Symantec 3Q FY2019 Prepared Remarks

Good afternoon. I am Cynthia Hiponia, Vice President of Investor Relations at Symantec and I am pleased to welcome you to our call to discuss our third quarter fiscal year 2019 earnings results. We've posted the earnings materials and prepared remarks to our investor relations events webpage. Speakers on today's call are Greg Clark, Symantec's President and CEO, and Nick Noviello, Executive Vice President and CFO. This call will be available for replay via webcast on our website.

I'd like to remind everyone that all references to financial metrics are non-GAAP, unless otherwise stated. Please refer to the supplemental tables posted on the Investor Relations website for further definitions of our non-GAAP metrics.

Please note, non-GAAP financial measures referenced during this call are reconciled to their comparable GAAP financial measures in the press release and supplemental materials posted on our website. We believe our presentation of non-GAAP financial measures, when taken together with corresponding GAAP financial measures, provides meaningful supplemental information regarding our operating performance for reasons discussed below. Our management team uses those non-GAAP financial measures in assessing our operating results, as well as when planning, forecasting and annualizing future periods. We believe our non-GAAP financial measures also facilitate comparisons of our performance to prior periods and that investors benefit from understanding our non-GAAP financial measures. Non-GAAP financial measures are supplemental and should not be considered a substitute for financial information presented in accordance with GAAP.

Today's call contains forward-looking statements based on conditions as we currently see them. Those statements are based on current beliefs, assumptions and expectations, speak only as of the current date and, as such, involve risks and uncertainties that may cause actual results to differ materially from our current expectations. Please refer to the cautionary statement in our press release for more information.

You will also find a detailed discussion about our risk factors in our filings with the SEC and, in particular, in our Annual Report on Form 10-K for the fiscal year ended March 30, 2018 and recently filed Quarterly Reports of Form 10-Q.

With that, let me now turn the call over to CEO Greg Clark. Greg?

Thank you for joining us, and good afternoon.

For the third quarter fiscal 2019 we posted operating results above our guidance. Our top-line results were driven by both our Enterprise Security business, which achieved revenue above guidance, and solid

revenue performance from our Consumer Digital Safety business. We achieved total company operating margins of approximately 32%, above our guidance. We generated strong cash flow from operations of $377 million in the third quarter, up substantially year-over-year.

In Enterprise Security, we delivered revenue of $616 million, $31 million above the high end of our guidance range. After a difficult first half of the year, we are pleased with a return to revenue growth in Enterprise Security, which grew 3% organically.

Our third quarter implied billings of $772 million at an average ratable billings duration of approximately 18 months, represents one of the highest performance quarters for Symantec since the divestiture of Veritas. We are pleased with customer adoption in the quarter and as a result, are guiding our full year fiscal 2019 Enterprise Security revenue higher. Importantly, third quarter duration was in line with our expectations and consistent with the prior year-ago period.

Our growth in contract liabilities grew 9% quarter over quarter and 23% year over year, excluding the impact of the adoption of ASC 606. We continue to build a large installed base of customers, which provides us with opportunities to execute on our cross-sell strategy, and longer-term creates a higher renewal base.

We continue to bring to market the world's most powerful cyber defense technologies. These last few months have been extremely productive in product development. One of the biggest challenges in the security industry is the lack of skilled security professionals to meet the needs of the enterprise. Our customers have heavily benefited from our leading Managed Security Service which provides expert threat hunting across their security estate. We were very pleased to announce this week the release our Managed Endpoint Detection and Response Service, or MEDR, which allows us to attach a focused threat hunting service to our large installed base of endpoint security customers. This expands our value substantially to our installed base, especially in light of the skill shortage in the industry. Symantec is one of the few organizations that can deliver this kind of assistance on a global basis.

This week we also announced several pioneering enhancements to our endpoint security offering, including the ability to isolate individual files and applications and place controls around them to mitigate even unknown attacks. This technology, developed internally, allows our customers to adopt the most aggressive defense posture on the endpoint.

