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NortonLifeLock, Inc. (NLOK)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, everyone. Thank you for standing by. My name is Jerome, and I'll be your conference operator today. I would like to welcome everyone to the NortonLifeLock Fiscal 2022 Second 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 of Investor Relations. Miss, you may begin.

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

Thank you, Jerome, and good afternoon, everyone. Welcome to the NortonLifeLock's fiscal 2022 second quarter earnings call. Joining me today to review our Q2 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 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 the IR website at investor.nortonlifelock.com.

In addition, we previously announced the merger of NortonLifeLock and Avast. The information shared today will be limited to what has already been disclosed in the documents published on our website in connection with the deal.

Today's call contains statements regarding our business, financial performance and operations, including the impact of the ongoing COVID-19 pandemic on our business and industry, which may be considered forward-

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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 our 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 2, 2021.

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

Vincent Pilette

Chief Executive Officer & Director, NortonLifeLock, Inc.

Thank you, Mary. Welcome, and good afternoon, everyone. We've come a long way since we became a consumer-focused stand-alone company exactly two years ago today. As I reflect on NortonLifeLock's transformation, I'm extremely proud of our team. We committed to operating within financial discipline and bringing meaningful and sustainable growth to this business, and we have delivered. We have relentlessly been building a strong track record and remain focused on meeting our long-term objectives.

As you've heard me share before, we are focused on driving growth by improving customer experience, scaling our integrated cybersafety platform and accelerating the pace of our product innovation from core securities to trust-based digital solutions. By putting our customers first and relentlessly executing to our plan, we believe our long-term goals are within reach.

Our strategy is working. And as we delivered another quarter of solid and consistent growth, Q2 revenue was up 11%, with high single-digit growth in bookings. We are delivering strong profitability and continued EPS expansion, up almost 20% year-over-year.

Our high single-digit bookings growth was in line to our long-term objectives and is reflective of our normal seasonality, with the first half of our fiscal year historically being seasonally lower. The start of Q2 was impacted by expected weaker summer demand and COVID reopening as more people mobilized or prioritized to travel and other activities.

As we balanced all of our operational metrics and investment, we finished the quarter with strong momentum, delivering our eighth straight quarter of net direct customer adds, sequentially. Our direct customer count grew over 178,000 sequentially, and we added over 2.6 million customers year-over-year, bringing our total customer count to 23.3 million.

In Q2, our direct-to-consumer revenue, which represented the majority of our business, was up 9%, with ARPU growing slightly quarter-over-quarter and unit retention stable. We have continued to build a richer and more robust product portfolio, as we reach more consumers on a global basis, while driving higher engagement with our existing customers. Our Net Promoter Score continues to improve from low-40s last year to 49 this quarter, reflecting our focus on customer experience and providing peace of mind to our customers as they live their digital lives.

Our international expansion efforts continued in Q2 and grew double digits, similar to last quarter. We continue to invest in our freemium model as it increases our consumer reach and awareness, and we are encouraged that our nascent expansion into identity internationally is now available in more than 20 countries across Europe and Asia. It is a critical component of our ability to provide more value to our customers outside of the US, replicating the success we have had with ID Advisor in Japan, where we combined Dark Web Monitoring with Elements Of Restoration.

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Our partner business posted double-digits revenue growth for the quarter – for the actually fourth straight quarter, up 25% in Q2. All channels contributed meaningfully to these results. Amongst those, the employee benefits channel delivered another very strong quarter. We've expanded beyond the United States, offering our employee benefit solutions to Canadian employers and unlocking a broader customer base.

Our investment in this area are paying off, as we have strengthened our sales team and market coverage in the last few quarters. We intend to expand our overall partner business, and we will continue to invest in our multichannel approach evaluating all potential opportunities and markets globally.

Overall, we are on track to our plan and committed to investing in what we see as a long-term secular growth opportunity to develop the best cybersafety portfolio for consumers. As a result, we continued to accelerate the pace of our product innovation pipeline, as we work to bring cybersafety to every digital user and release products that help protect consumers' devices, privacy and identity.

We opened the quarter with the release of Norton Utilities Ultimate, a new performance maintenance offering that helps create a faster and smoother and more secure experience for consumers whether they're gaming or browsing or streaming content or more on their Windows PC.

We expanded Norton Family with new features, including Favorite Locations, to help parents establish approved geographic locations and receive notifications when their child's device arrives or departs those set locations. We also introduced Alert Me, which helps parents stay informed about their children's location by setting specific dates and times to receive automatic check-in alerts from the location of their child's device. Both of these new features were quite timely as many kids headed back to school in person.

