McAfee, Inc.
Form 10-Q
November 06, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)** **OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended September 30, 2009**
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)** **OF THE SECURITIES EXCHANGE ACT OF 1934** **For the transition period from to**

Commission file number: 001-31216

McAfee, Inc.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**77-0316593** *(I.R.S. Employer Identification Number)*
3965 Freedom Circle **Santa Clara, California** *(Address of principal executive offices)*	**95054** *(Zip Code)*

Registrant s telephone number, including area code:
(408) 988-3832

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of October 30, 2009, 157,727,804 shares of the registrant s common stock, $0.01 par value, were outstanding.

MCAFEE, INC. AND SUBSIDIARIES

FORM 10-Q
September 30, 2009

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements (Unaudited)***

MCAFEE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2009	December 31, 2008
	(Unaudited)	
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 639,373	$ 483,302
Short-term marketable securities	244,082	27,449
Accounts receivable	231,764	322,986
Prepaid expenses	320,045	221,900
Deferred income taxes	285,810	310,870
Other current assets	42,025	38,281
Total current assets	1,763,099	1,404,788
Long-term marketable securities	22,408	82,974
Property and equipment, net	128,289	114,435
Deferred income taxes	318,549	303,937
Intangible assets, net	324,363	315,803
Goodwill	1,286,520	1,169,616
Other assets	65,315	66,328
Total assets	$ 3,908,543	$ 3,457,881
LIABILITIES		
Current liabilities:		
Accounts payable	$ 46,339	$ 41,529
Accrued income taxes	19,569	20,675
Accrued compensation	109,488	82,648
Other accrued liabilities	214,331	194,680
Deferred revenue	1,022,354	989,096
Bank term loan	100,000	
Total current liabilities	1,512,081	1,328,628
Deferred revenue, less current portion	311,409	304,014
Accrued taxes and other long-term liabilities	66,383	72,751

Total liabilities	1,889,873	1,705,393
Commitments and contingencies (Notes 8, 12 and 13)		
STOCKHOLDERS EQUITY		
Preferred stock, $0.01 par value:		
Authorized: 5,000,000 shares; Issued and outstanding: none in 2009 and 2008		
Common stock, $0.01 par value:		
Authorized: 300,000,000 shares; Issued: 185,881,841 shares at September 30, 2009 and 181,133,439 shares at December 31, 2008		
Outstanding: 157,558,171 shares at September 30, 2009 and 153,534,594 shares at December 31, 2008	1,859	1,812
Treasury stock, at cost: 28,323,670 shares at September 30, 2009 and 27,598,845 shares at December 31, 2008	(841,598)	(819,861)
Additional paid-in capital	2,204,260	2,053,245
Accumulated other comprehensive loss	(3,492)	(18,992)
Retained earnings	657,641	536,284
Total stockholders equity	2,018,670	1,752,488
Total liabilities and stockholders equity	$ 3,908,543	$ 3,457,881

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MCAFEE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Unaudited) (In thousands, except per share data)			
Net revenue:				
Service and support	$ 250,851	$ 208,773	$ 713,630	$ 596,745
Subscription	184,129	166,752	556,802	491,969
Product	50,291	34,154	131,234	87,364
Total net revenue	485,271	409,679	1,401,666	1,176,078
Cost of net revenue:				
Service and support	27,558	17,031	78,627	47,460
Subscription	51,192	48,245	148,526	141,210
Product	28,660	19,623	70,702	48,981
Amortization of purchased technology	19,360	13,610	57,193	40,527
Total cost of net revenue	126,770	98,509	355,048	278,178
Operating costs:				
Research and development	82,248	64,478	240,407	185,101
Sales and marketing	155,594	139,264	465,182	392,061
General and administrative	65,948	49,888	149,359	146,721
Amortization of intangibles	10,492	5,502	30,600	16,478
Restructuring charges	1,714	2,675	10,919	532
Total operating costs	315,996	261,807	896,467	740,893
Income from operations	42,505	49,363	150,151	157,007
Interest and other income, net	1,028	16,242	2,982	39,529
Impairment of marketable securities		(12,356)	(710)	(14,926)
Gain on sale of investments, net	41	663	267	5,913
Income before provision for income taxes	43,574	53,912	152,690	187,523
Provision for income taxes	6,785	5,104	33,792	60,720
Net income	$ 36,789	$ 48,808	$ 118,898	$ 126,803
Other comprehensive income:				
Unrealized gain (loss) on marketable securities, net	$ 1,584	$ 2,996	$ 3,346	$ (1,514)
Foreign currency translation gain (loss)	6,097	(39,803)	14,613	(26,924)
Comprehensive income	$ 44,470	$ 12,001	$ 136,857	$ 98,365

