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NortonLifeLock, Inc. (NLOK)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, everyone. Thank you for standing by. My name is Ann, and I will be your conference operator today. I would like to welcome everyone to the NortonLifeLock Fiscal 2021 Third Quarter Earnings Call. Today's call is being recorded and all lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

At this time for opening remarks, I would now like to pass the call over to Ms. Mary Lai, head, Investor Relations. Miss, you may begin.

Mary Lai
Vice President-Investor Relations, NortonLifeLock, Inc.

Thank you, Ann, and good afternoon, everyone. Welcome to the NortonLifeLock's Fiscal 2021 Third Quarter Earnings Call. Joining me today to review our results are Vincent Pilette, CEO; and Natalie Derse, CFO.

As a reminder, there will be a replay of this call posted on the IR website, along with our earnings slides, press release, and supplement materials defining our non-GAAP metrics. I'd like to remind everyone that during this call, all references to the final metrics are non-GAAP and all growth rates are year-over-year unless otherwise stated. A reconciliation of non-GAAP to GAAP measures is included in our press release, which is available on our IR website at investor.nortonlifelock.com.

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Today's call contains statements regarding our business, financial performance and operations, included the impact of the ongoing COVID-19 pandemic on our business and industry, which may be considered forward-looking statements and such statements involve risks and uncertainties that may cause actual results to differ materially from our current expectations. Those statements are based on current beliefs, assumptions, and expectations and speak only as of the current date.

For more information, please refer to the cautionary statement in our press release and the risk factors in our filings with the SEC, and in particular, our Annual Report on Form 10-K for the fiscal year ended April 3, 2020 and recently filed quarterly report on Form 10-Q.

And now, I will turn the call over to our CEO. Vincent?

Vincent Pilette

Chief Executive Officer & Director, NortonLifeLock, Inc.

Thank you, Mary, and good afternoon, everyone. I hope you are all safe and well. As we embark on 2021, I think it's important to recognize the sense of uncertainty and the ongoing challenges that we all face as individual or as a society. Despite the socioeconomic and health issues we are facing, I'm hopeful that collectively we will emerge stronger and more united.

At NortonLifeLock, the safety and well-being of our employees is our utmost priority and I want to thank each and every one of them for facing all those challenges while continuing to show a deep commitment to drive our vision of protecting and empowering people to live their digital life safely.

A lot has happened since our last earnings. On top of delivering another solid quarter, accelerating our growth, and adding some exceptional talent to our team and our board, we also are proud to have been recognized by the Human Rights Campaign Foundation for earning a top score on the 2021 Equality Index. We are proud of the diverse backgrounds represented by our entire team at NortonLifeLock, and we remain committed to building an inclusive company. We know that delivering on our vision cannot happen without a committed, talented, and diverse team.

In December, we announced LifeLock's (sic) [Norton LifeLock's] first acquisition. Now that the deal has closed, we are excited to welcome Avira's employees, customers, and partners to the Norton family. We are really excited by the opportunity to provide Avira's 30 million users and over 1.5 million paid customers the benefit of the Norton plus Avira offering. Together, we are now privileged to help protect over 80 million consumers globally as we embrace the important responsibility we have in securing their digital lives.

We are also quickly working to leverage Avira's strong presence in Europe, which now also includes BullGuard, a UK-based cybersecurity company that Avira added to their business last year. On top of expanding our reach deeper into EMEA, we look forward to adding Avira's and BullGuard's capabilities to our portfolio.

Before I dive into Q3 results, I want to revisit two key post-transition commitments we previously set as a standalone NortonLifeLock company. From returning to a growing customer base, a first since 2014 to delivering over $1.5 annualized EPS, I am proud to say that we have established the company on a trajectory of sustainable and profitable growth. We are a stronger Cyber Safety company today, 100% focused on protecting and empowering consumers to live their digital life safely.

While we are proud of these achievements, we know we have a tremendous responsibility to deliver a portfolio that stays ahead of cyber criminals. We don't take this lightly. As we innovate and work to keep our customers

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safe, we know that we will be transforming our company for a richer portfolio and expanded consumer reach and we're just getting started.

In Q3, we delivered solid growth and accelerated our momentum. Revenue was up 6% and non-GAAP EPS grew 52%. Reported billings growth was 10%, our first quarter of double-digit growth. We are closing the fiscal year out strong and more importantly, we're well on our way to creating a meaningful and sustainable growth business.

Leading the growth momentum, our partner business posted double-digit revenue growth, up 15%. Retail was strong in the quarter, performing well through e-tail and during the holidays. Internationally, Japan was particularly strong as it relates to identity theft protection solutions such as Dark Web Monitoring and ID Advisor sold through partners and retailers.

Finding the right opportunities and markets to build and expand these long-term partnerships is one of our key strategic focus areas to broaden our reach and provide Cyber Safety to more consumers in underpenetrated markets. Stay tuned for more developments in this area as we continue to transform the company.

Our direct-to-consumer revenue, which represent the majority of our business, was up 5%. We saw broad-based growth across the portfolio as well as strong performance through the holiday season. While our North America business is considerably larger than the rest of the world, the international growth rate continues to show strength and outpace the Americas.

