Symantec 3Q08 December 2007 Earnings Transcript
January 23, 2008

Helyn Corcos – Vice President, Investor Relations
Good afternoon and thank you for joining us. With me today are John Thompson, Chairman of the Board, and Chief Executive Officer of Symantec, Enrique Salem, Chief Operating Officer and James Beer, Executive Vice President and Chief Financial Officer.

In a moment, I will turn the call over to John. He will provide high level comments on our fiscal third quarter results, which ended December 28, 2007. Then Enrique will discuss more specific details of the quarterly results, then James will review the financial details and disucss our guidance as outlined in the press release. This will be followed by a question and answer session.

Today's call is being recorded and will be available for replay on Symantec's investor relations home page at www.symantec.com/invest. A copy of today's press release and supplemental financial information are available on our website and a copy of today's prepared comments will be available on the investor relations website shortly after the call is completed.

Before we begin, I would like to remind everyone that some of the information discussed on this call, including our projections regarding revenue, operating results, deferred revenue, cash flow from operations, amortization of acquisition-related intangibles and stock-based compensation, for the coming quarter contain forward-looking statements. These statements involve risks and uncertainties that may cause actual results to differ materially from those set forth in the statements. Additional information concerning these risks and uncertainties can be found in the company's most recent periodic reports filed with the U.S. Securities and Exchange Commission. Symantec assumes no obligation to update any forward-looking statements.

In addition to reporting financial results in accordance with generally accepted accounting principles, or GAAP, Symantec reports non-GAAP financial results. Investors are encouraged to review the reconciliation of these non-GAAP financial measures to the most directly comparable GAAP results, which can be found in the press release and on our web site.

And now, I would like to introduce our CEO, Mr. John Thompson.

John Thompson – Chairman and Chief Executive Officer
I am very pleased with the strength of our business and with the solid execution of our team during the December quarter. Strong sales performance in EMEA and APJ, coupled with continuing improvements in the Americas operation drove the over performance for our company. In addition, there were a number of key product areas that delivered strong double digit growth including email archiving, messaging, compliance and our windows-based backup solution.

While we can’t forecast the future economic environment, we have confidence in the strength of our portfolio. Security and storage management solutions continue to be top spending priorities for our customers. Furthermore, based on customer surveys, key purchase areas for the coming year also include solutions that address regulatory compliance, virtualization, and enterprise message management including archiving and data loss prevention. We are very well-positioned to capitalize on these growth trends.

The near-term catalysts that should drive attractive growth prospects for Symantec include the continuation of the market momentum we’ve established with core products, like Backup Exec, Enterprise Vault and Symantec Endpoint Protection. Furthermore, our broad international exposure and our strength in key buyer segments, like SME, should prove to be important for us as well. I’m confident our business is building momentum as we move into our fiscal fourth quarter.

Symantec has long focused on relevant IT trends in order to drive sustainable growth. These trends include optimizing existing infrastructure and lowering costs for enterprise customers. In addition, the evolving threat landscape compounds the growing problem of complexity and risk. The recent information security breaches in the UK and here in the US point to failures in the development and implementation of appropriate security policies. These incidents validate our view that a security strategy must be policy driven, information centric and “operationalized” across a well managed infrastructure.

Our customers face an enormous challenge in integrating all of the components they must acquire to ensure they are appropriately managing their information assets. Our board portfolio of products and services, coupled with a clear strategy for product integration, should make this task much easier for them, particularly those in the mid-market. For example, the tighter integration of Altiris with backup and systems recovery functions, as well as with Symantec Endpoint Protection should make the process of securing and managing their information much easier and provide real market differentiation for us.

As I mentioned last quarter, we’ve started an active review of our product portfolio to ensure many of the investments made over the years are meeting both our customer’s needs and our own financial expectations. As a result, last week we announced an agreement to divest our Application Performance Management business. We determined that our customers would be better served by creating a stand alone company dedicated to providing the investment required to develop innovative products. We will continue to support our customers for a period of time as they transition to the new company and it’s support operation.

Through this product portfolio analysis process, we expect to eliminate or harvest lower growth businesses or products with lower operating returns than we think are appropriate for our company. As a natural by-product of this process, many of the higher growth areas we’ve been investing in will become much more visible to investors. We expect this process to be on-going and is squarely focused on driving growth and stronger operating returns.