Net income per share basic	$ 0.23	$ 0.32	$ 0.76	$ 0.81
Net income per share diluted	$ 0.23	$ 0.31	$ 0.75	$ 0.79
Shares used in per share calculation basic	157,186	152,347	155,580	157,350
Shares used in per share calculation diluted	159,925	155,006	158,250	160,590

The accompanying notes are an integral part of these condensed consolidated financial statements.

MCAFEE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(Unaudited) (In thousands)	
Cash flows from operating activities:		
Net income	$ 118,898	$ 126,803
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	126,402	86,292
Impairment of marketable securities	710	14,926
Deferred income taxes	12,993	22,508
Non-cash restructuring charge (benefit)	840	(3,465)
Decrease in fair value of options accounted for as liabilities		(5,483)
Non-cash stock-based compensation expense	75,656	52,513
Excess tax benefits from stock-based awards	(8,643)	(17,167)
Other non-cash items	4,592	(4,510)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	95,744	23,173
Prepaid expenses and other assets	(72,097)	(48,391)
Accounts payable	2,203	3,532
Accrued taxes and other liabilities	(25,150)	(23,373)
Deferred revenue	19,071	11,120
Net cash provided by operating activities	351,219	238,478
Cash flows from investing activities:		
Purchase of marketable securities	(307,789)	(252,031)
Proceeds from sales of marketable securities	14,830	347,871
Proceeds from maturities of marketable securities	141,265	426,035
Purchase of property and equipment	(44,401)	(34,745)
Acquisitions, net of cash acquired	(171,618)	(103,237)
Other investing activities	158	
Net cash (used in) provided by investing activities	(367,555)	383,893
Cash flows from financing activities:		
Proceeds from issuance of common stock under stock option and stock purchase plans	70,548	117,307
Excess tax benefits from stock-based awards	8,643	17,167
Repurchase of common stock	(21,737)	(515,571)
Bank borrowings	100,000	
Other financing activities	(4,949)	(869)

Net cash provided by (used in) financing activities	152,505	(381,966)
Effect of exchange rate fluctuations on cash	19,902	(23,742)
Net increase in cash and cash equivalents	156,071	216,663
Cash and cash equivalents at beginning of period	483,302	394,158
Cash and cash equivalents at end of period	$ 639,373	$ 610,821

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Business

McAfee, Inc. and our wholly owned subsidiaries (we , us or our) are a global dedicated security technology company that secures systems and networks from known and unknown threats. We empower home users, businesses, government agencies, service providers and our partners with the ability to block attacks, prevent disruptions, and continuously track and improve their security and compliance. We operate our business in five geographic regions: North America; Europe, Middle East and Africa (EMEA); Japan; Asia-Pacific, excluding Japan; and Latin America.

2. Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements include our accounts as of September 30, 2009 and December 31, 2008 and for the three and nine months ended September 30, 2009 and September 30, 2008. All intercompany accounts and transactions have been eliminated in consolidation. These condensed consolidated financial statements have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The December 31, 2008 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, we believe the disclosures are adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto, included in our annual report on Form 10-K for the year ended December 31, 2008.

In the opinion of our management, all adjustments (which consist of normal recurring adjustments, except as disclosed herein) necessary to fairly present our financial position, results of operations and cash flows for the interim periods presented have been included. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year or for any future periods.

Significant Accounting Policies

Marketable Securities

All marketable securities are classified as available-for-sale securities. Available-for-sale securities are carried at fair value with resulting unrealized gains and losses, including the non-credit component of other-than-temporary impairments, reported net of tax as a component of accumulated other comprehensive income (loss). Premium and discount on debt securities recorded at the date of purchase are amortized and accreted, respectively, to interest income using the effective interest method. All proceeds received from the sale and maturity of our marketable securities are reflected in investing activities in the condensed consolidated statements of cash flows, including amounts related to discounts and premiums recorded at the time of purchase. Short-term marketable securities are those with remaining maturities at the balance sheet date of less than one year. Long-term marketable securities have remaining maturities at the balance sheet date of one year or greater. Realized gains and losses on sales of all such investments are reported in earnings and are computed using the specific identification cost method.