We have also announced our Threat Defense for Active Directory, which addresses the number one mechanism that attackers use to move laterally and expand their reach inside an enterprise. This product is based upon a technology that comes from our acquisition of Javelin Networks in early November. We are pleased with the speed with which our organization has delivered this value to our large installed base.

These new solutions show the ability of our teams to organically innovate, as well as rapidly integrate technologies from acquisitions. Gartner already recognizes Symantec in the leader's quadrant of their 2018 Magic Quadrant for Endpoint Protection Platforms where our solution scored the highest among all other vendors based on our completeness of vision and ability to execute. We believe these pioneering enhancements to our endpoint offering further distance us from our competitors and strengthen our business case at the customer.

The strength of our Integrated Cyber Defense Platform continues to be recognized by our customers and the industry. In November, Forrester named Symantec a leader and a "juggernaught" in Zero Trust. For those unfamiliar with the term, Symantec believes that in the long-term, our customers will operate on third party-controlled infrastructure, but still retain responsibility for their users and the associated data that they are entrusted with. We are focused on bringing innovative solutions to this rapidly changing risk profile driven by massive cloud adoption underway across the globe.

At Symantec, it has long been our mission to deliver security for a perimeterless world. From our first-mover acquisition of Elastica in the CASB space and of Fireglass in the Web Isolation space, we have built an integrated platform that allows customers to implement a security architecture that protects against even the most sophisticated threats in the cloud generation.

For customers, implementing a "perimeter-less" architecture, or "Zero Trust," means selecting vendors that provide superior protection and cross-product integration. Our Integrated Cyber Defense Platform offers this, as well as what we believe is a lower overall cost of ownership versus the alternative of self-integrating multi-vendor technologies.

Turning to our customer wins in the third quarter:

We are excited about the number of different verticals that are adopting our platform at scale and in different geographies, and we view this as a major indicator of the potential for our Integrated Cyber Defense Platform across the globe. In the third quarter, a European household appliance manufacturing company signed an eight figure deal, as they adopted a substantial footprint of our Integrated Cyber Defense solution set. This is a great example of how CIOs are recognizing not only the breadth of our Integrated Cyber Defense Platform, but also its superior protection and cross-product integration.

In Asia Pacific, a major securities and derivatives trading exchange that was a SEP customer, expanded their Symantec footprint and adopted our cloud security stack, which includes CASB, cloud proxy, DLP, Web Isolation and Cloud Malware Analysis. This customer chose Symantec to help them securely move to the cloud because of the strength of our integration between our endpoint technology and our powerful cloud security portfolio.

A global Fortune 500 power company which already had a SEP installed base was looking to build an internal SOC and faced a limited talent pool. In a seven figure win against two large managed service providers, the customer purchased Advanced Threat Protection, SEP Mobile, Managed Security Services,

DeepSight, Cyber Security Services and Managed Endpoint Detection and Response Service. The customer realized that our Integrated Cyber Defense Platform could improve operational efficiencies resulting in a faster ROI, as well as reduce its SOC staffing requirements.

We are also seeing customers of all sizes being able to deploy our technogy at a rapid pace, and positively resetting their expectations of "time-to-value" for security products. To give one example, a regional hospital in the Northern Europe purchased 4,000 licenses of our SEP and EDR endpoint technologies in late December. This purchase was the first phase of rollout that would replace a competitive endpoint product which was about to reach the end of its license period in March. The hospital had cautiously planned to renew their existing solution for an additional year to create overlap and cover the possibility of a lengthy rollout. In January, three weeks after their Symantec purchase, all 4,000 seats of our endpoint protection had been deployed, significantly ahead of schedule. As a result, this customer is in the process of procuring and deploying an additional 10,000 seats and they expect to avoid the planned license cost of the one year of overlap with our competitor.

Let me now turn to our Consumer Digital Safety business.
We are pleased with the third quarter outcome for Consumer Digital Safety, which was in line with our guidance. The third quarter marked the first anniversary of the Cyber Safety subscribers we acquired in connection with the 2017 Equifax breach and we are pleased that we grew revenue against this difficult period compare.

The core tenants of our Cyber Safety platform include identity protection, malware protection, privacy as well as home and family safety. We extended our platform with the launch of Norton Privacy Manager, which is a relevant topic in recent times and we believe a defining element in the minds of consumers.