During the December quarter, we closed the Vontu acquisition. Vontu has maintained its competitiveness and market momentum across a broad range of industries including, retail, healthcare, energy and utilities, and had record bookings for the quarter. Vontu expands our presence in the rapidly growing data loss prevention market with clear market leadership functionality.

In December, the Vontu team released Data Loss Prevention 8, the industry's first integrated solution that combines endpoint and network-based technology to prevent the loss of confidential data wherever it is used or stored. And earlier this month, InfoWorld recognized them as the “Best DLP Solution” for the third straight year.

Going forward we see excellent opportunities to broaden the distribution of the Vontu products, particularly in the international markets, and to integrate it with several of our key products including Symantec Endpoint Protection, our mail security appliances, Enterprise Vault, and our storage products -- further differentiating Symantec from the competition.

The early synergies in both product development and sales from Altiris and Vontu have been encouraging as they help to underpin new growth initiatives for our company. It’s my belief that these types of acquisitions should add new top-line growth for Symantec and help improve our operating returns.

I would expect us to continue to look for acquisitions that drive revenue growth and/or enhance our net income. In addition, just like Altiris and Vontu, they will add highly focused teams with great technology and strong customer relationships.

Just a few weeks ago, we announced a number of important organizational changes with an eye toward optimizing our diverse portfolio of products and services and ensuring we get better leverage from the investments we’re making in people and technology across our company.

Specifically, we created a new role of Chief Strategy Officer, which integrates the corporate strategy and M&A functions under one leader in order to bring a heightened level of focus on our overall product portfolio and our growth prospects. This new team will focus on ensuring the overall company is investing and managing the business for sustainable growth and profitability. It places greater emphasis on optimizing the company and not a particular business unit or product area.

In addition, the Chief Strategy Officer will lead the charge for our investments in emerging growth areas, like the creation of the Symantec Protection Network, which will serve as the basis for our software-as-a-service platform. The strategy team will play a vital role in our ability to identify and invest in new business models and go-to-market strategies.

Secondly, we announced the appointment of a Chief Operating Officer to help drive operational consistency across the company and deliver more predictable results. While this isn't a new role for Symantec, I felt the diversity of our portfolio and breath of our global business operations warranted that we revisit an operating model that had proven to be very successful for us in the past. Moreover, we should be able to achieve greater leverage from our broad portfolio of technology and services, while ensuring our field sales and services teams are ready to execute on current and new product initiatives.

With that, I'll turn the call over to our new Chief Operating Officer, Enrique Salem, who will provide more detail on the December quarter highlights.

Enrique Salem -- Chief Operating Officer
Thanks, John.

First of all, I want to say how excited I am to be given this opportunity.
My focus will be to drive consistency across the company and improve our ability to deliver top line growth. I'm highly confident we can maximize our potential and provide the best solutions and value to our customers.

As you know, we've made significant changes to the enterprise sales organization and I'm pleased to report that these changes helped lead us to greater operational improvements in the quarter. During fiscal 2008, the sales compensation model was modified to emphasize new license sales with our specialists teams. We are pleased with the results to date as I believe that our new license sales have seen a benefit from this change.

Our current geography leaders have done a tremendous job with their respective sales organizations leading to improved sales execution. Our EMEA team posted double digit growth with all sub regions performing solidly. We are particularly impressed with the EMEA team's ability to increase the number of big deal transactions by 100% over last year. In APJ, the leadership change has gone smoothly as the region continued to post strong numbers. And importantly, sales execution in the Americas continues to show solid progress.

The new competitive functionality in our core products, coupled with improved quality, gives me confidence about our growth prospects. Looking ahead, I believe we have built a strong pipeline going into our fiscal fourth quarter.

Now, I'd like to discuss a few of the highlights from the December quarter.

While still early in the customer adoption cycle, Symantec Endpoint Protection 11 has gotten off to a solid start. This product has already received some of the best evaluations and reviews from the industry.

Information Security magazine tested eight endpoint security solutions from all the major security vendors and ranked Symantec the best overall for our manageability and component integration. Our nearest competitor received the lowest grade in the manageability category, the single most important category for enterprise customers. In a separate review, PC Magazine calls SEP 11 "the most comprehensive centrally managed endpoint security solution for businesses" and gave it the coveted Editor's Choice award.

