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GEN.OQ - Q2 2023 NortonLifeLock Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 08, 2022 / 10:00PM GMT

OVERVIEW:

Co. reported 2Q23 non-GAAP reported revenue of $748m, net income of $269m and diluted EPS of $0.45. Expects 3Q23 non-GAAP revenue to be $925-940m and non-GAAP EPS to be $0.42-0.45.

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PRESENTATION

Operator

Good afternoon, everyone. Thank you for standing by. My name is Matt, and I will be your conference operator today. I would like to welcome everyone to Gen's Second Quarter Fiscal Year 2023 Earnings Call. Today's call is being recorded. (Operator Instructions)

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

Mary Lai - *NortonLifeLock Inc. - Head of IR*

Thank you, Matt, and good afternoon, everyone. Welcome to Gen's first earnings call. Joining me today to review our second quarter fiscal year 2023 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 slides and press release.

I'd like to remind everyone that during this call, all references to the financial measures 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 investors.gendigital.com.

Today's call contains statements regarding our business, financial performance and operations, including the impact of our business industry that 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 most recent reports on Form 10-K and 10-Q.

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

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

Thank you, Mary, and welcome, everyone, to our first earnings call at Gen Digital. In many ways, we are a new company, better positioned as a leader in Cyber Safety and with an expanded purpose of powering Digital Freedom for everyone. Our mission is to create technology solutions for people to take full advantage of the digital world safely, privately and confidently.

Let me tell you a little bit about why we created Gen. Generations today are normally associated with age, such as Gen X, Gen Y or Gen Z, but all generations, no matter what your age, are connected by one thing. We are all digital, generation digital. We shop, bank, learn, socialize online. And that is just today. We have reimagined what the future will bring and what we can bring to Generation D.

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Digital technology and innovation bring tremendous benefits to consumers in ways we could never have imagined, but they also make our world more complex, more demanding, more exposed. They have created new threats and challenges. Hacking has become a profession. The dark web is a black market used by bad actors and the challenges are not limited to hacking, scamming or phishing. Our personal data is exposed everywhere, and algorithms are influencing our reasoning.

Safety, of course, remains an absolute requisite for protecting our digital lives and fully benefiting from the digital world we live in. Protecting online security is how we got started 30 years ago, and it's still at the heart of what we do today, but that's not enough anymore. At Gen, we are committing to bring our credibility, our passion, our innovation to step up and boldly tackle new challenges, powering digital freedom for everyone.

Gen is now the leader that consumers trust to deliver comprehensive digital protection and empowerment in the digital world. We are now united by our family of trusted brands, including Norton, Avast, LifeLock, Avira, AVG, ReputationDefender and CCleaner. These amazing brands have and will continue to spend generations with products and solutions that suit different lifestyles and life stages.

We will also focus on trust-based solutions that will do more than just help people around the world live fuller, safer digital lives today. We will help define what it means to be freely in the digital world of tomorrow.

As you know, Gen is dual headquartered in both the U.S. and Czech, giving us the benefits of a truly global talented team located across America, Europe and Asia. We have a purpose-driven culture with an innovative mindset. We have products and solutions in over 150 countries with an omnichannel distribution strategy, and we are trusted by over 500 million users around the world.

It is critically important to us to provide a seamless integrated Cyber Safety portfolio with best-in-class functionalities and products that are easy to use and consumer-friendly.

Before I share more about the quarter, let me talk a little bit about our integration. We closed the Avast acquisition on September 12, and we are off to a great start. We have announced our new organizational design and leadership teams to help drive the next chapter of this company. On November 1, we merged our back-end systems and have detailed technology and integration road maps.

As a result, we have increased our annual savings to over $300 million, and we believe we will be fully completed within the next 18 months.

With the combined go-to-market, leveraging a powerful set of trusted brands, we are focused on the opportunity to deliver more value to our current customers across our brands. We know that higher engagement leads to growth in ARPU and growth in retention for our nearly 65 million Cyber Safety customers, which includes both paid direct and partners.

As of today, we have identified initiatives that are revenue synergy opportunities of about $200 million in the next 2 years, giving us additional confidence in our ability to sustain a mid-single-digit growth rate in the midterm. While an integration is never easy for the team, we are collectively very motivated by the opportunity in front of us.