On the Identity front, we added Payday Loan Lock to selected US LifeLock plans to help block the opening of fraudulent payday loans and other short-term loans. And we've added new features like Social Media Monitoring in more markets to provide consumers with broader protection as their digital footprint expands. As awareness grows globally for Identity Protection, we continue to evolve our roadmap to protect our customers and provide the most relevant products and features to new audiences.

As we continue to strengthen our privacy pillar and help provide additional ways for consumers to control their online privacy, we released Norton AntiTrack in the US, a new app and browser extension that helps prevent websites from tracking and profiling users in ways normal private browsers or VPNs cannot do. That way, people can protect and control their digital footprints from companies and websites that track online activities and collect or sell their personal data.

We've seen positive momentum from this new product release as consumers are seeing ways to protect their privacy. And I'm pleased to share that Norton AntiTrack as we expanded now to APJ and EMEA earlier this week. Privacy, overall, is one of the three pillars of our cybersafety portfolio, and we should continue to see investment in this area to help consumer manage their privacy and reputation online.

In Q2, we also released our first Environmental, Social and Governance Report. This report highlights NortonLifeLock's ongoing pledge to bring together our team, expertise and technology to help build a safe, inclusive and sustainable future. We are making good progress on this front, and I'm proud of all of our employees, the commitment we have made together to develop a responsible company. I encourage you to check all of our achievement in that area on our IR website.

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Additionally, we were recognized by the Business Intelligence Group 2021 Sales and Marketing Technology Awards, or what they call The Sammys, which ranked NortonLifeLock as one of the top medium-sized companies of 2021 for innovation in sales and marketing technology. We were recognized for our efforts upgrading customer service operations with the development of a new internal sales platform that was built by our own in-house engineers and launched in the spring of 2021. This technology enable us to better deliver key customer services within a single easy-to-use interface.

The platform also replaced a legacy vendor-supplied solution, driving cost efficiencies for the company. This is a great example of the team's living our value. They advocated for the customer. They were empowered to take initiative to identify the opportunity, and they delighted customers while improving our business operations. And more importantly, they've delivered.

Before I turn the call over to Natalie to discuss the financial results, I would like to provide an update on our proposed merger with Avast. We have made great progress, and we continue to be enthusiastic about the combination of the two companies and the opportunity to accelerate innovation in cybersafety. We crossed an important milestone today with NortonLifeLock shareholders voting to overwhelmingly support our ongoing transformation through the proposed merger with Avast, with the next key step being the Avast shareholder vote scheduled for November 18.

We're also actively and collaboratively working through the antitrust and other regulatory processes in all relevant jurisdictions, and we believe we are on-track to close mid of next calendar year 2022, as previously stated. Our strategy has been to protect and empower consumers as more and more of their lives move online, and this transaction will allow the combined companies to invest in and accelerate innovation for new cybersafety products.

And now, let me turn the call over to Natalie for more details on the financials.

Natalie M. Derse

Chief Financial Officer, NortonLifeLock, Inc.

Thank you, Vincent, and hello, everyone. To all our customers, shareholders and listeners around the world, who are celebrating Diwali today, may the festival of lights bring joy and happiness to you and your families.

For today's discussion, I will focus on non-GAAP financials, starting with our Q2 results, and then provide our outlook for Q3 and full year. We delivered another solid quarter, rounding out a strong first half of our fiscal year. Our Q2 revenue was $695 million, up 11%. Our growth remains broad-based across geos and products. Bookings growth of 7% was supported by our renewal efforts, expanded product offerings and continued international expansion.

Our total direct customer count increased to 23.3 million, adding 2.6 million customers year-over-year and adding 178,000 net new customers quarter-over-quarter. This was our eighth consecutive quarter of sequential net direct customer adds.

In a quarter where there is seasonally lower demand, our strong net adds in Q2 is evidence that there is growing demand for our products, and we feel proud to have added over 300,000 net new customers in the first half of our fiscal year. Our operational metrics remain strong, with 85% unit retention and our monthly average revenue per user, or ARPU, increased on a sequential basis to $8.85.

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As a result, our direct business maintained consistent growth momentum, up 9% in revenue. We continue to drive higher engagement with our existing loyal customers through the accelerated pace of new product releases, while scaling up our cross-sell efforts. We are also reaching more audiences with the expansion of our Identity Protection offerings into more international markets, providing broader cybersafety protections to newer cohorts of customers.

As Vincent mentioned earlier, our partner business again posted strong results in Q2, up 25% year-over-year with continued strength in employee benefits, as well as growth from other distribution channels. Although it accounts for approximately 10% of our total, our partner business remains a key tenant of our long-term growth strategy and will continue to be an important investment area for us, and we are encouraged by the year-to-date growth unlocks thus far.

