Symantec 2Q08 September 2007 Earnings Transcript
October 24, 2007

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 and James Beer, Executive Vice President and Chief Financial Officer.

In a moment, I will turn the call over to John. He will provide highlights of our fiscal second quarter results, which ended September 28, 2007. Then James will provide financial details and review 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

Thanks, Helyn.

Our team's performance during the fiscal second quarter demonstrated solid execution against our four key financial metrics – revenue, earnings per share, deferred revenue and operating cash flow.

As we continue our focus on improving the operational efficiencies of our company, we continue to see higher in-period revenue contributions from key product innovations. These efforts have the obvious off set in deferred revenue as we recognize a greater portion of revenue in the period. In addition, last year's shift in our business model drove a greater portion of our sales activity to the balance sheet as deferred revenue. Therefore, this year we are able to recognize an increasing amount of revenue off the balance sheet.

Performance for the September quarter was driven by two factors. We experienced strong demand for our emerging enterprise technologies, specifically endpoint management, our compliance solutions and Enterprise Vault. And, some of our core products such as Backup Exec and consumer protection, produced strong results.

While our first half performance has been solid, exceeding our operating plan in both quarters for revenue, EPS, and cash flow from operations, we have not met our planned new business targets. As you may recall, our North America operations experienced weak new business generation in the June quarter. And, while we saw solid sequential improvements in the Americas, we remain cautious about the business outlook. This, coupled with the uncertain economic environment, causes us to take a more conservative view of the December quarter and the remainder of the fiscal year.

We continue to optimize our sales leadership team around the globe to improve execution. In addition, we are taking several actions to drive new business growth during the second half of the year. First, we have initiated new sales incentives in North America to create more excitement within the sales force. Second, we continue to make operational improvements to make doing business with Symantec much easier for our customers and more productive for our team. And, third, we are focusing our hiring efforts within the sales operation on the faster growing emerging markets such as Asia Pacific, the Middle East and Eastern Europe.

In addition to these initiatives, we will continue our strong focus on controlling our costs with specific targets for each operating unit for the second half of our fiscal year.

Earlier this year, we started an active review of our product portfolio to ensure many of the investments made over the years are meeting our return expectations. During the September quarter, we identified some non-strategic assets in the Data Center Management group that have not met those expectations. As a result, we are taking an $87 million write-down of some assets in the Data Center Management group acquired by Veritas during the 2003 and 2004 timeframe. Going forward, we will continue to evaluate our portfolio to ensure that we focus our investment efforts on a few key strategic areas that drive long-term revenue growth.

Now, I’d like to highlight a few items from the quarter:

One of the largest growth drivers over the next twelve months will be the two major product upgrade cycles that we are just beginning in the areas of enterprise protection and enterprise back-up.

We are encouraged by the prospects for Symantec Endpoint Protection 11.0. This is the first truly integrated, single agent endpoint security product that incorporates a strong compliance function. We garnered several early customer wins during the September quarter. One large multi-million dollar displacement occurred with a European power company that has over 100,000 laptops and desktops, in addition to thousands of servers. Symantec's Network Access Control feature will be deployed on tens of thousands of laptops where we will displace McAfee in the account. This customer valued our multi-layer solution with a centralized management console managing all components including a strong personal firewall.

We also generated solid interest for NetBackup 6.5, a single solution for centralized, end-to-end management of heterogeneous data protection environments. Other special features that customers particularly like are data de-duplication and continuous disk-based backup. During the quarter, we closed a multi-million dollar deal that replaces Legato at a large financial media company. The customer favored NetBackup's increased functionality and reliability.

In addition to the strength of these two products, we are pleased with how Altiris is leveraging Symantec's international presence to further expand its business. One of the largest Altiris transactions during the quarter came from an international food and agriculture company. And, we also signed a significant transaction with an important US government agency. While several of our large Altiris deals slipped into the December period, the team has been successful in up-selling additional products to existing customers.

At the Altiris Managed Fusion conference last month, we demonstrated the integration of Altiris 7.0 client management suite with Backup Exec Systems Recovery. This solution offers our customers a more complete management solution for their distributed desktop environment and leverages the strengths of both companies. The Altiris technology is also playing a key role in migrating our enterprise antivirus customers to Symantec Endpoint Protection 11.0.