In April 2009, new accounting guidance was issued, which revised the existing impairment model for debt securities by modifying the current intent and ability indicator in determining whether a debt security is other-than-temporarily impaired. For debt securities in an unrealized loss position, we are required to assess whether (i) we have the intent to sell the debt security, or (ii) it is more likely than not that we will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an other-than-temporary

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

impairment on the security must be recognized in earnings equal to the entire difference between its fair value and amortized cost basis.

For debt securities in an unrealized loss position where neither of the criteria in the paragraph above are present, the difference between the security s then-current carrying amount and its estimated fair value is separated into (i) the amount of the impairment related to the credit loss (i.e., the credit component) and (ii) the amount of the impairment related to all other factors (i.e., the non-credit component). The credit component is recognized in earnings. The non-credit component is recognized in accumulated other comprehensive income (loss). The credit loss component is the excess of the amortized cost of the security over the best estimate of the present value of the cash flows expected to be collected from the debt security. The non-credit loss component is the residual amount of the other-than-temporary impairment. Previously, in all cases, if an impairment was determined to be other-than-temporary, then an impairment loss was recognized in earnings in an amount equal to the entire difference between the security s amortized cost basis and its fair value.

When calculating the present value of expected cash flows to determine the credit loss component of the other-than-temporary impairment, we estimate the amount and timing of projected cash flows on a security-by-security basis. These calculations reflect our expectations of the performance of the underlying collateral and the ability of the issuer to meet payment obligations as applicable. The expected cash flows are discounted using the effective interest rate of the security prior to any impairment. The amortized cost basis of a debt security is adjusted for credit losses recorded to earnings. The difference between the cash flows expected to be collected and the new cost basis is accreted to investment income over the remaining expected life of the security.

Pursuant to recently issued accounting guidance, we were required to separate other-than-temporary impairments recognized in earnings through April 1, 2009, between the credit loss and the non-credit components, and record a cumulative effect adjustment to retained earnings for the non-credit component. Upon adoption on April 1, 2009, we recorded a net after tax increase to retained earnings and a corresponding decrease to accumulated other comprehensive income of $2.5 million, net of $1.6 million in tax benefits. Periods prior to April 1, 2009, have not been restated for this new accounting policy and therefore, current period and prior period financial statements may not be comparable.

Inventory

Inventory, which consists of components and finished goods held at our warehouse and other fulfillment partner locations and finished goods sold to our channel partners but not yet sold through to the end-user, is stated at lower of cost or market. Cost is computed using standard cost, which approximates actual cost on a first in, first out basis. Inventory balances are included in other current assets on our condensed consolidated balance sheets and were $12.8 million as of September 30, 2009 and $10.2 million as of December 31, 2008, net of write-offs for inventory expected to be excess or obsolete.

Deferred Costs of Revenue

Deferred costs of revenue consist primarily of costs related to revenue-sharing and royalty arrangements, and the direct cost of materials that are associated with product and subscription revenues deferred over a service period, including arrangements that are deferred due to lack of vendor-specific objective evidence (VSOE) of fair value on an

undelivered element. At September 30, 2009, our deferred costs were $284.4 million compared to $184.6 million at December 31, 2008. Of the $284.4 million of deferred costs at September 30, 2009, $250.2 million is included in the prepaid expenses line item and $34.2 million is included in the other assets line item on our condensed consolidated balance sheets. Of the $184.6 million of deferred costs at December 31, 2008, $152.7 million is included in the prepaid expenses line item and $31.9 million is included in the other assets line item on our condensed consolidated balance sheets. The prepaid line item includes revenue sharing costs that have been paid in advance of the anticipated renewal transactions. Costs associated with renewal transactions are classified as current

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

or non-current consistent with the associated deferred revenue. We recognize deferred costs ratably as revenue is recognized.

Reclassifications

In the condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2008, we reclassified sales order operation department expenses to conform to our current period presentation. Expenses of $2.7 million and $8.3 million for the three and nine months ended September 30, 2008, respectively, including $0.1 million and $0.4 million, respectively, of stock-based compensation expense previously reported in general and administrative expenses are now included in sales and marketing expenses. This reclassification improves the transparency of the cost of our sales process and does not affect our total operating costs, income from operations or net income for the three and nine months ended September 30, 2008.