The Symantec Network Access Control component of SEP 11, also known as SNAC, is testing well. In an assessment by Network World, Symantec ranked number one as the best-all-around, all-in-one NAC product in a test of 13 products from companies like Cisco, Juniper, Check Point, and McAfee among many others.

More importantly, customers are seeing the value in SEP 11 and SNAC and are rapidly adopting the new products. During the December quarter, we shipped 23 million seats of SEP. In addition to implementing upgrades to current customers, we also garnered several major new customer wins that included many competitive displacements.

NetBackup 6.5 also got off to a solid start and was part of many of our largest multi-product deals during the quarter. Data center administrators are increasingly moving from tape to disk based backup. NetBackup 6.5 features new disk based backup capabilities, which are focused on delivering leading integration of backup appliances and delivering native SAN disk backup and de-duplication features. These options allow users to take full advantage of the power of disk-based data protection. Customers also like NetBackup's ability to back up VMWare environments. NetBackup 6.5 won the best in show VMWorld Gold Award in September.

One of our strongest revenue growth products is Backup Exec, the market's leading window-based data and system recovery solution. The 11d version of Backup Exec, which was released a little over a year ago, has been a tremendous success for both Symantec and our channel partners. We have found that small and medium sized businesses are embracing the product's robust management capabilities. We're looking forward to building on that momentum with the release of Backup Exec 12 in the March quarter.

Worldwide demand is also unprecedented for Enterprise Vault, the leading email archiving and retrieval product. Enterprise Vault has been in the leadership category of Gartner's Magic Quadrant for the past several years and is currently the ONLY product in the leadership category. We believe Enterprise Vault has become the de facto solution for addressing the ever increasing regulations around e-discovery.

The Altiris business experienced strong new license growth and robust sequential growth as customers are embracing the convergence of security and systems management at the endpoint. These results include the SME benefits received from the channel alignment and mapping work that has been done for some time now. For large enterprise accounts, we are particularly pleased with the traction Altiris is getting with sales force cross training, particularly in the international markets as Altiris continues to leverage Symantec's broad global reach.

Over the past three quarters, we've made significant strides in integrating Altiris technologies into some of our key products. The Altiris architecture has allowed for relatively easy integration into products such as Symantec Endpoint Protection 11.0 and Back-up Exec System Recovery. This rapid progress has redefined the benchmark for all of our engineering teams with regards to new technology integration.

Currently, we're focused on further extending Altiris' web services model to tie all the technologies together via the Altiris framework. Additional integration opportunities exist, which would enhance the Altiris offering ability to push patches and link to a vulnerability database.

And finally, we are well positioned as companies migrate to Vista and are excited about the sales opportunities Altiris solutions can bring to us during this process.

On the consumer side of the business, we are maintaining our category leadership by bringing the most innovative products to the market targeted at various consumer segments.

Norton Internet Security works well for the Wired segment who are more used to assembling their own PC solutions and are often the folks who own NIS together with Norton SystemWorks or another one of our point products.

The introduction of Norton 360 allowed us to focus on an underserved segment we call Digital families. Many of these customers already own an Internet solution, but want it to be easier to use and demanded that it provide an all-in-one protection service. Norton 360 delivered and has ramped to over 25% of our new consumer sales, representing our most successful consumer product launch to date.

The explosive adoption rates of Norton 360 validates our consumer strategy, underscores the market's demand for a more targeted product portfolio and affirms consumers willingness to pay a premium price for the best solution.

We expect to launch the 2.0 version of Norton 360 by the end of March. The new product includes browser protection, Norton Identity Safe, which secures your passwords, and Symantec's advanced anti-phishing technology, which extends our WholeSecurity capability to offer protection against online fraud. The new version will also provide more options for backup destinations, including Blu-ray, iPods and shared drives. It's clear to me that the most advanced PC security tool on the market is about to take another big step ahead of the competitors.

And with that, I'll hand it over to James to provide the financial details of the quarter.

James Beer -- Chief Financial Officer
Thank you Enrique, and good afternoon everyone.

I am pleased to report that our December quarter results performed better than expected on each of our four primary financial metrics: revenue, deferred revenue, earnings per share and cash flow from operations.

Now, I'll review the financial details of the December quarter.