On the consumer front, we delivered new versions of our market leading security products. We continue to be pleased with the uptake of Norton 360. And, Norton Internet Security 2008 has a set of new features including stronger protection against web-based attacks, as well as password and identity management tools. PC Magazine recently awarded NIS the Editor's Choice award again this year which represents the sixth win over the last seven years.

Looking at the business from a broader perspective, we believe long-term growth for our company will be driven by our customers' desire to address the growing cost and complexity challenges associated with managing and securing their systems environments. In doing so, we can also help them meet the added challenge of ensuring compliance within the overall IT infrastructure.

Specifically, we think we are well positioned to address two high growth areas that customers are prioritizing in the coming 12 -24 months. These include systems and application virtualization and data loss prevention.

As some have noted, virtualization may be the biggest disruptor of data center technologies over the next few years. Server virtualization is being adopted rapidly by large enterprises to drive higher utilization rates and reduce hardware costs.

It's clear to us that virtualization also brings a big opportunity to Symantec. As customers start to deploy virtualization technologies in their production and mission-critical environments, complexity will rise as they work to manage both the physical and virtual environments delivered from many different vendors. This in turn will create a greater need for sophisticated device and application management tools, as well as strong data-protection tools.

Symantec is directly addressing the growing challenges of managing today's complex data centers by providing a single platform that can reduce downtime and improve manageability across heterogeneous physical and virtual environments. A single platform to secure, manage and provide business continuity, regardless of architecture, makes it easier for our customers to select and change hardware and platform vendors.

We are committed to ensuring interoperability with every major operating system, virtual machine, and storage device. No other company can match our breadth and depth of platform support.

One example of this is NetBackup 6.5. Our enterprise data protection solution not only protects physical platforms, but also delivers the most comprehensive protection for VMware environments, providing an industry first by enabling granular file-level and image level-recovery from a single backup. NetBackup 6.5 was also presented with the Best of Show Gold Award for Data Protection and Security at the VMworld conference.

Outside of data center, software virtualization is gaining traction as IT departments move to reduce the costs associated with patching, upgrading and maintaining a host of applications. Many customers want greater flexibility in deploying applications in an "on-demand" environment.

Our award winning Altiris Software Virtualization Solution provides a unique desktop approach that decouples software from the OS to simplify the deployment and management of applications running on virtual machines. Altiris Software Virtualization Solution allows users to instantly activate, deactivate or reset applications and to completely avoid conflicts between applications, without altering the base Windows platform. InfoWorld calls our Software Virtualization Solution a "paradigm-shifting technology that fundamentally alters your perception of what is possible with IT."

One of our large transactions last quarter was an Altiris SVS deal. This large European financial institution chose Altiris for its focus on complete desktop lifecycle management. Our Software Virtualization Solution helped them reduce costs by reducing application conflicts and speeding up application deployment.

In addition to our own product efforts, Symantec is also actively partnering with both VMware and XenSource to offer a host of solutions to improve the manageability, functionality, and performance of their virtual machine environments. We have also partnered with Intel to deliver new security and management solutions designed to work on Intel's vPro platform.

Another area of growing interest for our customers is Data Loss Prevention or DLP. There has been some recent speculation about our intentions in this space. Suffice it to say, it's an important area for our customers and we have a very strong sense of how the technology solutions will evolve in this area. We believe that true DLP solutions require the layering of technologies in a similar manner as malicious code detection has evolved. No single technology addresses all of the requirements of a true DLP solution.

The reason this market is growing so rapidly is because nearly all corporate information exists in electronic form. Additionally, companies are opening up their infrastructure to enable new collaboration, providing employees, partners and customers with more access to more information.

At the same time, threats are proliferating from both external and internal sources making information not just a critical asset but also a potential liability. We believe a more policy driven and information centric approach to security is essential in today's information intensive environment.

Data loss prevention solutions help organizations control the flow of sensitive information, whether that information is in-motion on the network, in-use at the device endpoint or at-rest within an organization's IT infrastructure.

Over the past several years we have been adding complementary DLP technologies to our compliance, messaging security and archiving products through a number of important acquisitions.

We also continue to develop our own technology with our recent introduction of new or upgraded products that assist with data loss prevention. For instance, the integrated application and device control capabilities within Symantec Endpoint Protection 11.0 can help prevent data loss by enforcing policies and controls around the use of certain applications and disabling the use of USB ports.