In the quarter, our direct business grew double digits across multiple countries, including Germany, France, Australia, and New Zealand, where we have recently added Dark Web Monitoring into our Norton 360 offering. This is part of our strategic push to expand Norton Identity products internationally and bring more comprehensive Cyber Safety offering to international consumers. We definitely have more room to grow here, especially with the synergies and expanded global reach we will be leveraging with Avira and the freemium model.

In Q3, our direct customer count grew over 300,000 sequentially and close to 900,000 year-over-year, bringing our total count to 21 million. This was our fifth straight quarter of net direct customer adds sequentially. Our customer retention rate remained stable at 85%.

Our industry-leading monthly ARPU, average revenue per user, also remained strong at $9. Both metrics are strong indicators that our current customers see the value of our products. Notwithstanding the effect of tenure and geographical mix, we continue to see opportunities to improve ARPU, as we enrich the Cyber Safety value offered to our customers, and to improve retention rates, especially in the early years of the customer journey.

One of the key contributors to our customer count growth and retention success continues to be the Norton 360 integrated platform, the first truly integrated Cyber Safety offering in the market. At the end of Q3, approximately 60% of our installed base are using Norton 360. This platform is designed to provide a comprehensive protection, while driving higher customer engagement.

This level of adoption shows that our approach to provide an easy to use platform and comprehensive protection through a membership model resonates well with our customers. And we're working hard to continue bringing new functionalities, simplifying the membership plans, and constantly improving the user experience.

The combination of Norton 360 platform, our international expansion effort, and our strategic shift to new forms of digital marketing is working and bringing Cyber Safety to new customers.

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Looking back at the last 12 months, we've welcomed approximately 4 million new customers to NortonLifeLock, the majority of which was on Norton 360. We are seeing early improvements in renewal trends with these newer customer cohorts. We're engaging with this customer differently, communicating with new alerts, measuring what works, what doesn't, and we're able to scale product launches more effectively through our in-house eCommerce platform.

At the heart of all of this, it's our technologies and accelerated pace of innovation that enable us to be nimble in bringing new and incremental value to customers. Sometimes, we may run the risk of failing fast, but the reward is that we learn even faster to translate that into success as we move to own the consumer Cyber Safety category.

With the ever-expanding scope of cybercrimes and the acceleration of the numbers of attacks that we've all witnessed in the news, we know it's critical to focus on product and service innovation to help keep consumers' digital lives safe and to raise the overall awareness of consumer Cyber Safety across all audience.

We plan to continue to release new products and features at an accelerated pace that we have not achieved in years. Let me tell you about a couple of them launched in Q3.

As part of our global expansion efforts, we successfully launched Norton ID Advisor in Japan, Powered by LifeLock. Here, we specifically targeted retail and service providers to reach new audiences and increase awareness on the value of Dark Web Monitoring. One of the differentiators in this product is the access to a dedicated ID Restoration Specialist, a Japanese-speaking service agent, to help resolve fraudulent claims from start to finish.

Another example is our enhanced Norton 360 mobile experience, which provides customers access their device security, online privacy, and identity features through one single easy-to-use app, making it easier for customers to access and manage their Cyber Safety tools from one dashboard. This is another example of our commitment to bring a richer and simpler experience to consumer Cyber Safety.

Looking back, we have demonstrated our continued commitment to grow the top line through our disciplined operating leverage and pursue value creation for all stakeholders. It's important to me and our entire leadership team to build credibility and a sustainable and growing financial track record.

It's also worth noting that behind our strong third quarter performance, you will find a very passionate team working hard to fulfill our vision to protect and empower people to live their digital lives safely. We think customer first, we innovate and grow, we're scrappy, we own it, we're open, we're authentic. These are the core values we live by. And making the world cyber-safe is what inspires us.

Finally, before I pass it to Natalie, I'm excited to share a little more detail on our recent additions to the board. Sherrese Smith is Vice Chair and Partner at Paul Hastings, a prominent global law firm. She brings extensive international experience in data privacy, cybersecurity, and breach response issues.

Similarly, Emily Heath, DocuSign's Chief Trust and Security Officer, brings significant experience in information security, data privacy, in addition to being a key contributor in creating consumer trust to digitally transform an industry. They are both passionate and accomplished leaders, while already valuable member of the board team.

And now let me turn the call over to Natalie for more details on the financial results.

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Natalie Derse

Chief Financial Officer, NortonLifeLock, Inc.

Thank you, Vincent, and hello, everyone. For today's discussion, I will focus on non-GAAP financials, starting with our Q3 results, and then provide our outlook for Q4.

We delivered strong performance in Q3, with growth year-over-year and quarter-over-quarter across our key metrics. Our Q3 revenue was $639 million, up 6% year-over-year and above the high end of our guidance. We accelerated reported billings growth to 10%, including a 2-point positive impact from FX in our ending contract liability balance.

Our growth momentum was driven by broad-based strength across all geos and products, as well as a successful holiday season. Our total direct customer count increased to 21 million, adding 334,000 customers quarter-over-quarter and 876,000 customers year-over-year. This was our fifth consecutive quarter of net customer adds sequentially.