In the third quarter, we announced a strategic parternship with AON, which we view as validation of our longer-term strategy to drive consumer adoption through business-to-business-to-consumer relationships. AON offers solutions to help high-net worth individuals to defend their assets against cyber criminals. Our offering to AON customers will include features across our Consumer Digital Safety platform. Cyber Safety is synergistic with many brands globally, such as insurers, banks, telecom providers and other member organizations that are anchored in trust. As we expand Cyber Safety internationally and to address a growing array of vertical needs, we believe partnerships such as AON will expand the value we bring customers and the revenue potential for our consumer business.

Turning back to the company performance in the third quarter, we are pleased with the results.

Before I turn it over to Nick, I want to take a moment to recognize his leadership and many contributions to our company. As we announced in our press release earlier today, Nick will be stepping down from his role as CFO in the coming months to pursue other opportunities.

It has been a great privilege to work alongside Nick, first at Blue Coat and now at Symantec, where he has played an important role in successfully transforming our company: through the integration of both Blue Coat and LifeLock; the substantial improvements we've made in our business systems and processes; and in helping me and the executive team set the stage for Symantec's next chapter of growth and shareholder value creation. Nick and I have worked closely for over three years, and I'm grateful to have had such a committed, focused and talented partner. On behalf of the entire Symantec team, I thank Nick and wish him all the best in the next chapter of his professional life.

We are initiating a search process to identify a new CFO. While we are working expeditiously to conduct the search, we are committed to taking the time we need to find the best candidate for the role. We are grateful that Nick is staying on board throughout the search process to help identify a strong successor and will remain with the Company until mid-2019 to ensure a seamless and orderly transition.

In addition, today we announced the appointment of Matt Brown as Chief Accounting Officer, effective immediately. Matt has served as Symantec's Vice President and Corporate Controller since August 2016 and is a valued member of our finance organization.

With that, I'll turn the call over to Nick for the financial details.

Thank you, Greg, and good afternoon everyone.

Before I jump into our results and guidance, I want to thank Greg and everyone at Symantec for the opportunity to be a part of this remarkable journey. As Greg noted, I will remain in this role until a successor has been appointed, and I will work closely with him or her to ensure a smooth transition with the goal of this being seamless for all of you on the phone, as well for our internal Symantec team.

In the meantime, I look forward to continuing to work with Greg and the executive team, as well as the strong team supporting me in the finance and operations organization, to support Symantec's execution on our strategic growth, transformation and profitability initiatives, and driving shareholder value.

Now, moving on to our results.

All references to financial metrics are non-GAAP, unless otherwise stated. Please note we've posted information on our financial metrics, other tables and reconciliations of GAAP to non-GAAP measures, as well as currency impacts to our financial results, in our supplemental materials to our investor relations website.

Starting in the first quarter of fiscal year 2019, Symantec adopted the new revenue recognition accounting standard, ASC 606, under the modified retrospective transition method. Due to this adoption method we did not recast any historical financial information prior to fiscal year 2019. However, to help investors understand our performance relative to historical results, in fiscal year 2019 we are also

providing select results as calculated under ASC 605 in our supplemental materials to our investor relations website.

As a reminder, the first three quarters of fiscal year 2018 included results from our website security and related PKI products that we divested on October 31, 2017. For comparative purposes, we report organic growth rates which we define as growth adjusted for acquisitions and divestitures.

Now, Q3 results:
Total company revenue was above our guidance range, with year over year organic revenue growth in constant currency of 3%. The upside was due to outperformance in Enterprise Security.

At the end of the third quarter, contract liabilities of $2.928 billion were up 7% year-over-year. This ending contract liabilities balance and year-over-year growth rate was negatively impacted by $192 million due to the impact of ASC 606.

Operating margin for the third quarter was 32%, above our guidance of 30%, driven primarily by the overachievement in Enterprise Security revenue.

Our effective tax rate for Q3 was 19.3%, in line with our guidance.

Fully diluted earnings per share was $0.44, above our guidance. We did not repurchase any shares during the quarter.