Now let me move to our Q2 results. I will provide a high-level summary, and then Natalie will spend more time walking you through our detailed results and the reporting structure post acquisition.

Supported by our strong execution in a challenging environment, we delivered our 13th consecutive quarter of growth, with Q2 bookings up 11% and revenue up 12% in constant currency, which includes 7 percentage points of contribution from Avast. Excluding Avast, our Cyber Safety bookings revenue grew 5% in constant currency, in line with our mid-single-digit growth expectation. Earnings grew 5% or 12% excluding the impact of currency headwinds.

Our market leadership, our strong customer loyalty and the continued increase in value we delivered to our product innovation and membership adoption enable us in the current economic environment to really tackle the business from a position of strength.

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At the core, we are a technology and product company. And one thing that will not change is our continued pursuit for a faster pace of innovation and build out of our product portfolio. Combining our offering with Avast gives us the most comprehensive product portfolio featuring a full coverage of Cyber Safety needs. We are the first to offer a fully-integrated platform covering device security and performance, data and cloud security, identity protection, personal privacy and reputation management.

Before the acquisition, over 60% of our customers had taken a membership or platform approach using Norton 360. Now with Avast, we approximately have 35% of our customers having adopting a platform, giving us the opportunity to offer another 15 million customers the benefits of a feature-rich platform.

While we are making fast progress on the technology front and the product integration front, we remain focused on the pace of our product releases, whether they are new products, new functionalities or platform upgrades. We continue to make strong inroads with our privacy solutions. In Q2, AntiTrack expanded its capabilities to additional browsers and countries and we launched our privacy monitoring assistance, or PMA solution into retail channel for the first time.

In the identity pillar, we continued our international expansion and launched our ID Advisor Plus offering to more European countries, including Germany and France. We have also launched several new enhancements to the U.S. LifeLock experience, including guided child credit fees. We also launched e-mail gradient with Avast, a new feature capable of filtering malicious e-mails with no endpoints present independent of Avast used.

The new online safety score provides regular feedback on the user's digital habits and personalized tips to help them take charge of their online safety. Finally, we are also very pleased by the performance of the Avast security engine, which scored top marks in leading independent tests. Overall, the Avast team brings a lot of technology know-how and an innovation mindset around human-centric Cyber Safety, which makes our combination even richer for consumers.

Expanding our ability to reach customers is equally important. Gen is now a house of brands with diversified set of sales channels and a business model that spans from freemium to premium. Direct-to-consumer business remains the main channel for us today. Despite macroeconomic pressure that showed in global e-commerce traffic through the quarter, we're able to grow bookings 3% in our direct-to-consumer business. We strategically deployed our marketing spend, focusing on higher ARPU versus customer counts. We believe that this is the right way to deploy our marketing spend in this current environment and we will continue to adapt to deliver the most efficient and highest returns on our investment.

On the partner side, we continue to expand geographically, delivering another double-digit growth quarter. Our value proposition of complete Cyber Safety, including security, identity and privacy protection is taking root. As an example, we're excited to have launched our identity offering for a large British telco provider expanding our effort of identity protection for the U.K. market and replicating the success we have had in Canada.

As Gen, we have expanded our customer universe but that is a small step towards our mission to protect and empower every one of the 5 billion global Internet users. Today, we have over 500 million total users, including paid and free customers. One layer down, we have a new classification of paid Cyber Safety, towing about 65 million customers that is made up roughly of 39 million paid direct customers and over 25 million paid customers from our partner business.

And while our direct customers count declined by roughly 60,000 quarter-over-quarter on the NortonLifeLock side and 190,000 on the Avast side, our short-term focus and opportunity coming out of the acquisition is to work on the increasing -- on increasing the value for millions of our customers and consequently their satisfaction and retention rate.

While paid direct customer count is an important metric, it is also important to highlight that we have multiple levers to drive booking growth in more diversified ways such as growing in ARPU with the opportunity of cross-selling new products, growing in memberships, offering a platform approach to Cyber Safety and growing in retention rates, especially on the Avast side, supported by our best-in-class support and services organization.