Our customer retention rate, a unit retention metric, remains stable at 85%. Our monthly average revenue per user, or ARPU, was over $9.00 this quarter, up 1% year-over-year in stable quarter-over-quarter. As we continue to grow our customer base, it is important to note that our first year ARPU and retention rate for newly acquired customers is generally lower than our total average.

As we explore new business models and add more customers globally, ARPU can vary as our mix changes. We will look for opportunities to improve ARPU and first year retention as we continue to grow and diversify our business. We are still in the early innings, but our go-to-market efforts are beginning to take hold.

We are leveraging our distribution channels to reach more customers globally. We accelerated growth in our direct business in Q3, driven by our growing renewable base. As we continue to add new customers, we are seeing positive data points in retention, directly correlated with our Norton 360 membership suite. As we have accelerated the pace of our innovation and launched new in-demand products and features, we are beginning to see improvements in our cross-sell and upsell efforts. And we have the opportunity to accelerate further as we expand our reach to new audiences and continue to foster growth in our loyal customer base.

In our partner business, Q3 revenue grew 15% year-over-year. We continue to make strides internationally, signing new partnerships that we expect will scale over the long term. As we have noted in previous conversations, these partner sales cycles are longer, taking one to two years or more to realize. We continue to invest in these partnerships for the long term as they are strategically important for us to expand our reach.

Next, Q3 operating margin was 51%. We remain focused on driving operational discipline and prioritizing investments in product innovation and diversified marketing. With R&D, we continue to accelerate the pace of product introductions, growing and expanding our product portfolio, and providing an increasingly differentiated value proposition for consumers.

With marketing, we continue to invest to drive new customer acquisition, as well as diversify our spend into more digital and international channels to help widen our audience, measuring and ensuring effectiveness along the way. We are disciplined in our approach and will continue to invest in sustainable growth.

Q3 net income was $229 million, up 44% year-over-year. Diluted EPS was $0.38 for the quarter, up 52% year-over-year and at the high end of our guidance range. We are now operating above the $1.50 annualized EPS

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level and have established a strong foundation to build upon. As we look to the future, we will continue to prioritize EPS expansion while taking advantage of the sustainable growth opportunities.

Turning to our cash flow and balance sheet, Q3 operating cash flow was $293 million and free cash flow was $291 million. For a few quarters now, we have been generating more than $900 million in annual free cash flow, excluding stranded costs. We ended Q3 with over $1 billion of total cash and a $1 billion of undrawn revolver capacity. We continue to have a strong liquidity position and are levered at approximately 2 times net debt.

Now, a quick update on our real estate assets held for sale. We see a lot of activity and interest in each of our properties, and recently agreed to terms for the sale of one of our buildings in Mountain View. The buyers are expected to complete their due diligence in our fourth quarter. While we've seen a lot of interest and continue to be in active discussions on all properties, we remain focused on achieving fair market value for the remaining assets for sale in Mountain View, Dublin, and Tucson.

Let me spend a few minutes specifically on capital allocation. In Q3, we returned approximately $207 million to shareholders in the form of our regular quarterly dividend and share repurchase. In the quarter, we paid a dividend of $0.125 per common share. Despite the limited open trading window, we were active in the last month of the quarter and deployed $133 million and purchased 7 million shares.

As of the end of Q3, there was approximately $420 million remaining in our $1.6 billion share buyback authorization, which we expect to continue to deploy opportunistically. As described in the press release, the board of directors approved a regular quarterly cash dividend of $0.125 per common share to be paid on March 17, 2021 for all shareholders of record as of the close of business on February 22, 2021.

Before I move on to our Q4 outlook, let me provide an update on Avira. As you heard from Vincent, we closed the acquisition of Avira in January, which falls in our fiscal fourth quarter. While it is early, the integration process is well underway and on track to plan. As a reminder, we expect to add approximately 3 points of growth to our total revenue and be financially accretive in the first year, targeting to achieve 50% operating margin post-synergies within six months.

Now turning to our Q4 outlook, we expect Q4 revenue in the range of $655 million to $665 million, which translates to high-single digit growth year-over-year. We expect non-GAAP EPS to be in the range of $0.37 to $0.39 per share, assuming stable currency rates and share count dilution from Q3 buybacks. Our Q4 outlook includes the partial impact of Avira.

As we enter the last quarter of our fiscal year 2021, we are proud to have achieved all of the long-term commitments we set when we set up NortonLifeLock, including revenue growth of mid-single digits, operating margin at 50%, generating annualized free cash flow of more than $900 million and an annualized EPS of $1.50. Achieving all of those is a true testament to our renewed focus on execution and building a consistent and sustainable track record. We look forward to closing out the fiscal year strong with accelerating momentum and a scalable foundation, and we're excited about the tremendous opportunities ahead.

Thank you for your time today, and I will now turn the call back to the operator to take your questions. Operator?

