “flagship” suites introduced at the end of last year -- Total Protection for the Secure Business and Total Protection for the Endpoint "Essential" – are showing exceptional results.

We also signed the largest Data Protection deal in our history at more than \$3 million. We continue to see major competitive displacements in Data Protection across the world due to strength of our product offering, ease of deployment and our sales execution.

Solidcore Systems exceeded our expectations in the second quarter. What we’re seeing is strong demand for embedded security across all geographies driven by PCI compliance initiatives. The first phase of integration was completed ahead of schedule as Solidcore Systems was already a Strategic Innovation Alliance partner when we acquired them. This is another benefit to the SIA program that Dave talked about.

On the consumer side, revenue grew 13% year-over-year for the second quarter to \$177 million. This was another record revenue quarter for our consumer business and marked the 11th of 12 quarters of double-digit, year-over-year revenue growth. We continue to deliver above-market

results in the consumer space because of our diversified portfolio built on a SaaS model.

Reviewing the rest of the income statement, GAAP gross profit margin for the second quarter 2009 was 75.4%, compared with the first quarter 2009 of 74.7% and second quarter 2008 of 77.4%. Non-GAAP gross profit margin for the second quarter was 79.7%, compared with last quarter's 79.3% and a year-ago gross profit margin of 81.0%.

GAAP operating income for the second quarter was \$56 million - resulting in a GAAP operating margin for the period of 11.9%. The year-over-year decrease in GAAP operating margin percentage is driven primarily by acquisitions.

Operating income on a non-GAAP basis for the second quarter was \$125 million resulting in a non-GAAP operating margin of 26.7%. This was our highest operating margin in more than 3 years and we exceeded the second quarter non-GAAP operating margin guidance we provided in April. Excluding acquisitions, McAfee's core non-GAAP operating margin was even higher at 29.5%.

The sequential and year-over-year non-GAAP operating margin expansion was the result of our cost reduction and cost avoidance initiatives we outlined for you at the beginning of the year, related to discretionary cost controls, integration synergies related to Secure Computing; ongoing business process improvements and disciplined management of our headcount.

And, as I outlined earlier, we have ongoing infrastructure projects underway that are helping to drive further efficiencies as we continue to grow.

Total employee headcount at the end of the quarter was 5,778 employees, up 230 employees from the first quarter of 2009 reflecting approximately 100 employees from the Solidcore Systems acquisition which closed June 1st, and approximately 130 new McAfee employees primarily in our sales organization. As our second quarter results reflect, we are focused on balancing capacity requirements for future growth with the importance of continued margin improvements.

Continuing, GAAP other income for the quarter was a loss of \$800 thousand.

Non-GAAP other income was a loss of \$800 thousand, compared with \$3 million of other income in the first quarter 2009 and \$13 million of other income in the second quarter 2008. This decrease in other income reflected foreign currency losses, lost interest income associated with cash used for acquisitions and lower interest rates, as well as the interest expense from our \$100 million term loan drawn down early in January as part of a credit agreement entered into with a consortium of banks late in 2008.

For the quarter we had a GAAP tax rate of 48.0%. The higher GAAP tax rate this quarter is primarily due to an increase in the annual effective GAAP tax rate from Q1 to Q2 due to changes in the jurisdictional mix of income. On a non-GAAP basis, our tax rate continues to be 24%.

In the second quarter of 2009 we reported net income, on a GAAP basis, of \$29 million, or \$0.18 per share on a diluted basis.

Our second quarter net income, on a non-GAAP basis, was \$95 million. Non-GAAP earnings per diluted share was \$0.60, up 15% year-over-year.

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 second quarter 2009 was \$266 million, up more than 30% compared with \$202 million for the same period last year. Days sales outstanding were 51 days for the second quarter 2009, up 5 days compared to the year-ago period primarily due to the acquisition of Secure Computing in the fourth quarter of 2008 and a higher number of large transactions in the second quarter of 2009.

Deferred revenue at the end of the second quarter 2009 was \$1.31 billion, up 20% year-over-year. Currency fluctuations had a negative impact of approximately \$45 million year-over-year and a positive impact of approximately \$29 million sequentially on deferred revenue.