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Post acquisition, we have about 2/3 of our customers that benefit mainly from a broadly defined security offering. As a result of the acquisition, our aggregated monthly ARPU is now $7 per customer. And we have -- as we have done before, we believe we have the opportunity to demonstrate the need for a comprehensive Cyber Safety approach, including cross-selling identity and privacy solutions from a richer portfolio and increase ARPU over time.

As I mentioned, our platform strength continues to be a cornerstone of our strategy. We have over 14 million members with a membership plan for Norton 360, Avast One or Avira Prime. This represent approximately 35% of our direct customers and believe we have the opportunity to bring that ratio to over 50% over time as we did it at NortonLifeLock over the last 2 years. We have observed higher utilization, higher satisfaction and better retention for our customers that have subscribed to a membership and now benefits from our broad portfolio.

Customer satisfaction is a very important metric at Gen. It is supported by consumer-centric approach to our innovation and the largest service organization in consumer Cyber Safety. As a result, our NortonLifeLock Direct customer renewed their membership at a retention rate of 85% plus. When including our Avast customer base and mobile customers, our aggregate retention rate is now 75%. This is an opportunity to cross-pollinate our operational know-how and offer a rich portfolio supporting by a global service organization to all of our 65 million customers whether direct or through partners. We see this as an opportunity to increase our 75% retention rate over the next 2 years.

In addition to our integration work, we have clean line of sight and priorities for our growth and operational initiatives. Taking into consideration what I just mentioned, we have identified $200 million of potential revenue synergies that should lead to growing ARPU and growing retention rates over the next 2 years. We have channel diversification initiatives focused on partnerships and new segments such as the Avast platform for small businesses. And we will prioritize the effectiveness of our marketing spend on bookings growth over direct customer count.

These revenue opportunities, combined with over $300 million of cost synergies should deliver tremendous value and create room to invest for the long-term opportunity. So as we look to the future, the current and potentially a recessionary economy does put downward pressure on some part of our business, but we also see this as an opportunity and a catalyst for us. I am confident with our high recurring revenue model, coupled with our operational discipline that our business will remain durable and flexible to navigate the short-term challenging environment.

At the end, we know that the need for comprehensive Cyber Safety and Digital Freedom is a secular growth trend, and we are the leader.

And now let me turn the call over to Natalie to cover our results and new reporting details. Natalie?

Natalie Marie Derse - *NortonLifeLock Inc. - EVP, CFO & Principal Accounting Officer*

Thank you, Vincent, and hello, everyone. It's a very exciting time for our company. We are thrilled to bring the Avast and NortonLifeLock businesses together and move forward as Gen. Our team is highly motivated to get started and bring our vast opportunities to market.

For today's discussion, I will walk you through our Q2 results, outlook for Q3 and wrap up with details on our long-term model. I will focus on non-GAAP financials and year-over-year growth rates, unless otherwise stated. A reminder that our reported results also include a partial quarter of Avast, which was acquired on September 12, 2022.

Before we dive into the results, I would like to share how we evaluate and measure business performance as Gen. Gen is centered on Cyber Safety. Our product portfolio is split by consumer security, identity and information protection and our go-to-market omnichannel business lines are split by direct and partners.

Direct makes up about 90% of our business with subscriptions sold directly through our e-commerce sites or third-party app stores. We have further harmonized our direct channel definitions and aligned to industry standards now including NortonLifeLock mobile app store customers and revenue in this category.

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Although partners only account for approximately 10% of our combined business, this channel remains an investment area for us as we further diversify our distribution models to provide multiple entry points for the consumer, including employee benefits, retailers, OEMs, telcos, service providers and small businesses.

With the combined focus on Cyber Safety and go-forward portfolio identified through the integration with the Avast, we have also carved out a legacy category, which includes end-of-life products or accident markets. In total, this makes up less than 3% of our overall revenue base, and we expect it to phase out over the next few quarters.

Going forward, our discussions will be focused on Cyber Safety growth. For more details on our reporting structure, I'd like to point you to Slide 13 in our earnings presentation.