GAAP revenue was $1.52 billion. Non-GAAP revenue grew 15% versus the December 2006 period to $1.53 billion.

Foreign currency movements positively impacted non-GAAP revenue by 5 percentage points year-over-year, and by 2 percentage points sequentially.

The December quarter's diluted GAAP earnings per share were 15¢. Non-GAAP diluted earnings per share grew 27% to 33¢ as compared to December 2006.

International non-GAAP revenue for the December quarter grew 21% to $812 million versus the year ago period, and represented a record 53% of total non-GAAP revenue. The Europe/Middle East/Africa region grew 26% and Asia Pacific, including Japan grew 19%. Foreign currency movements benefited EMEA revenue by 13 percentage points and APJ revenue by approximately 8 percentage points year-over-year. The Americas grew 8% year-over-year.

Now, I'd like to move to the December quarter's non-GAAP revenue by segment.

Consumer revenue generated $440 million up 8% versus the December 2006 quarter. Norton Internet Security revenue grew 8% and remains the single largest product contributor to our consumer category - - generating approximately 59% of consumer revenue. As Enrique mentioned, Norton 360 now accounts for over 25% of consumer sales activity and is serving to protect and grow our premium market position. The rich feature set of Norton 360 brings with it a higher average selling price, which has allowed us to generate growth despite the continuing decline in the retail channel, which now accounts for only 25% of our consumer revenue.

Moving now to the enterprise. In the December quarter, we generated a record number of large deals. We booked a total of 554 transactions valued at more than $300,000 each, an increase of 35% as compared to 409 deals in the December 2006 quarter. We also recorded, 127 deals worth more than $1 million each as compared to 115 in the December 2006 quarter. Almost 80% of large transactions included multiple products or services.

Our Security and Data Management revenue of $448 million grew 9% over the December 2006 quarter. Backup Exec continued to build momentum, posting revenue growth of over 30% compared to the year ago period and generating solid sequential growth for the fourth consecutive quarter. Enterprise Vault and our compliance products grew at mid-to-high teens rates year-over-year.

The Data Center Management group produced revenue of $444 million and grew 11% from the year ago period. Storage and Server Foundation generated record results growing revenue at mid-teens rates year-over-year and sequentially. The results were driven by our customers' desire to simplify their data center infrastructures. Our customized ROI tool clearly demonstrates how our solutions can improve the operational performance of data centers, as well as drive dramatic direct cost savings. The cost reduction benefits of our simplification and standardization themes continue to resonate with data center customers. In addition, our foundation solutions provide high availability as well as storage and server optimization across all major virtual machine platforms.

The Altiris business unit posted non-GAAP revenue of $100 million. Standalone Altiris solutions generated record non-GAAP revenue of $65 million. Altiris' non-GAAP revenue includes the impact of $9 million worth of deferred revenue lost on a GAAP basis as a result of the purchase accounting method related to the acquisition. Also, our legacy Symantec products, Ghost and pcAnywhere, performed better than expected during the quarter.

Our Services group posted strong top line performance increasing revenue to $96 million. We are pleased with the services team's ability to generate value by increasing both customer satisfaction and our ability to sell, deliver and implement more software. Strong year-over-year growth of 40% was assisted somewhat by one-time administrative challenges that occurred during the December 2006 quarter.

Non-GAAP gross margin increased to 86.2% for the December 2007 quarter as compared to 83.2% for the year ago period, driven by lower costs resulting from our reduction in force actions, in addition to the movement of the majority of our consumer OEM fees from the cost of goods sold line to operating expenses. This is the third consecutive quarter of sequential gross margin improvement, reaffirming that our cost controls are making an impact.

Improved revenue and cost efficiency actions have increased operating margins for the quarter to 27.4%, up 170 basis points year-over-year and up 220 basis points sequentially. Non-GAAP operating expenses for the quarter were approximately $900 million. Operating expenses declined by about 1% year-over-year, after adjusting for the impact of acquisitions, exchange rates and the addition of consumer OEM fees to the operating expense line. We expect operating expenses excluding acquisitions, exchange rates and consumer OEM fees in the March quarter to decline by approximately 2% year-over-year. While we are encouraged by the progress we've made on costs, we expect consumer OEM fees to increase going forward driven by PC shipments.