Turning to profitability. Q2 operating margin was 52%, up 200 basis points year-over-year. We operate with a growth-focused approach in our investment decisions. With sales and marketing, we are constantly evaluating the effectiveness of our spend to optimize how we reach consumers and market our products to maximize the return on these investments for both the short-term and long-term in an increasingly competitive advertising environment.

With R&D, we have focused our efforts on increasing the pace of new product launches, while maintaining a robust evolving product pipeline for our customers. And we self-fund these investments through productivity gains and lower infrastructure costs, operating at 87% gross margin and with G&A less than 5% of revenue, as we drive long-term sustainable growth.

Q2 net income was $255 million, up 19% year-over-year. Diluted EPS was $0.43 for the quarter, also up 19% year-over-year and at the high end of our guidance range. We remain focused on EPS expansion and achieving our long-term EPS objective of $3 that we shared back in May this year.

Turning to our cash flow and balance sheet. Q2 operating cash flow was $60 million, and free cash flow was $59 million, which included seasonal tax payments. Year-to-date operating cash flow was $318 million, in line with our net income improvement and growth. We ended Q2 with over $1.5 billion of total cash, which includes the cash proceeds from the July sale of our Mountain View Ellis buildings. We remain levered at approximately two times net debt and maintain both a strong liquidity position and a healthy balance sheet.

In Q2, we also returned approximately $73 million to shareholders in the form of our regular quarterly dividend of $0.125 per common share. For Q3, the Board of Directors has approved a regular quarterly cash dividend of $0.125 per common share to be paid on December 15, 2021, for all shareholders of record as of the close of business on November 22, 2021, as described in the press release. And a reminder that while we still have approximately $1.8 billion remaining in the current share buyback program, we cannot deploy it in the short-term due to the pending Avast transaction.

Now, turning to our Q3 and full year outlook. We expect Q3 non-GAAP revenue in the range of $695 million to $705 million, assuming stable currency rates quarter-over-quarter, which translates to 9% to 11% growth year-over-year. We expect Q3 non-GAAP EPS to be in the range of $0.42 to $0.44 per share.

For the full year, we expect non-GAAP revenue growth of 9% to 10% year-over-year in constant currency and non-GAAP EPS in the range of $1.70 to $1.75, narrowing the range to the high end on both revenue and EPS versus what we shared with you back in May at our Analyst Day. We look forward to building on our growth

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momentum and consistent profitability in the second half of this year, and we are well positioned to deliver on our objectives.

Even with the macro impacts around inflation, foreign exchange rate fluctuations, and the evolving pandemic conditions, we have successfully navigated through and continued to hit expectations. As we look forward, we will continue to challenge ourselves to anticipate, prioritize and meet customer needs in a growth-focused manner.

Thank you for your time today, and I will now turn the call back to the operator to take your questions. Please do keep in mind we are not able to answer any questions related to any specific M&A at this time. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Saket Kalia from Barclays. Your line is now open.

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

A

Okay, Saket. Good afternoon.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Hey, Vincent. Hey, good afternoon. Hey, Vincent. Hey, Natalie. Thanks for taking my questions here.

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

A

Yeah.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Natalie, maybe just to start with you. I was wondering if you could just double-click a little bit into the billings metric. I think we heard 7% growth in bookings, which was really good to hear. I think the billings growth is a little bit lower than that. I come to about 5%. Can you just walk through maybe some of the puts and takes there? I know that maybe there was a slightly tougher compare. There's always currency. I mean, just maybe you could just touch on that growth kind of compared to bookings, kind of compared to billings growth in prior quarters.

Natalie M. Derse
Chief Financial Officer, NortonLifeLock, Inc.

A

Sure. Thanks, Saket. Look, I'm not surprised with the question around 7% bookings. I'm going to focus on bookings in the response to your question. But I'm also not surprised at our Q2 results as it's in line with our models – our internal models. As you know, we don't guide bookings, but we did share that Q2 is historically a seasonally lighter quarter. We also recognized early on that, even if you look at the external search traffic metrics, either on Google metrics, Analytics, et cetera, and you hone in on our branded and non-branded terms, we knew that that search volume was lower than prior quarters and what we saw last year. And then, we also saw very early on that the advertising spend being put into the market across our competitive landscape was up.