And our newest version of Symantec Database Security, which was announced earlier this week, helps companies reduce the risk of losing sensitive information from backend databases by providing greater control over database traffic and insight into suspicious activity.

So, in conclusion, September was a solid quarter. And, while our over performance on revenue and EPS in the first half of the fiscal year could easily lead one to be very bullish for the remainder of the year, our lighter than expected new business generation and an uncertain economic environment leads us to be cautiously optimistic. We are encouraged by the much improved execution of our team in the September quarter. But, we know we have much more work to do. We are excited about our recent product launches and are focusing our marketing efforts on demand creation. Overall, we believe that we are strengthening our position with both our enterprise and our consumer customers.

And with that, I'd like to hand the call to James.

James Beer -- Chief Financial Officer

Thank you John, and good afternoon everyone.

I am pleased to report that our September quarter results delivered on each of our four primary financial metrics. As we outlined at our analyst day in June, we measure the strength of our business by looking at the combined results of revenue, deferred revenue, earnings per share and operating cash flow.

As we've previously discussed, last year's shift in our business model drove a greater portion of our sales activity to the balance sheet as deferred revenue. This year, therefore, we are able to recognize an increasing amount of revenue off the balance sheet.

In addition, our continued focus on operational execution has contributed to us being able to recognize a greater portion of our sales activity as revenue in the period.

It is also important to note that while our sales activity for the business remains seasonal, we are now seeing that the business model shift coupled with the focus on operational execution is having the effect of somewhat smoothing out our revenue and earnings performance. This has resulted in our revenue and earnings for the first half of the fiscal year accounting for approximately 50% of our full year forecast, as opposed to the traditional split of 45% versus 55% for the front versus back half of the year.

Going forward, seasonality will continue to generate fluctuations in our deferred revenue and cash flow metrics, with cash flow being the most volatile in any given quarter.

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

GAAP revenue was $1.42 billion. Non-GAAP revenue grew 13% versus the September 2006 period to $1.44 billion. The revenue acquired from Altiris accounted for 4.4 points of our year-over-year growth.

Foreign currency movements positively impacted non-GAAP revenue by $41 million in the September 2007 quarter as compared to September 2006. Sequentially, foreign currency movements had approximately an $11 million positive impact on revenue. Holding currency constant, revenue grew 10% year-over-year.

The September quarter's diluted GAAP earnings per share were 6¢, which includes a write-down of $87 million related to our revaluation of some non-strategic data center management assets, as part of our ongoing review of our product portfolio.

Non-GAAP diluted earnings per share grew 11% to 29¢ as compared to September 2006.

International non-GAAP revenue for the September quarter grew 15% to $730 million versus the year ago period, and represented 51% of total non-GAAP revenue. The Europe/Middle East/Africa region grew 20% and Asia Pacific, including Japan grew 9%. The Americas grew 10% year-over-year.

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

Consumer revenue generated $434 million up 10% versus the September 2006 quarter. Electronic distribution channels reached a new high during the quarter representing 72% of consumer revenue and grew 16% versus the September 2006 quarter. Norton Internet Security revenue grew 21% and remains the single largest product contributor to our consumer category - - generating approximately 61% of consumer revenue. We also continue to be pleased with the reception that Norton 360 is receiving in the marketplace.

Moving now to our enterprise segments. In the September quarter, including Altiris' sales, we generated a total of 302 transactions valued at more than $300,000 each as compared to 292 in the September 2006 quarter. We also recorded, 64 deals worth more than $1 million each as compared to 67 in the September 2006 quarter. 75% of large transactions included multiple products or services which under scores both the success of our solution selling approach and the reality that as CIO's try to lower their costs and minimize complexity, we are well positioned to meet their needs with a broad portfolio of products and services.

Our Security and Data Management revenue of $423 million grew by 7% over the September 2006 quarter. Within this business unit, Backup Exec continued to build momentum, posting double digit revenue growth for the third consecutive quarter. In addition, compliance, one of our emerging growth areas, continues to garner strong year-over-year growth rates. As expected, however, our corporate desktop security product slowed ahead of our Symantec Endpoint Protection 11.0 launch.

The Data Center Management group produced revenue of $402 million and grew 7% from the year ago period. NetBackup and Storage Foundation also grew revenue at double digit rates.