Now on to our Q2 results. Q2 results reflect our consistent execution and focus on driving long-term sustainable growth. Q2 is our 13th consecutive quarter of bookings growth, supported by a healthy and robust customer base and strong unit economics.

Q2 bookings grew 11% in constant currency and was in line with our expectations. Excluding Avast, Cyber Safety bookings grew 5% in constant currency as we drove increased value through cross-sells in the Norton customer base and our key partner channels continue to scale, including identity-driven partnerships with international telcos and employee benefit partners in the U.S.

Q2 non-GAAP reported revenue was $748 million, up 12% in constant currency and up 8% in USD. This includes a partial quarter of Avast, which contributed $48 million or 7 points of growth in constant currency. Similar to prior quarters, our top line growth includes an unfavorable impact of 4 points as a result of increased foreign exchange headwinds of over $30 million year-over-year. We expect this currency headwind to continue with both the euro and yen depreciating further against the U.S. dollar in recent weeks.

Despite volatile macroeconomic impacts, our Cyber Safety revenue, excluding Avast, continues to grow mid-single digits in constant currency, in line with expectations and, again, a reflection of our focused and consistent execution.

Stepping through our other key operating metrics. Direct revenue of $660 million grew 11% in constant currency and 7% in USD supported by cross-sell and other monetization initiatives with our existing customer base. Direct customer count went from $23.3 million reported at the end of Q1 as NortonLifeLock to $38.6 million at the end of Q2 as Gen, including approximately 15 million Cyber Safety customers from Avast.

Quarterly performance implied a combined decline of $252,000 quarter-over-quarter with $62,000 from NortonLifeLock and $190,000 from Avast. Both companies saw continued headwinds from lower global website traffic to our e-commerce site, impacting new online customer acquisition. But together with Avast, we now have an even larger opportunity to leverage our go-to-market efforts and further optimize our marketing investment across brands and SEO to drive up traffic and conversion.

Q2 direct monthly average revenue per user, or ARPU, was USD 6.98, which reflects a blended ARPU of NortonLifeLock and Avast combined with a vast ARPU of approximately $4.30 and mobile ARPU of approximately $2.50. Specifically for NortonLifeLock results, ARPU expanded over $0.30 year-over-year adjusted for FX.

We are proud of the progress we've made in the last year, increasing the value provided to our existing customers through our cross-sell and upsell efforts and are excited to drive similar improvements with the Avast customer base. Our customer base remains loyal with NortonLifeLock retention stable at 85% exiting Q2. As we merge with Avast, our overall customer retention rate moves from 85% to 75% blended. We believe the 20-point retention differential between NortonLifeLock and Avast presents a large synergy opportunity to drive growth with our existing customer base. I will expand on this more as we discuss revenue synergies shortly. For further details on our performance metrics, please refer to Slide 14 in the earnings deck.

Moving on to partners. Partner revenue was $74 million, up 21% in constant currency and 16% in USD, impacted by 5 points of FX headwind. This is our eighth consecutive quarter of double-digit revenue growth in partners as we leverage this channel to extend our reach to consumers and broaden our product and geo expansion efforts. We will continue to invest in this omnichannel strategy, specifically in telco and retail partnerships

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that drive distribution of our expanded portfolio offerings, employee benefits were Cyber Safety and identity protection is essential to the employees' lives and through small businesses where entrepreneurs can scale their businesses with peace of mind knowing they are digitally protected. Partners will remain a key cornerstone of our investments going forward.

Turning to profitability. Q2 operating income was $388 million, up 7% year-over-year with partial results from Avast. We continue to run G&A lean at roughly 4% of revenue, which provides the operating leverage to invest in sales and marketing and R&D. We remain disciplined in our cost structure with margins flat year-over-year.

Looking ahead as Gen, we will strike the right balance on investments across our expanded portfolio and channels and will be intentional on how we spend in order to drive the highest returns across the markets, channels and customers we serve.

Q2 net income was $269 million, up 5% compared to last year. Diluted EPS was $0.45 for the quarter, up 5% year-over-year or 12% in constant currency, including $0.03 of currency headwind. Please note that this reflects partial dilution from the $94 million of Avast share issuance and higher cost of our debt. And our non-GAAP tax rate estimate was 23%, which represents a blended rate before any tax restructuring efforts.