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The other thing I'd encourage you guys to look at is, as you know, with our recurring business model, and as you know, with customer acquisition, when they get to the first year retention and renewal, there's a healthy step-up in terms of the bookings amount that we get as those customers choose to renew with us. So you really have to date back to last year. In Q1, we added 379,000 net new customers. Again, factor in the seasonality component from Q1 to Q2, last year, at this time, we added about 117,000 net customers. When you factor into the model, the step-up in the renewal bookings that we get from that renewable customer base, it would point you to a 7% result for us.

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

A

If I can add, just if you step back, Saket, quarter-in, quarter-out, obviously, we represent bookings, so investors can understand the underlying metrics. But revenue and bookings trend about the same way, not every quarter, but on a multi-quarter trend. And we guided revenue for next quarter, 9% to 11%. Again, we don't guide bookings, but we see this trending somewhat in that range.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Got it. Got it. That's very helpful. Vincent, maybe for my follow-up for you, a lot of good things happening internationally. Can you just remind us how big is international currently as a percentage of the business? And sort of what's – I guess, how big can you see international long term as a percentage of total? And is that more of a antivirus type of market? Is that more of an identity monitoring market? Is it a little bit of both? Curious, how you sort of see international sort of longer term?

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

A

It's a good question, Saket. I'll give you the short Belgium answer. International is not big enough. Today, it represent about 30% of our business. As you know, we acquired Avira to accelerate our growth internationally. As you said, a lot of good efforts initially are offering in those outside of the US countries did not include identity elements. We now start to build up the portfolio to move above and beyond that security, moving into protecting the digital lives, exploring element of restoration and so what I call solutions, which includes services. I think on a long-term perspective, outside of the US, we have a huge structural growth opportunities.

Obviously, the proposed merger with Avast will boost all of that. It will be more balanced. When I look at different industry technology or even the demographic, as you know, we should be more 40% in the US, 60% international versus the reverse on a unit basis, and we're going to continue to expand.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Very helpful. Thanks guys.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] Your next question comes from the line of Hamza Fodderwala from Morgan Stanley. Your line is now open.

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Hamza Fodderwala
Equity Analyst, Morgan Stanley & Co. LLC

Q

Hey, good evening guys.

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

A

Hey.

Hamza Fodderwala
Equity Analyst, Morgan Stanley & Co. LLC

Q

Thanks for taking my questions.

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

A

Yeah. For sure.

Hamza Fodderwala
Equity Analyst, Morgan Stanley & Co. LLC

Q

So I'll keep it to one question. Natalie, since you alluded to inflation, I'm curious what NortonLifeLock is thinking about in terms of pricing on renewal, particularly into the next fiscal year. Thank you.

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

A

If you don't mind, I'll take it and I'll step back a little bit in a broader context. First, as you know, we've acquired Avira. Our number one objective is to scale our cybersafety platform. And you're going to see us continue to invest into the freemium model, expanding the freemium model to above security, expanding to other countries, and that's our first point of entry, we would love that the 5 billion Internet users are all fully consciously protected from cybercriminality.

When it comes to then our ongoing prices, obviously, pricing structure and how do you upsell and move to a premium model have different structure. First, your price, as you know, as a promotion to get in the first time you get in. And then you have the renewal price at the normal MSRP that we have set. And then we're tracking the dynamic of cost, inflation, competition in every country. It is a dynamic environment. It is a competitive environment. And so our pricing philosophy follows the value we provide to the members. As we continue to add the new product and new value to that membership, then customers opt to higher level of membership, and that's the whole business model the way I've described it.

Hamza Fodderwala
Equity Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

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

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Vincent Pilette

Chief Executive Officer & Director, NortonLifeLock, Inc.

Why don't we wait one minute to see if there's nobody? Last time, there was no more question. We had, two minutes later, plenty of questions trying to get in. So let's check one more time, operator, if you don't mind.

Operator: Sure. [Operator Instructions]

Vincent Pilette

Chief Executive Officer & Director, NortonLifeLock, Inc.

Okay. Well, we'll – obviously are always, as a management, very open and available for any questions our investors or analysts would have. We'll have plenty of one-on-one sessions between now and the next few days. I do want to thank our shareholders that have overwhelmingly approved the issuance of shares to – for the acquisition or the merger with Avast. We see that as a vote of confidence, confidence into our strategy, confidence into the specific transaction, confidence into the board and management. So, thank you, everyone, and we'll be connecting very soon.

Operator: Thank you. This concludes the conference call. You may now disconnect. Thank you.

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NORTONLIFELOCK PROFIT FORECAST

This document contains the following statements regarding NortonLifeLock's anticipated earnings per share ("**EPS**"):

- "*We expect Q3 non-GAAP EPS to be in the range of $0.42 to $0.44 per share*"; and
- *"For the full year, we expect … non-GAAP EPS in the range of $1.70 to $1.75, narrowing the range to the high end … versus what we shared with you back in May at our Analyst Day*."