We are on course to drive cost benefits of approximately $350 million versus our original goal of $200 million in FY08. Our cost improvement initiatives are targeting areas across the business, but we have been diligent to insure that these reductions don't impede our ability to bring high quality products to market or hurt our ability to meet customer service levels. The value of these initiatives is building as the year is progressing, placing us in a stronger expense position as we exit the fiscal year. We will continue to focus on our cost structure going forward, while simultaneously working to identify new opportunities for revenue growth.

GAAP net income was $132 million for the December 2007 quarter. Non-GAAP net income equaled $292 million, up 16% versus the December 2006 quarter and up 11% sequentially.

Symantec exited December with a cash and short-term investments balance of approximately $2 billion. We have continued to return excess cash flow to our shareholders. As such, during the quarter, we repurchased $400 million of our outstanding shares, or 22.7 million shares at an average price of $17.60.

Our net accounts receivable balance at the end of the December 2007 quarter was $902 million. Days-Sales-Outstanding, or DSOs, was 54 days compared to 51 days in December 2006. DSOs typically peak above 50 in December quarters due to renewals activity concentrated towards calendar year end.

Cash flow from operating activities for the December 2007 quarter totaled $462 million. This figure was higher than forecast due to better than expected sales activity.

GAAP deferred revenue at the end of the December 2007 quarter was $2.88 billion. Non-GAAP deferred revenue at the end of the quarter was approximately $2.9 billion, up 12% as compared to the December 2006 quarter and up 10% sequentially. Foreign currency movements benefited deferred revenue by 5 percentage points year-over-year, and by two percentage points sequentially.

Now, I'd like to spend a few minutes discussing our guidance for the March quarter. Two quarters of improved sales execution coupled with four consecutive quarters of improved revenue yield leads us to be more positive on our view of the fourth quarter.

Taking into account the macro economic environment and an exchange rate of $1.45 per EURO, our forecast for the March quarter is as follows.

GAAP revenue is estimated to be between $1.5 and $1.54 billion. Non-GAAP revenue is estimated to be between $1.51 and 1.55 billion.

We expect to recognize Vontu revenue ratably over the next few quarters until we have established VSOE. As such, we expect revenue from Vontu sales to be a relatively minor contributor to total revenue during this time.

GAAP earnings per share are forecasted between 16¢ and 18¢. Non-GAAP earnings per share are estimated between 33¢ and 35¢. This includes two cents of dilution related to the acquisition of Vontu as we discussed last quarter.

During the March quarter, we expect almost $910 million of our non-GAAP deferred revenue balance to convert into recognized revenue. This is 18% higher than the year ago figure. Going forward, we expect deferred revenue growth to stabilize and be more aligned with revenue growth rates.

GAAP deferred revenue at the end of the March quarter is estimated to be between $2.94 and $3.04 billion. We expect non-GAAP deferred revenue to be in the range of $2.95 to $3.05 billion.

We are raising our guidance for fiscal year 2008 based on improving operational performance as follows.

GAAP revenue is estimated to be between $5.835 and $5.875 billion. Non-GAAP revenue is estimated to be between $5.9 and 5.94 billion. At the midpoint, this is $220 million greater than the guidance initially provided.

GAAP earnings per share are forecasted between 46¢ and 48¢. Non-GAAP earnings per share are estimated between $1.24 and $1.26. At the midpoint, this is 13¢ above our initial guidance.

We expect cash flow from operations for the fiscal year to be greater than the $1.67 billion reported in fiscal year 2007, in line with our original guidance.

And with that, I'll turn the call back over to John for some closing remarks.

John Thompson – Chairman and Chief Executive Officer
Thanks James.

So, in conclusion, we are quite pleased with how we executed during the December quarter. We remain enthusiastic about the prospects for our recently launched core products such as Symantec Endpoint Protection 11 and NetBackup 6.5. And, we are encouraged by the worldwide demand for our solutions as evidenced by the strong pipeline we are seeing going into our fiscal year end.

We have implemented several initiatives to drive our top line results. At the same time we’ve also focused on the cost side of the equation and will continue to look for ways to make our business even more profitable.

While we will continue to keep a watchful eye on the macro economic conditions around the world, we are optimistic that our near-term prospects remain strong.

Overall, I’m confident in our ability to deliver solid growth and improving profitability into the next quarter and fiscal 2009.

With that, I’ll turn it back to Helyn to see if we can take some of your questions.