Turning to our cash flow and balance sheet. Q2 operating cash flow was a use of cash of $88 million and CapEx was consistent at $2 million in the quarter. Seasonally, Q2 operating cash flow is the lowest quarter of the year due to the concentration of tax payments. This quarter also includes approximately $110 million of cash payments tied to the closing of the Avast deal and related financing transactions. Looking ahead, we have high confidence in our cash flow generation, which will continue to grow with profitability.

Year-to-date, we have returned over $550 million back to shareholders in the form of both buybacks and dividends. We deployed a total of $404 million towards share repurchases or over 17 million shares in the first half of this fiscal year and have approximately $1.4 billion remaining in our current buyback program.

In Q2, we repurchased $104 million or 5 million shares. We also paid $73 million to shareholders in the form of our quarterly dividend of $0.125 per common share. For Q3, the Board of Directors approved a regular quarterly cash dividend of $0.125 per common share to be paid on December 14, 2022, for all shareholders of record as of the close of business on November 21, 2022.

Moving to our capital structure. We had a lot of activity in Q2 related to the Avast acquisition and maturities that came due during the quarter. We now have a capital structure in place that we believe sets us up well for the long term. Our debt maturities have been extended and staggered through fiscal year 2031 with no near-term maturities due until April of 2025.

We remain well positioned with $2.6 billion in liquidity, and our gross leverage is 4.4x with net leverage just under 4x. You can refer to Slide 31 in the earnings deck for more details on our go-forward capital structure.

Looking ahead, Gen as a combined business has predictable and highly ratable revenue, generates significant free cash flow on an annual basis and is backed by a strong liquidity position. We will drive a balanced and disciplined capital allocation approach between targeted deleveraging and opportunistic share buybacks. We feel good about where we are at, and we will continue to evaluate and assess our overall debt needs and leverage profile in this ever-changing environment.

Now an update on the Avast integration and expected synergies. We're pleased to report that our pre-integration planning and actions we've taken to date have successfully accelerated our integration time line from 24 months to 18 months. This is a big undertaking, and we are aggressively going after this. Our integration efforts are well underway with day 1 of integration officially kicked off a week ago on November 1, and I'm pleased to share with you today that we are increasing our annual gross cost synergy estimate to over $300 million.

In terms of phasing, we intend to exit fiscal year 2023 with 50% of the $300 million annual run rate achieved and exit the first half of our next fiscal year with 70% achieved. 100% completion exiting fiscal year 2024. We expect the post-synergy structure with gross margins of over 88% and OpEx reduced from approximately 35% of revenue today to 28% to 30%. This translates to an operating margin framework of approximately 60% and any leverage we drive above that creates flexibility to drive even more growth and portfolio diversification.

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With the addition of Avast, our complementary strengths provide increased levers to drive top line growth across the combined $500 million existing user base. We have identified approximately $200 million in revenue synergies over the next 2 years. Opportunities include Avast retention improvement, increased cross-sell and upsell, leveraging an expanded product portfolio and marketing spend optimization across brands, just to name a few. Achieving these synergies will help strengthen our mid-single-digit growth rate.

We expect traction with revenue synergies to be measured directly through ARPU and retention improvements over the coming quarters to support our bookings and top line growth expectations.

Now turning to our Q3 outlook. For Q3, we expect non-GAAP revenue in the range of $925 million to $940 million, which reflects the first full quarter of contribution from Avast and reflects Cyber Safety mid-single-digit bookings growth. This also includes approximately $40 million of headwinds from FX. We expect Q3 non-GAAP EPS to be in the range of $0.42 to $0.45 per share. This reflects the first quarter dilutive impact from Avast. But please note, we expect Avast to be accretive in the first 12 months.

Based on the continued strengthening of the U.S. dollar quarter-to-date, we anticipate the currency headwinds to persist and the interest rate conditions to remain volatile. But I want to emphasize that the underlying health of the business remains strong and durable. And given our high cash flow generation and strong liquidity, we are confident in our ability to navigate through the near-term challenges. Q3 is just the first step post-Avast towards our long-term objectives.