We generated cash flow from operating activities in Q3 of $377 million vs. $294 million in the year ago period, and Q3 capex was $58 million. While total company cash flow from operating activities was up 28% year over year, cash flow from continuing operations was up 45%. We ended Q3 with approximately $2.6 billion in cash and short-term investments, with $2.2 billion held in the US.

Now let's discuss our Q3 operating segment performance.

First, Enterprise Security.
Our Enterprise Security revenue was $616 million, and reflected organic growth of 3% year over year in constant currency. Revenue was $31 million above the high end of our guidance range due to a higher mix of sales yielding up-front revenue than we had built into our guidance.

Enterprise Security contract liabilities were $1.889 billion, up 11% year-over-year. This ending contract liabilities balance and year-over-year growth rate was negatively impacted by $210 million due to the impact of ASC 606. Enterprise Security contract liabilities were up 9% compared to the prior quarter.

Our Q3 Enterprise Security implied billings were $772 million, down 4% year-over-year adjusted for the WSS/PKI divestiture, and generally in line with our expectations built into our revenue guidance.

In our Enterprise Security segment in the third quarter, approximately 76% of our revenue was ratable under ASC 606, as compared to 81% in the second quarter of fiscal year 2019 and 82% in the first quarter of fiscal year 2019. This decrease was due to a higher mix of sales yielding up-front revenue in the quarter.

As we stated on our earnings call in May, we are disclosing contract duration for our ratable business in Enterprise Security on a quarterly basis through fiscal year 2019. Please note this is an ASC 605 metric that we will not be reporting after this fiscal year. Contract duration for our ratable business in Q3 was approximately 18 months. This compares to just under 17 months in Q2 and just under 18 months in the year ago period.

With respect to our performance obligations as of the end of Q3, consistent with Q1 and Q2, we project approximately 65% of our total Enterprise Security performance obligations will be recognized as revenue within 12 months, approximately 89% within 24 months and approximately 98% within 36 months.

Enterprise Security operating margins were 16% under ASC 606, as compared to 23% in the year ago period under ASC 605. The website security and related PKI products divestiture contributed to the year-over-year decline.

Turning to Consumer Digital Safety and our quarterly Digital Safety metrics.
Consumer Digital Safety segment revenue of $602 million, was in-line with our guidance, and reflected organic growth of 2% year over year in constant currency.

In the third quarter, our average direct customer count was 20.4 million, down slightly from Q2. Direct ARPU increased to $8.84 per month, up slightly from Q2. We expect these direct customer statistics to represent approximately 90% of our revenue stream at any point in time.

Finally, Consumer Digital Safety operating margin was 49%, compared to 53% in the prior year period. Our operating margin is consistent with what we saw in Q2.

Turning to our guidance, under ASC 606.
Our guidance reflects our current view of the business. Our organic growth rates are adjusted for the website security and related PKI products divestiture. Based on Q3 ending FX rates, we are not forecasting a significant impact from FX on our revenue and operating income for the rest of the year.

For Q4:
We are forecasting a Q4 fiscal year 2019 revenue range of $1.19 billion to $1.22 billion, comprised of $595 to $615 million in Enterprise Security and $595 to $605 million in Consumer Digital Safely. At the mid-point, our guidance, on an organic basis and in constant currency, implies approximately flat revenue growth for the total company.

We are forecasting operating margin in Q4 to be approximately 30%

We expect our effective tax rate in Q4 to be approximately 19.3% and our guidance assumes a fully diluted share count of approximately 656 million.

Our Q4 fiscal year 2019 EPS is forecasted to be in the range of $0.37 to $0.41.

Now to our Fiscal Year 2019 guidance. We are adjusting guidance for the full year fiscal 2019 to reflect our outperformance in Enterprise in the third quarter.

We are forecasting fiscal year 2019 revenue in the range of $4.76 to $4.79 billion, consisting of $2.36 to $2.38 billion in Enterprise Security and $2.40 to $2.41 billion in Consumer Digital Safety. At the mid-point, on an organic basis and in constant currency, our guidance suggests a growth of 1.5% in revenue for the total company, relatively flat revenue for Enterprise Security, and 3% growth for Consumer Digital Safety.