Each of the above statements (together, the "**NortonLifeLock Profit Forecast**") constitutes an ordinary course profit forecast for the purposes of Rule 28.1(a) and Note 2(b) on Rule 28.1 of the UK's City Code on Takeovers and Mergers (the "**Code**").

Notes

References to "GAAP" in the NortonLifeLock Profit Forecast are to U.S. GAAP, being the accounting policies applied in the preparation of NortonLifeLock's annual results for the year ended April 2, 2021. The press release published by NortonLifeLock on November 4, 2021, being the same date as the earnings call of which this document constitutes a transcript, contains the following explanation regarding non-GAAP financial measures:

"*We use non-GAAP measures of operating margin, net income and earnings per share, which are adjusted from results based on GAAP and exclude certain expenses, gains and losses. We also provide the non-GAAP metrics of revenues, constant currency revenues, and free cash flow, which is defined as cash flows from operating activities less purchases of property and equipment. These non-GAAP financial measures are provided to enhance the user's understanding of our past financial performance and our prospects for the future. Our management team uses these non-GAAP financial measures in assessing NortonLifeLock's performance, as well as in planning and forecasting future periods. These non-GAAP financial measures are not computed according to GAAP and the methods we use to compute them may differ from the methods used by other companies. Non-GAAP financial measures are supplemental, should not be considered a substitute for financial information presented in accordance with GAAP and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Readers are encouraged to review the reconciliation of our non-GAAP financial measures to the comparable GAAP results, which is attached to our quarterly earnings release and which can be found, along with other financial information including the Earnings Presentation, on the investor relations page of our website at Investor.NortonLifeLock.com. No reconciliation of the forecasted range for non-GAAP EPS guidance is included in this release because most non-GAAP adjustments pertain to events that have not yet occurred. It would be unreasonably burdensome to forecast, therefore we are unable to provide an accurate estimate*."

Basis of preparation

The NortonLifeLock Profit Forecast has been prepared on a basis consistent with NortonLifeLock's accounting policies, on the basis summarized in the Notes above.

The NortonLifeLock Profit Forecast excludes any transaction costs attributable to the Merger or any other associated accounting impacts as a direct result of the Merger.

Assumptions

The NortonLifeLock Profit Forecast is based on the assumptions listed below.

Factors outside the influence or control of the NortonLifeLock Directors:

- There will be no material changes to existing prevailing macroeconomic or political conditions in the markets and regions in which NortonLifeLock operates.

- There will be no material changes to the conditions of the markets and regions in which NortonLifeLock operates or in relation to customer demand or the behavior of competitors in those markets and regions.
- The interest, inflation and tax rates in the markets and regions in which NortonLifeLock operates will remain materially unchanged from the prevailing rates.
- There will be no material adverse events that will have a significant impact on NortonLifeLock's financial performance.
- There will be no material adverse events that will have a significant impact on the timing and market acceptance of new product releases and upgrades by NortonLifeLock.
- There will be no business disruptions that materially affect NortonLifeLock or its key customers, including natural disasters, acts of terrorism, cyber-attack and/or technological issues or supply chain disruptions.
- There will be no material changes to foreign exchange rates that will have a significant impact on NortonLifeLock's revenue or cost base.
- There will be no material changes in legislation or regulatory requirements impacting on NortonLifeLock's operations or its accounting policies.
- There will be no new material litigation and no unfavorable resolutions of existing material litigation in relation to any of NortonLifeLock's operations.
- The announcement of the Merger will not have any material impact on NortonLifeLock's ability to negotiate new business.

Factors within the influence and control of the NortonLifeLock Directors:

- There will be no material change to the present executive management of NortonLifeLock.
- There will be no material change in the operational strategy of NortonLifeLock.
- There will be no material adverse change in NortonLifeLock's ability to maintain customer and partner relationships.
- There will be no material acquisitions or disposals.
- There will be no material strategic investments over and above those currently planned.
- There will be no material change in the dividend or capital policies of NortonLifeLock.
- There will be no unexpected technical or network issues with products or processes.

NortonLifeLock Directors' confirmation

With the consent of Avast, the Panel on Takeovers and Mergers has granted a dispensation from the UK Takeover Code requirement for NortonLifeLock's reporting accountants and financial advisers to prepare reports in respect of the NortonLifeLock Profit Forecast.

The NortonLifeLock Directors have considered the NortonLifeLock Profit Forecast and confirm that it has been properly compiled on the basis of the assumptions set out in this document and that the basis of the accounting used is consistent with NortonLifeLock's accounting policies.