Beyond Q3, we continue to remain focused on our long-term $3 EPS objective that we communicated during our last Investor Day. Given the meaningful macroeconomic changes since then and now that we have merged with Avast, we have looked at a revised path to achieve this. First, we recognize that the rising cost of debt and FX headwinds has created a $0.60 to $0.65 headwind. Beyond that, the building blocks and past remain largely the same as we've laid out previously at Investor Day as well as 15 months ago during the Avast deal announcement.

The annual gross cost synergies of over $300 million, combined with the accretion from Avast profits, will create more capacity for reinvestment in a faster time line, and will fund the diversification efforts and next Horizon Bet that helps solidify our growth targets.

We expect our business to grow at mid-single digits, supported by the revenue synergies I laid out above, the complementary strengths and increased levers as a combined company and the long-term secular importance of Cyber Safety.

These growth drivers are centered on product innovation and new product introductions, expanding reach and distribution through our omnichannel strategy and expansion of our trust-based services. The focus remains on customer experience at the core.

Finally, we intend to use our capital to deliver incremental EPS with a disciplined approach of debt paydown and opportunistic share buyback ultimately offsetting the dilution from the Avast share issuance. This all ladders up to an annualized EPS of $3 as we exit fiscal year 2025 and in line with the time line we shared with you 18 months back.

We are excited about these opportunities for growth and remain relentlessly focused on what we can control to achieve it. For more details, please refer to the whiteboard bridge in Slide 27 of the earnings presentation.

In summary, we remain committed to driving EPS expansion. We are focused on accelerated integration time line, on execution against our business opportunities and driving towards our long-term objectives. We have a very robust business model with a healthy customer base, and we remain focused on expanding new customer acquisition through new channels and geos, driving more value for our existing customers as well as increasing engagement with new products and services. We will provide updates and increments as we work through integration in these next few quarters.

As always, 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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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from the line of Saket Kalia with Barclays.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Okay. Great. Congrats on closing Avast. Yes, Vincent, there's a lot to go through, particularly with Avast, but then maybe we can start just with the organic Gen business, if you will, right? It was great to see the churn improve versus last quarter. The net churn, the 62,000 net churn metric. I think most of us were prepared for something worse even versus last quarter, just given the trend in PC shipments. Maybe the question for you is, what do you think drove that improvement from last quarter's result despite that trend in PCs?

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

Yes. So I mean, as you guys know, we're not directly related to PCs. I think the PC is a good indicator of the pressure on the overall consumer spend and a lot of PC where bought and where onetime purchase during the COVID period, we obviously are more of a subscription business post device. People still spend time online, as you know. That is a growing metric. People still are exposed to risks in the digital world, and that's also a growing scary metric. So the need for our product is still there.

We said it for now 2 quarters that those macro level trends are impacting our global traffic and our ability to grow faster, our new customers coming from our direct marketing investments. But we continue to really foster their installed base, making sure we deliver the best value possible and it showed up into continued growing ARPU and high retention rates.

Quarter in, quarter out, I don't think there is like something to conclude. We now have 39 direct million customers, 65 million total customers. And the trend would be -- although it's slightly negative, I would call them like flat plus or minus a percentage point. And I think you're going to continue to see that trend for probably a couple of quarters for as far as we can see. But we are really focusing on the opportunities we have within our current installed base and growing bookings through cross-pollination of all of the best practices both companies bring together.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Got it. Got it. That makes a lot of sense. Natalie, maybe for you. I mean, you said in the prepared remarks, just a really busy quarter for just the capital structure. I was wondering if you could just build on that and just talk about the delevering plan going forward. Obviously, a good amount of debt here to finance the acquisition. I think we said $0.40 to $0.45, just from the rising rate environment that eats into some of that EPS accretion. Maybe the question for you is, how do you think about your options here for delevering? Or maybe any other options to just generally control interest expense?

Natalie Marie Derse - *NortonLifeLock Inc. - EVP, CFO & Principal Accounting Officer*

Yes. Saket, thanks for the question. So I would start with -- our capital allocation tenants are largely the same pre and post-Avast deal. I think the first and a very critical component of that is for us to get on to our annual free cash flow target of generating $1.5 billion. That's going to really bring to light the execution of the internal leadership team, really executing on all of these opportunities, both revenue and cost synergies and really generate that free cash flow.