The Altiris business unit generated non-GAAP revenue of $92 million. We continue to be pleased with the performance of the products we acquired from Altiris which contributed $56 million in non-GAAP revenue during the quarter. Altiris' non-GAAP revenue includes the impact of $13.5 million worth of deferred revenue lost on a GAAP basis, as a result of the purchase accounting method related to the acquisition of Altiris.

Our Services group once again posted strong top line performance increasing revenue to $86 million up 30% versus the September 2006 quarter. Services represented 6% of our total revenue during the September 2007 quarter. Importantly, we believe that the participation of our services group in our solution selling process is leading to higher levels of customer satisfaction. Going forward, the services group will focus more on its profitability, while continuing to generate value by increasing both customer satisfaction and our ability to sell, deliver and implement more software.

Non-GAAP gross margin increased to 85.3% for the September 2007 quarter compared to 83.5% for the year ago period, driven by the movement of consumer OEM fees from the cost of goods sold line to operating expenses, as we discussed on our May conference call.

Non-GAAP operating expenses of $865 million for the September 2007 quarter were up 20% year-over-year. Expenses grew primarily due to three factors. Altiris added $37 million, foreign exchange movements added $26 million and the OEM issue I just mentioned added $56 million to our operating expense base. However, we were able to offset a portion of this expense growth as a result of our cost reduction activities which continue to run ahead of plan. Thus, operating expenses grew 3.5% year-over-year, after adjusting for Altiris, exchange rates and OEM fees.

GAAP net income was $50 million for the September 2007 quarter. Non-GAAP net income equaled $263 million, flat versus the September 2006 quarter.

Symantec exited September with a cash and short-term investments balance of $2 billion. We remain committed to returning excess cashflow to our shareholders. As such, during the quarter, we repurchased $400 million of our outstanding shares, or 21.6 million shares at an average price of $18.51.

Our net accounts receivable balance at the end of the September 2007 quarter was $602 million. Days-sales-outstanding, or DSO, was 38 days, in line with normal seasonal patterns.

Cash flow from operating activities for the September 2007 quarter totaled $331 million. This figure was higher than previously projected due to unexpected foreign tax refunds and our continued focus on cost reduction activities.

GAAP deferred revenue at the end of the September 2007 quarter was approximately $2.6 billion. Non-GAAP deferred revenue at the end of the quarter was approximately $2.62 billion, up 12% as compared to the September 2006 quarter. Foreign exchange rates positively benefited deferred revenue by approximately $115 million versus the September 2006 quarter.

Now, I'd like to spend a few minutes discussing our guidance for the December quarter.

Taking into account the currently somewhat uncertain business environment and an exchange rate of $1.37 per EURO, our forecast for the December quarter is as follows.

GAAP revenue is estimated to be between $1.41 and $1.45 billion. Non-GAAP revenue is estimated to be between $1.425 and 1.465 billion.

GAAP earnings per share are forecasted between 6¢ and 11¢. Non-GAAP earnings per share are estimated between 25¢ and 30¢.

As I mentioned in my opening comments, we expect our revenue and earnings results during the second half of the fiscal year to be similar to our revenue and earnings results during the first half.

During the December quarter, we expect about $900 million of our non-GAAP deferred revenue balance to convert into recognized revenue. This is 16% higher than the year ago figure as we are now seeing the benefits in the Profit and Loss Statement of the model shift that last year placed more of our sales activity on the balance sheet. 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 December quarter is estimated to be between $2.635 and $2.785 billion. We expect non-GAAP deferred revenue to be in the range of $2.65 to $2.8 billion.

The December 2007 quarter operating cash flow is expected to be below the $454 million we recorded in the December 2006 quarter. The lower cash flow estimate is being driven by lower than expected business activity in the first half of the fiscal year and higher consumer OEM fees. As noted earlier, I should emphasize that quarterly operating cash flow is the most volatile of our four primary financial metrics.

And with that, I'll turn the call back over to Helyn so that we can take some of your questions.

Helyn Corcos – Vice President, Investor Relations
Thanks. Operator will you please begin polling for questions.

While the operator is polling for questions, I'd like to announce that Symantec plans to attend the Goldman Sachs conference on November 7th, the UBS conference on November 13th, the Lehman conference on December 6th, and the CIBC virtualization conference on December 11th.

In addition, we will be reporting our fiscal third quarter results on January 23rd.

For a complete list of investor related events, please visit our events calendar on the investor relations website. Operator, we are ready for the first question.