We ended the second quarter with \$1 billion in short-term deferred revenue, up \$22 million when compared with the first quarter 2009. Long-term deferred revenue was up \$16 million in the second quarter compared to the first quarter 2009, ending the quarter at \$306 million.

We did experience slightly higher discounting during the quarter as a result of our growth in larger customer sales.

The composition of our deferred revenue balance at the end of the second quarter of 2009 was 66% related to Corporate and 34% for Consumer. Please note that this slight shift in weighting towards corporate deferred revenue compared to the year-ago period is the result of the acquisition of Secure Computing which closed in the fourth quarter of 2008.

We ended the second quarter of 2009 with cash and marketable securities of \$886 million which included a payment of \$32 million related to the acquisition of Solidcore Systems, compared with \$801 million at the end of the first quarter of 2009.

In the second quarter 2009, we generated total GAAP operating cash flow of \$53 million which includes increased investments in working capital and \$20 million for a litigation settlement and tax payments for prior-year filings dating back to 1998, compared with \$80 million in the year-ago period. For the six month period ended June 30, 2009, operating cash flow was \$199 million, compared to \$151 million in the year-ago period, an increase of 32 percent year-over-year.

Our third quarter forecast and progress to-date for operating cash flow give us confidence in achieving our cash flow objectives. We currently expect cash flow from operations to be in-line with Wall Street analyst expectations for the third quarter which is currently slightly above \$100 million.

Secure Computing was neutral to our second quarter non-GAAP earnings per share results of \$0.60, slightly outperforming our expectations.

In the second quarter, we completed the unification of our price book; integration of our sales order operations functions and IT infrastructure. Looking forward, we will continue to drive leverage of the combined McAfee sales forces.

We continue to expect this acquisition to be neutral to slightly accretive to full-year 2009 non-GAAP results.

Now I would like to turn to guidance.

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 third quarter of 2009:

- We expect a revenue range of \$475 million to \$495 million.
- We expect a GAAP operating income margin of 12.0% to 14.0%.
- We expect an operating income margin, on a non-GAAP basis, of 24.0% to 26.0%.
- We expect a diluted share count in the range of 159 to 161 million shares.
- We assume an annual 28% GAAP tax rate and a non-GAAP tax rate of 24% for 2009.

Also, for the third quarter of 2009:

- We expect GAAP earnings per share of between \$0.25 and \$0.29 per share on a diluted basis.
- On a non-GAAP basis, we expect earnings per share in a range from \$0.58 to \$0.62 per share on a diluted basis.

Our expectations regarding MX Logic's contribution to our revenue for the remainder of the year post-closing is approximately \$8 to \$10 million.

Please note currently MX Logic's revenues are primarily from monthly subscriptions resulting in modest deferred revenue. Over time, MX Logic's business model will evolve to more closely reflect McAfee's model of longer-term contracts. We expect this acquisition to be slightly dilutive to third quarter and full-year 2009 non-GAAP results and neutral to slightly accretive to 2010 non-GAAP results.

Guidance for the third quarter of 2009 outlined this afternoon contains our current expectations regarding the impact of the acquisition of MX Logic.

On behalf of the Executive Management team we want to thank our employees for their commitment, sacrifices and performance during the second quarter because they are the ones who deliver McAfee's success. In addition, we would like to welcome the Solidcore team and soon the MX Logic team to McAfee and look forward to their contributions in making McAfee the market leader in security.

And now I would like to turn it back to Dave for closing comments.

Thank you, Rocky.

As Rocky indicated, second quarter 2009 was a strong quarter for McAfee. We had records set in most of the key metrics of our business.

We believe security will remain a top priority and we are focused on becoming the undisputed leader in digital security.

We intend to continue building market share through an approach that bundles market leading solutions into suites; integration through ePO; and creates trusted advisor status with McAfee's security only focus and world-class service and support team.

For the remainder of 2009 our focus is on execution:

- Our pipeline remains strong, with several large deals already closed in the third quarter.
- We remain on track with all of our acquisitions and expect to continue recognizing operational and sales synergies through the remainder of 2009; and
- We continue to prudently manage our cost structure, while investing where we see opportunity and being mindful of the environment.

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

Now, I will turn it back over to Brandie.

Thank you, Dave and Rocky. As the operator polls for questions, I would like to inform you that McAfee plans to attend the Pacific Crest Technology Forum on Tuesday, August 11th in Vail.

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