Beyond that, as a reminder, what we've said is our key tenants are we want to get -- we're going to stay committed to our dividend, so take -- put that aside. And then we're going to find the right balance across our leverage ratio and our opportunistic share buyback. Of course, with the Avast financing and with the dramatic shift in the rates and the debt environment, we're about 1 point higher on our net debt leverage than we expected. And we're obviously facing into that.

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It's not the only component of our capital allocation, and I don't think we can look at deleveraging in isolation. If you looked at it in isolation, I mean, obviously, the cost of debt is about 3x what we thought it was going to be even, I don't know, call it, 7 to 9 months ago. But when you also take a look at the dilution that came with the deal. We've talked about the Avast share issuance. So we're facing into that. We're also facing into what the -- when you look at our share price and really think about opportunistic share buybacks, the balance is incredibly key. And I think it's not only a balance of 1 lever or the next, there's also a timing component to that, too.

And so by no means is it easy to strike that right balance, but we are super clear eyed about it, and we're trying to find and find how we actually balance across all these different factors, especially as the dynamics change so rapidly in the market.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Yes, absolutely. Well said. If I can sneak in a last one and then I'll cede the floor. Vincent, maybe for you. The $200 million in revenue synergies was great to see. I think you touched on it a little bit just in terms of retention rates, in particular. But I was wondering if you could just go one little deeper just in terms of, the building blocks of the $200 million in synergies, any thoughts on time frame in terms of when you get there and kind of how you get comfortable with that $200 million in revenue?

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

Yes, absolutely. And so we have about 6 initiatives identified. It's important to note that they are not dependent on new product innovations. It's really about leveraging the strength of both organizations to offer more value to our customers, retention rates supported by our service organization coming into this deal will hugely benefit on the Avast side. You know that they have pressure on the retention rate, about 65%, and we've identified a set of operational initiatives here to move that up.

Cross-selling identity and privacy more complete, comprehensive plan is an important one as well. Avast has a lot of focused technology and features and products. On the privacy side, we bring our identity protection expertise. And I think the cross-selling is the second one. The third one is really the move and upselling to the platform approach. I mentioned that about 60% of our customers had adopted before the acquisition, that platform view. We see higher satisfaction, higher usage. Avast has just launched Avast One. And I think now we're going to leverage that expertise to offer to the 15 million customers coming from Avast, the opportunity to benefit from it.

And then you have a set of go-to-market efficiency improvements. One is the e-commerce side and the operational capabilities we have developed. We know we can benefit from rebalancing a very significant performance marketing budget across all lines and leveraging our freemium to premium scope of business model will be the fifth initiative. And the sixth one is expanding in a few various channels that we did not have, one of them being the very small and small businesses.

So those are the 6 initiatives. We put them over 24 months. Make no mistakes. We are treating that as the priority day 1 immediately. We know we'll integrate, we know we'll deliver the cost synergies, obviously, driving value for our customers is our overall priority for us.

Operator

The next question is from the line of Matt Hedberg with RBC.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

Congrats from me as well on the deal. Vincent, for you. The 66% Avast retention certainly seems like an opportunity from the cost synergy or from the revenue synergy perspective, you talked about. I'm wondering how much of that is just due to European exposure versus something maybe structurally with Avast? Just sort of wondering like how quickly we could see that Avast retention look more like sort of let NortonLifeLock?

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Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

Totally, let me break it down and timing, we can talk about it because I think timing is linked to the bucket, but definitely at a very high level. If you separate, I would call it, there's a bucket of structural differences that you will never change. And I told you and all of you that the acquisition of Avira was a great warm up for us to understand how to manage freemium to premium business models, and it gave us the confidence to merge with Avast and create this new foundation. We know it is definitely an enabler of our future growth.

On that retention side, I would say there's a set of structural view such as our European business or premium business model or other things. And about, I would say, 1/3 to half would be structural. Now some of the structural things we can tackle them, but back to timing, they will take longer.