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QUESTION AND ANSWER SECTION

Operator: Yes ma'am. [Operator Instructions] Our first question comes from line of Gregg Moskowitz from Mizuho. Your line is open.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

All right. Thank you very much. Good afternoon, guys.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Hey, Gregg.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Congratulations on a good Q3.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

So Vincent, you've invested a lot more in marketing over the last 12 months, and it seems pretty clear, inclusive of these results, that you've already seen a really good yield on those investments. So looking forward, how much more room for improvement do you see with regard to driving traffic to the site and increasing monetization?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah. And it's important to note that your marketing investment is never done in a vacuum, right? We've also launched Norton 360 a year and a half ago, we introduced a bunch of new products and new functionalities into our overall portfolio, and we started to accelerate the spend or at least the penetration of certain international markets. I think as we continue to play on all three levers, including the marketing spend, if you want, we'll be able to continue to show good growth, and with the acquisition of Avira, actually maybe an accelerated growth as we move forward.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

All right. Perfect. And then, you mentioned in your prepared remarks that you're seeing early improvements with newer customer cohorts, and that's interesting because typically, that first year renewal rate is, of course – or first year renewal is, of course, the most challenging. So, my question is your retention has been extremely stable at 85%, and I know it's early, but given some of the improvements that you're seeing, is there a potential to get that retention higher?

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Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

I think it's still early. As you mentioned, the first year and the second year retention is where we have the most improvement to achieve. If I look at the out years for those who are in the full portfolio, we achieved the 90 plus percent retention on a unit basis. And so, we see the full potential between first year and that 90% as the improvement needed. It has many different operations increasing the engagement, showing the value, adding new functionalities. The results I mentioned is mainly on Norton 360, when we have the ability to show cross-category values, if you want, to the users. We've seen better retention rate in the first year than standalone product. And still early to say, right, we're still in the early phase of renewing the early adopters of Norton 360, but we're very encouraged by what the numbers show.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

All right. Terrific. Thanks. And maybe just one quick one for Natalie, so the billings growth of 10% reported, 8% constant currency, I just wanted to confirm that none of that includes Avira, and then also, how much of Avira is sitting in deferred revenue as of Jan 31? Thank you.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah. Thanks for the question. Just really quickly, Avira is not in our Q3 results at all. And so, whether you think about growth or you think about the liability balance, any of that, it's not going to be in our financials until Q4.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Okay. Even though it was closed at the end of the January, it's not sitting on the balance sheet at all. Is that right?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

That's correct.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Okay. Fantastic. Thanks for the clarification. Nice job.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Operator: Your next question comes from the line of Saket Kalia from Barclays.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Hey, guys. Thanks for taking my questions here and congrats on the quarter.

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Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thanks, Saket.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Sure. Vincent, maybe first for you, just maybe zooming out a little bit, can we just talk a little bit Avira's freemium business model and sort of how you see that complementing what Norton currently offers?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah. Let me zoom out even one more. We definitely see more and more consumer moving their activities online. The pandemic has only accelerated that movement, and I think a lot is here to stay. Along with that, as you know, cyber criminals are adapting and we've seen an increasing activity there. And their awareness, from a consumer standpoint, to have a Cyber Safety protection is more relevant than ever.

We feel good about where we are as a company, both investing, as we discussed, organically and inorganically. We have a platform, the Cyber Safety integrated platform we've launched, Norton 360, covering three pillars: security, privacy, and identity protection and restoration.

And then, along with that, we said we're going to continue and accelerate the growth by doing three things. One is accelerating our penetration of international markets. The second one was to – while we double down on a direct-to-consumer, go-to-market model, explore new go-to-market models, partner with companies like TELUS to penetrate Canada, or explore new business models. Obviously, a membership plan was the first in the market for Cyber Safety. We'll continue to build on that. And the third one is adding new functionalities with gaming, with home title , et cetera.

When I take those three dimensions, Avira plays in all three. Expanding internationally, obviously, they're very strong in Europe. We were number three market share in Germany. With Avira, we moved to number one. And we accelerate our growth across Western Europe. And Avira, to penetrate internationally, many markets, will be definitely an asset.

The second one, which you mentioned, which is the free model, going to market in different ways is very important. We have the direct-to-consumer and the premium model. We are doing B2B2C activities and trying to bring combined solutions to consumers.

The free model, for us, is just one more tool in our toolbox. As functionalities could become more commoditized, we can have and offer first access for all consumers to Cyber Safety, using some of those in the freemium model. And then using the muscle of cross-selling and upselling and converting to the full portfolio over time.

So it's a way of acquiring those eyeballs, if you want, and experience around Cyber Safety to then later on demonstrated that value without spending more in marketing.

And the third element is they had a few nuggets in their technology. They have a very nimble and creative engineering team. And there's some functionalities, like we mentioned, the gaming booster functionality from BullGuard that we can integrate into our gaming editions of Norton 360.

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So we'll continue to look at their capabilities from a portfolio perspective to enrich our overall experience. So that's how Avira plays into our growth moving forward.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Got it. That's really helpful. Maybe for my follow-up for you, Natalie, great to see the uptick in net adds this quarter. I guess the open-ended question is, was there anything on conversion rates or renewing cohorts, I mean it sounds like the renewal rate was maybe a little bit better.