We are forecasting operating margin in fiscal year 2019 to be approximately 30%.

We expect our effective tax rate in fiscal year 2019 to be approximately 19.3% and our guidance assumes a fully diluted share count of approximately 660 million.

We are forecasting EPS for fiscal year 2019 in the range of $1.57 to $1.61.

We are forecasting cash flow from operations for fiscal year 2019 to be in the range of $1.25 to $1.35 billion as compared to total cash flows from operations of $950 million in fiscal year 2018.

Turning now to our fiscal year 2020 outlook.

Consistent with prior quarters, we are providing our growth outlook for fiscal year 2020. On our next earnings call, we will provide specific fiscal 2020 financial guidance. While our perspective on the growth potential for each of our business segments is unchanged, we are adjusting our revenue growth outlook at this time simply to reflect the increase in our fiscal 2019 revenue forecast as reported this quarter.

We expect that total company organic revenue will grow in the mid-single digits year-over-year in fiscal year 2020. We expect Enterprise Security segment organic revenue will grow in the mid-to-high single digits year-over-year. Our expectations continue to be built on a combination of factors, including: one, the rolloff from existing contract liabilities, which have grown substantially year-over-year; two, our expectations for performance in the fourth quarter; and three, the growth we expect in FY20. Our expectations for Consumer Digital Safety organic revenue growth are unchanged at low-to-mid single digits year-over-year.

Our fiscal year 2020 outlook for total company operating margins is in the mid-thirties. This operating margin outlook reflects continued revenue growth in both our Enterprise Security and Consumer Digital Safety segments, as well as a set of cost reduction actions we announced in August.

With operating margins in the mid-thirties, we expect EPS growth in the low double digits, and cash flow from operations growth at or above net income growth as we largely work through our restructuring, transition and transformation efforts in fiscal year 2019. As noted in our Q3 income statement, we incurred year-to-date costs of $205 million related to restructuring, transition and other costs. These initiatives are largely coming to a close in fiscal year 2019, which will have a positive impact on cash flow in fiscal 2020.

Now turning to capital allocation.

We completed a review with our Board of Directors and plan to restart our capital allocation program in Q4. Consistent with our capital allocation strategy we will take a balanced approach, including share repurchase, debt repayment, and flexibility to pursue strategic options, including M&A. Regarding share repurchase, we have increased our repurchase authorization by $500 million to $1.3 billion, giving us additional flexibility to deploy the excess capital on our balance sheet and future cash flow. We expect to start repurchases in Q4, and will update shareholders on the amount of equity repurchased on a quarterly basis. Regarding debt repayment, we plan in Q4 to prepay our $600 million term loan due August 2019. This prepayment is consistent with our de-leveraging plan, pursuant to which we will have repaid $3.8 billion of debt in FY18 and FY19 and reduced total debt from $8.3 billion at Q417 to $4.5 billion. Finally, we expect to continue to pursue acquisition opportunities and to continue our regular quarterly dividend of 7.5 cents per share.

Let me now turn the call back over to Greg for some closing remarks.

Thank you Nick.

As Nick discussed, we are pleased with the third quarter and look forward to delivering on our fourth quarter guidance. After a difficult first half in fiscal year 2019, regaining momentum in the business is our core focus.

As we raised revenue guidance in fiscal year 2019 to reflect our outperformance in Enterprise Security in the third quarter, this resulted in a higher revenue comparison which affects the period compare in fiscal year 2020. Our comments on FY20 outlook are based on the change in period compare from our increased FY19 outlook. I would note that we are closely watching the widely reported concerns on potential softening of global economic growth, as a material amount of our business is from outside of the the U.S. With that said, it is important to note that we are still seeing a healthy pipeline in our Enterprise Security business, and over the long-term we believe that the cyber defense market has tailwinds for our business. The third quarter marks another quarter of installed base expansion which benefits future renewals.

Finally, we have increased our shareholder purchase authorization which is a signal of our confidence in our ability to continue to drive strong operating cash flow and growth.

Thank you very much for your time.

Nick and I would be happy to take your questions. Operator?