And then there is another set of operational differences. And that we know we've already brought to Avira and will bring to Avast in terms of improving retention, whether it's customer help service organizations, some of the feature insider product. I won't go too much into the details. But we know that we have at least 10 points here that are linked to our own operational execution. And that's what we, in the short term, are focused on.

We said over 2 years because we'll do a lot of, obviously, testing and deployment. We'll be cautious on timing of revenue synergies. They always take longer, but we'll accelerate the cost synergies to support the accretion on the bottom line. That's at the high level what the retention means.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

That's super, super great. That's super helpful. And then Natalie, it looks like apples-to-apples versus your revenue guide, it looks like kind of core NortonLifeLock was about $700 million, which is a little below the low end of the range. I'm wondering how much of that was due to currency headwinds that transpired since your last guidance? In other words, what was the incremental currency headwind since you reported your Q1 results to revenue?

Natalie Marie Derse - *NortonLifeLock Inc. - EVP, CFO & Principal Accounting Officer*

Yes, it was about 4 points of growth. It's definitely a pretty significant headwind that we've been facing into the last few quarters with the volatility.

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

If I can complement to that answer. I would say, Matt. Matt, one sec. I would say that the growth -- you broke it down pretty well, which is basically our core business is marching towards what we had said our guidance was and growing at mid-single digits. And we see these trends to continue. The difference, of course, are the macro level, currency being the #1 factor hitting us.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

Yes, great. And I think you said 4 points of headwind. I don't know if that's a year-on-year perspective, but do you know it was like a $5 million headwind incrementally, $10 million since last guidance? Just on kind of just -- I don't know if you have that figure or we can certainly circle back on a call back.

Natalie Marie Derse - *NortonLifeLock Inc. - EVP, CFO & Principal Accounting Officer*

No, we have it. So we're facing into about $30 million of currency headwind. From a quarter-over-quarter perspective, it was about $3 million to $4 million. Worse.

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Operator

The next question is from the line of Fiona Hynes with Morgan Stanley.

Fiona Grace Hynes - *Morgan Stanley, Research Division - Research Associate*

Congrats on closing Avast. And I'm covering for Hamza. So I appreciate all of the color on the updated reporting structure that you walked through in the prepared remarks. I wanted to follow up a little bit on the partner channel. It looks like the sequential growth there was a little bit lighter this quarter, even including the $5 million of contribution from Avast. So wanted to get any updated commentary on what drove that performance in the quarter? And then kind of your view of the ability of the partner channel to contribute on a go-forward basis. Where do you see that overall mix and contribution of revenue growing over the midterm?

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

And I'll take the first question. Natalie you can supplement. Definitely, in our partner business, I would continue to see that, as Natalie mentioned, an investment area. There's 4 or 5 key buckets from employee benefits to telco channels to now adding with Avast the SMB area. Now we had in our partner business in the past, as you know, also the mobile app direct customer, which will move into the direct business. So that may influence a little bit. Quarter in and quarter out, I think that -- I wouldn't call it deceleration, you'll see up and down in that business, all outgrowing the direct business based on our investment profile.

Natalie Marie Derse - *NortonLifeLock Inc. - EVP, CFO & Principal Accounting Officer*

Yes, I just would supplement that, right? So from a partner perspective, it's about 10% of our business. So we're going to continue to invest. We've seen strong quarters, very consistent double-digit rate of growth. It continues to help. It's more important in the expansion into different markets and different channels and different customer cohorts. That's the value that we really get out of it. Of course, double-digit rate of growth in our -- in 10% of our revenue isn't bad. That's helpful as well. It's a diversification channel for us.

Operator

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

Vincent Pilette - *NortonLifeLock Inc. - CEO & Director*

Thank you. So Gen's opportunity ahead is massive. Even with the near-term macro headwinds, we're still in early stages of long-term secular needs. And as we start this new chapter as Gen, let me recap how I feel.

Our purpose is broad, meaningful and inspirational. The market is vast and full of opportunities. We are a house of trusted consumer brands. We have scale and a diversified go-to-market and we have great products, technology and technologists. And above all, we have a passionate and skilled team that thinks big and plays to win.

So thank you for your support, and I look forward to talking to you soon.

Operator

This concludes the conference call. Thank you.

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