But was there anything that surprised you? Especially looking at the net adds last quarter versus this quarter, what sort of changed as you look back at sort of the tea leaves?

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah. Thanks for the question. So look, we've seen consistent customer adds five quarters in a row. If I take a look – if I step back and take a look at just this fiscal year, 600,000 net new adds in the first half, now 300,000 in Q3, with growth across the board, across geos, across product lines, and positive contribution from holiday.

Now to answer your question around renewal and conversion, yes, we are seeing early improvements in our renewal rates related to our new customer cohorts. And now look, it's early, but I would say the Norton 360 platform is definitely helping us. It's gaining good traction, with now nearly 60% of our base. And so all in, all of that's helping us sustain that strong 85% overall retention.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Got it. Very helpful. Thanks, guys.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Thank you.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Operator: Our next question comes from the line of Brad Zelnick from Credit Suisse. Your line is open.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Hey, Brad.

Brad Zelnick
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you so much. Hey, Vincent. Congratulations on a great quarter...

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Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Brad Zelnick
Analyst, Credit Suisse Securities (USA) LLC

Q

...and to the team as well. I wanted to just touch on international a bit more. It's nice to hear about the success that you're having in Japan.

And I was hoping you can just better – help us to better understand the international opportunity broadly away from the freemium asset that you get with Avira. Obviously, that gives you a lot more reach. In which theaters does the value prop translate best? Where might there be just too much competition? And how should we think about the cost of reaching these markets?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah. When you think about international, 70% of our business is still in the US, 30% international. So when you look at the geographical mix of the overall market, it's clear to see that we are underpenetrated internationally.

So from a core security first entry point, if you want, Avira will definitely be a strong help. But where we add a real differentiator is when we bring our expertise in privacy and identity management and restoration from LifeLock and make it in the form of an international proposal, which was always the intent when we bought LifeLock. But it was late to come, as we were trying to find a first angle.

With Dark Web Monitoring, which is really protecting your multiple digital identities that you have out there, we see a lot of very good positive feedback from consumers. And so now adding to that Dark Web Monitoring activities the restoration and helping the consumers to restore claims when there is some, is definitely also a value-add and a differentiator.

I think that opportunity to push Norton Identity international is broad across many countries. And we'll start with the big one. Japan was the first one, where we got real roots. We expanded into Australia, New Zealand, Germany, UK, touching France. And we'll continue to penetrate actively all of the interesting markets.

Brad Zelnick
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. That makes a lot of sense. And maybe just a follow-up for Natalie, specific to the Avira deal, can you share with us when exactly in January did it close? Just so we can understand how much of a contribution it might have this – in Q4 and going forward?

And as well, what's assumed in guidance in terms of contribution? And if you can speak to the deferred write-down, like what's the mix of duration in their portfolio? Thanks.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah. The Avira deal closed on January 8. And so, yeah, that's when it closed. In terms of the guide, we definitely have partial impact of Avira in. We have shared with you the contribution on revenue just from a growth

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perspective. And then, from an EBITDA perspective, we will – we have folded them in, and we'll look to really drive the business hard to get the synergistic savings we've communicated to you over the next six months.

Brad Zelnick
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Fatima Boolani from UBS. Your line is open.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Hey, Fatima.

Operator: Ms. Boolani, your line is open.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Fatima, you might be on mute.

Fatima Boolani
Analyst, UBS Securities LLC

Q

Hey. Sorry about that. Maybe I'll start with you, Vincent, and just with respect to Avira and some of the things you mentioned in your prepared remarks around maybe introducing some NortonLifeLock functionality into that base. I know you've been very categorical about keeping the premium brand premium and the Avira freemium brand freemium. And so, I'm curious how do you bridge that gap with some of the goodness of the LifeLock capability without diluting the pricing power in the branding around LifeLock. And then, I have a follow-up for Natalie, please.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yes. And the great news with our digital business, we can run a lot of experiments. So, we are not concluding yet from a brand perspective. But definitely, there is a way to get new consumer or address consumers on the freemium model, which has certain functionalities, mainly commoditized, provided value but commoditized. And then, it's about adding the path for upselling and cross-selling the different functionalities that today are either differentiators or offered at a premium to the market.

And as we discussed, our long-term success is based on that pace of innovation, introducing new functionality all the time. As cyber criminality is evolving, we continue to increase the overall level of protection for consumers, from Dark Web Monitoring to restoration services, focus on privacy, identity, are all the next level. We obviously have a very rich funnel of new ideas that we're working on. And so, the freemium is one way, if you want, to get the first access to then see more closely the value of the overall portfolio. For the short term, as you mentioned, we going to keep Avira separate as one brand and Norton on the other side. But obviously, we're testing different way in term of branding.

Fatima Boolani
Analyst, UBS Securities LLC

Q

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Fair enough. Natalie, maybe shifting gears to you around the strength in the partner segment of the business. You gave some very helpful color around these partnerships take longer to get off the ground and it's an area of investment for you. But I'm wondering how we should think about some of the key drivers of strength this quarter within the partner business? And what are some of the largest components in the partner business that we should be thinking about going forward? And that's it for me. Thank you.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.
A

Yeah. Thanks. So from a partner's perspective, it's pretty diverse. We've got a lot of different channels within the partnership business. Overall, we grew 15% year-over-year and we saw relatively broad-based strength across all of those different channels. The one that we are really very excited about and really plays to our strength is employee benefits. Employee benefits is – really is a great distribution channel that widens our audience but brings users very close to our book of business, as we have the direct relationship with those users or those customers. And so, we're really, really excited about that, but overall, for the quarter, just overall, just generally speaking, broad stroke growth across the partner side.

Fatima Boolani
Analyst, UBS Securities LLC
Q

Very helpful. Thank you so much.

Operator: Our next question comes from the line of Matt Hedberg from RBC Capital. Your line is open.

Matthew Swanson
Analyst, RBC Capital Markets LLC
Q

Great. Yeah. Thanks.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.
A

Hey, Matt.

Matthew Swanson
Analyst, RBC Capital Markets LLC
Q

This is Matt Swanson on for Matt Hedberg. Natalie, if I could just follow-up on Fatima's question, I would think Q4 is going to kind of be the strongest quarter for that employee benefit segment. Could you just talk a little bit more about kind of the trends that you're seeing this year from that area?

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.
A

Yeah. I would say I hear you on the timing in terms of, of course, we've got to figure out from an employee benefit calendar. Most people really get started understanding what partners they're going to do business with, et cetera as those annual enrollments come later in the year.

So we are definitely working hard. The employee benefits channel for us has been pretty consistent. We have been really working across the employee benefits channel to gain more partners and to really get our Norton 360 value proposition out there, and really get the education and the audiences widened through the employee benefits channel.

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And then as we look forward, again, just to reiterate, we love this channel, and we want to make sure that we are working with the partners in the right way. There's a lot of different size and types of partners that we can go after from a growth perspective and we're just really excited to take advantage of the opportunity. But you're right, the time is now. I mean – and you really have to pay attention to when those employee benefits annual enrollments are. So we're trying to get after it for sure.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

And, Matt, if I can add to that taking back outside of the channel, Q3 traditionally has been more of a Norton quarter and then Q4 has been more of a LifeLock quarter aligned to the tax season in the US where most of our business is protecting identity. So from that perspective, on the identity side here coming into this quarter, we expect a very strong quarter building to Natalie's guidance.

Now, we also are closing Avira and doubling down on Norton Identity internationally. So that's not linked to the tax season, but it is definitely new areas, whether it's market or product positioning, if you want, for us to continue to accelerate our growth.

Matthew Swanson
Analyst, RBC Capital Markets LLC

Q

That's really helpful. And then, Vincent, obviously maybe not the first security company when you're thinking about your core customer base as far as impact from Sunburst. But when a major breach like that is front page news all over the place, what do you think that does to the demand environment just in terms of kind of mind share and awareness being front and center for consumers around security and breaches?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

I think you're totally right. The first level is continue to increase awareness. I can tell you, the highest retention rate is when we have customers who have been breached and we help them restore what they've had, and they're a customer for a long, long time. And then the rest it's about really building up the awareness that it's not just breach of your old data or your devices but it's breach of your personal data and access to you as an identity, if you want, or digital identities now.

And I think, same with the pandemic, when more activity moved online, as we mentioned, with that, cyber criminals are adapting and have a wider scope to play in. And it's upon us as a company, NortonLifeLock, to continue to build a portfolio to show the relevance and staying a step or two or three ahead of those risks that consumer face.

Matthew Swanson
Analyst, RBC Capital Markets LLC

Q

Thank you for the time.

Operator: Our next question comes from the line of Keith Weiss from Morgan Stanley. Your line is open.

Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

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Excellent. Thank you, guys, for taking the questions. I think most of my questions has been answered. Just a couple of clarification questions, if you will. In terms of ARPU, is there any significant differentiation between like your international average ARPUs in the US that we should be keeping in mind on a go-forward basis?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah. I think the value perceived by markets obviously changes. The value perceived by also the pillars that you subscribe to into our membership level also changes, right? So if you are a Norton 360 level 3 customers that has most of the security password managers, VPN access, it's one level ARPU. If you add Identity Protection and if you add Identity Protection and Restoration, the ARPU will grow and therefore from that perspective, LifeLock being mainly in the US, we are getting a high ARPU in the US.

And then as you move into Western Europe, we start to add some of those Identity Protection and Restorations, we're able to grow ARPU, although it is lagged on our aggregate. And then if you move into more international, closer to emerging markets, you'll have lower ARPU.

The way we think about it is really about a set of all combined levels by cohort and by market. So in aggregate, we may have pressure on an ARPU or retention rate but as long as we continue to grow more customers and by cohort or by market, it's going to need to improve the value we deliver to customers. We're moving into the right direction.

Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Got it. That makes sense. And then on Avira, for Q4 explicitly, is it 3 percentage points of growth in Q4 or did you not give an explicit number for the Q4 contribution as of yet?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah. So overall, the business will contribute on an annual basis at about 3 points of our revenue growth.

Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

Right.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Call it 75 million...

Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

Actually so how should we think about Q4 in particular in terms of your ...

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah, I understand.

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Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

...contribution?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah, and Natalie mentioned we closed Avira in the early month of January. It's not every quarter exactly the same. That will also be the seasonality. But if you model it, you are somewhat in the same level.

Keith Eric Weiss
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Got it. Got it. That helps. Great quarter, guys. Thank you very much.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Operator: Our next question comes from the line of Walter Pritchard from Citi. Your line is open.

Walter H. Pritchard
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Two questions.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Hi, Walter.

Walter H. Pritchard
Analyst, Citigroup Global Markets, Inc.

Q

Hi. How are you doing, Vincent?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Good.

Walter H. Pritchard
Analyst, Citigroup Global Markets, Inc.

Q

Two questions for you on the kind of product side. One, relative to the mobile product, can you update us there on what you're seeing on phones and tablets and conversions and how you're thinking about that strategy as you move into next year?

And then a lot of focus here on the channels and benefit channels and so forth running Identity. I'm curious if you've – as you've sort of put the marketing dollars into direct channels, how you've thought about some of the device-attached channels, PCs, and other things that might attach traditional sort of security sales and circling back on those markets as you've understood customer acquisition here better?

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Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah, let me take the product first. Forgot the question. What was the question again on product?

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Mobile.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Mobile, yeah.

Walter H. Pritchard
Analyst, Citigroup Global Markets, Inc.

Q

On mobile. Mobile.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

So yeah, yeah. Sorry, sorry. Yeah, yeah, yeah.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

So mobile, very important user experience, right? And we acquired through multiple channel.

I know in the past, as security started on a device then on a desktop, then moved to a laptop, then moved to a mobile, I get very often the question of, well, do you need security on your cell phone, for example?

And the answer is we've moved to a user-centric view of Cyber Safety, which includes security but also identity and privacy. And we see a lot of our customers using their Cyber Safety dashboard and tools, both on desktop and on tablet or cell phones. And therefore, mobility from a user experience perspective is hugely important to us.

Simplifying that experience as we continue to enrich the value is also a core element of our investment. So you'll see more around simplifying, making Cyber Safety easy to use, to consume, and giving consumer full peace of mind.

In term of the channels, we have a direct-to-customer. And I'll pass you to Natalie. And we have a second angle, which is partnership. It's very important for us to continue taking that user perspective to work on B2B2C offering, combining our value-add with other offering to provide full total protection to consumers, depending on their situations. And I think that's the one we approach.

It's not only device, hardware-centric world, but it's really a user service-centric world that we're taking as an approach.

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Natalie, I don't know if you want to add anything else.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah. I was just going to add, look, from a customer acquisition perspective, we don't necessarily plan through the eyes of just LifeLock versus Norton. I would say it's about reach, it's about expanding audiences, it's about doing it in an effective way and an efficient way. So from a channel reach perspective, we've focused in the last year really trying to diversify.

Of course, historically we've been more in the longform TV and radio. We've been diversifying into online digital channels, so that we can get really relevant and interesting content out there. We can diversify the users that are coming to our platform.

We've got really, really strong brand awareness. We've got brand strength that we will continue to leverage and strengthen in the market as we diversify and really try and attract new customer acquisition, as well as get the word out there on all of our product innovation, our product introductions, as we build and strengthen the Norton 360 suite.

Walter H. Pritchard
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Operator: Next question is coming from the line of Yi Fu Lee with Oppenheimer. Your line is open.

Yi Fu Lee
Analyst, Oppenheimer & Co., Inc.

Q

Hi. Thank you for taking my question and congrats on another strong set of results. A question for either Vincent or Natalie.

Just on the capital allocation front, in terms of the free cash flow, the number is now about $250 million, $300 million each quarter. Was wondering if you could just remind us on the capital allocation plans, Vincent, like any areas that you look to further invest? I know you just went through the other acquisition. Just want to get your heads around how to spend this cash flow generation. That's it for me.

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Yeah. Thanks for the question. I'll take it. Our capital allocation strategy remains relatively unchanged. And what I mean by that is, we have said we are – we've been – for the last couple quarters, been on track to generate $900 million of annualized cash flow.

And from a capital allocation perspective, we've talked about three main tenets, the first one being the dividend, which we paid the regular dividend in the quarter. And then as we progress, we said we would strike the right balanced approach as it pertains to opportunistic share buyback and acquisition.

And so the actions in Q3, I think, speak for themselves in terms of if you look back and you think back to approximately November. And all things considered, now you guys know why we didn't necessarily – we had the

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acquisition activity going on. As soon as our trading window was open, we opportunistically bought shares, the share buyback to the extent of $133 million.

And so as you take that into account, high ratio in terms of leveraging and maximizing the value of our capital allocation tenets and you look forward, our strategy remains unchanged. We will continue with the quarterly dividend. And then strike that right balance on opportunistic share buyback. But we've not been shy to say that we are interested in M&A activity, especially as we look forward and look for those sustainable growth opportunities.

Yi Fu Lee
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for that, Natalie. Maybe just one quick one, like in terms of like areas that you intend to look at, I know there's international opportunity you're taking care of, the gaming opportunity as well. Like, Vincent, like just try to wrap our heads around like which area of focus are next?

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah, well, it all started with our vision, right? We want to both protect and empower everyone that's connected to the Internet to live their digital life safely. That's our vision and that gives us a wide range of opportunities to fulfill that we have not fulfilled yet.

And so when you look at our overall strategy, I would say number one is continue to scale up the Cyber Safety platform. Three pillars today – security, privacy, and identity – and building that up.

As we continue to do that, adding digital services that address the vision is very important, and we'll continue to do it, increasing into the gaming verticals and with new functionalities, now integrating some of the BullGuard functionality that are really interesting. And so we have a long list, if you want, of opportunities that we are working with our engineers and our product people.

And then the third element, of course, is to continue to expand outside of the US to be truly global and reach out everyone, the 5 billion connected to the Internet that have digital lives online.

Yi Fu Lee
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for that, Vincent and Natalie.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Yeah.

Operator: The next question will be coming from the line of Gregg Moskowitz with Mizuho. Your line is open.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Okay. Great. Thank you for the follow-up and, first of all, apologies for the earlier Avira billings-related question. So many simultaneous earnings calls, so many January ending quarters, so I got thrown for a moment there.

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But I do have a follow-up for Natalie. So I know that you're a data-driven executive just given your background and now that you've been in this seat for several months, I guess I'm wondering are there opportunities to leverage data in a way that you think is translating or potentially could translate into more business for NortonLifeLock?

Natalie Derse
Chief Financial Officer, NortonLifeLock, Inc.
A

Absolutely, I would say and I don't how I would answer that question no. We just have opportunities everywhere. I think from a value and a culture of put the customer first, we have so many opportunities to use analytics to get closer and closer to the customer and understand their behavior, understanding their needs and wants and how we can serve that the best.

If I get into specifics, of course, we will continue to build out our marketing analytics. It's not just in a silo. When I think about marketing analytics, I think customer analytics and it's about making sure that we are at the very top of the funnel expanding our audiences in a diverse way, in an efficient way and making sure that we've got the content out there that really showcases our value proposition, everything from the expanding Norton 360 integrated platform and the suite of products that Vincent's talked about.

And whether you talk about where you're at in the funnel in terms of whether you're brand-new and we need to explain the value that we can bring to consumers globally or if you are an existing customer perhaps on the security side and we can find ways to share the value we can bring to your life from an identity perspective. There's just so many opportunities to just get to as close to the customer as possible, understand where they are in their journey and in their life, and really use data analytics to predict how we can take that next step in the customer journey. There's so many opportunities to build that out.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC
Q

All right. That's great, Natalie. Thanks very much.

Mary Lai
Vice President-Investor Relations, NortonLifeLock, Inc.
A

Operator, we have time for one more question.

Operator: And that question will be coming from the line of Shaul Eyal with Oppenheimer. Your line is open.

Shaul Eyal
Analyst, Oppenheimer & Co. Inc.
Q

Thank you so much for squeezing me in. In addition to Yi's prior question, Vincent, I have more of a technology-related question. I think also it is related to your Japan launch.

When I look at your Norton ID Advisor and your solutions associated with the gaming industry, there's definitely plenty of dark web capabilities. Are these capabilities homegrown? Do you actually use your own sensors in the dark web or is it facilitated through some third-party? Thank you for that.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.
A

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Yeah, so we have – as LifeLock had a mix of integrated third-party technologies and own algorithm that builds on top. So it's a mix of the two and we'll continue to build upon that to offer it not only in Japan but across all countries.

Someone was asking, hey, if you launch it in Japan, why don't you launch in all countries internationally exactly for that reason because you want to adapt your data architecture, your sensors and your approach to the country and the data that's relevant in each country. And so we're taking a country by county approach to build up the solution.

Shaul Eyal
Analyst, Oppenheimer & Co. Inc.

Q

Thank you.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

A

Thank you.

Operator: At this time, there are no more questions. I will turn the call back to Vincent Pilette, CEO, for closing remarks.

Vincent Pilette
Chief Executive Officer & Director, NortonLifeLock, Inc.

Thank you, Ann. The overlap between the physical world and the digital world continues to grow. More and more activities are moving online from shopping to socializing. Almost every aspect of our life has a digital component.

Unfortunately, many of those activities are left unprotected or weakly protected at best, leaving many doors open for cyber criminals. Our vision is to protect and empower people to live their digital lives safely and while we have already accomplished a lot since we launched NortonLifeLock over a year ago, we're just getting started.

We plan to leverage our leading technologies and integrated product portfolio, our relentless focus on customer experience, our trusted global brand, our unmatched skill and direct distribution, as well as a growth-focused financial model. If I have to summarize it in four words, I would say our future is bright.

Thank you for joining and for your support, and we look forward to connecting with you very soon.

Operator: This concludes today's conference. Thank you, everyone, for your participation. You may now disconnect.

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