Fair Value Measurements

Carrying amounts of our financial instruments including accounts receivable, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The carrying amount of our bank term loan approximates fair value as the interest rate is consistent with current rates on similar debt. The fair values of our investments in marketable securities and derivatives are disclosed in Note 5.

In August 2009, additional guidance provided clarification in measuring the fair value of liabilities in circumstances in which a quoted price in an active market for the identical liability is not available and in circumstances in which a liability is restricted from being transferred. This guidance required companies to determine the fair value of liabilities using market prices for similar or identical liabilities when traded as an asset, if available. This guidance is effective for us beginning October 1, 2009, and is not expected to have a significant impact on our financial statements.

The following table presents the types of fair value measurements for our marketable debt securities, foreign currency contracts and contingent purchase consideration liabilities as of September 30, 2009 (in thousands):

		Fair Value Measurements at September 30, 2009 Using		
Description	**September 30, 2009**	**Quoted Prices in Active Markets Using Identical Assets (Level 1)(1)**	**Significant Other Observable Inputs (Level 2)(2)**	**Significant Unobservable Inputs (Level 3)(3)**
Assets:				
United States treasury and agency securities(4)	$ 105,578	$ 102,768	$ 2,810	$

Foreign government securities(4)		23,315				23,315		
Certificates of deposit and time deposits(4)		34,673				34,673		
Corporate debt securities(4)		83,374				83,374		
Mortgage-backed securities(4)		10,319				10,319		
Asset-backed securities(4)		9,231				9,231		
Cash and cash equivalents(5)		145,725		2,000		143,725		
Foreign exchange derivative assets(6)		41		41				
Total assets measured at fair value	$	412,256	$	104,809	$	307,447	$	
Liabilities:								
Foreign exchange derivative liabilities(7)	$	157	$	157	$		$	
Contingent purchase consideration liabilities(8)		35,261						35,261
Total liabilities measured at fair value	$	35,418	$	157	$		$	35,261

(1) Level 1 classification is applied to any financial instrument that has a readily available quoted price from an active market where there is significant transparency in the executed/quoted price.

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(2) Level 2 classification is applied to financial instruments that have evaluated prices received from fixed income vendors with data inputs which are observable either directly or indirectly, but do not represent quoted prices from an active market for each individual security.

(3) Level 3 classification is applied to fair value measurements when fair values are derived from significant unobservable inputs.

(4) Included in short-term or long-term marketable securities on our condensed consolidated balance sheets.

(5) Includes certificates of deposit, corporate debt securities, commercial paper and United States agency securities that have maturities that are less than 90 days. Balance is included in cash and cash equivalents on our condensed consolidated balance sheets.

(6) Included in other current assets on our condensed consolidated balance sheets.

(7) Included in other accrued liabilities on our condensed consolidated balance sheets.

(8) Included primarily in accrued taxes and other liabilities on our condensed consolidated balance sheets. See Note 4 for further discussion.

Market values were determined for each individual security in the investment portfolio. For marketable securities and foreign currency contracts reported at fair value, quoted market prices or pricing services that utilize observable market data inputs are used to estimate fair value. We utilize pricing service quotes to determine the fair value of our securities for which there are not active markets for the identical security. The primary input for the pricing service quotes are recent trades in the same or similar securities, with appropriate adjustments for yield curves, prepayment speeds, default rates and subordination level for the security being measured. Similar securities are selected based on the similarity of the underlying collateral for asset-backed and collateralized mortgage securities, and similarity of the issuer, including credit ratings, for corporate debt securities. Investments are held by a custodian who obtains investment prices from a third party pricing provider that uses standard inputs to models which vary by asset class. We corroborate the prices obtained from the pricing service against other independent sources and, as of September 30, 2009, have not found it necessary to make any adjustments to the prices obtained.

The fair values of the foreign exchange derivatives do not reflect any adjustment for nonperformance risk as the contract terms are three months or less and the counterparties have high credit ratings.

Recent Accounting Pronouncements

Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance on revenue recognition that will become effective for us beginning January 1, 2011, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue

recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. We believe that when we adopt this new guidance our condensed consolidated financial statements will be impacted and we are currently assessing the magnitude of the impact.

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting for Uncertainty in Income Taxes

In September 2009, the FASB issued authoritative guidance which provides additional implementation guidance on accounting for uncertainty in income taxes. This guidance is effective beginning July 1, 2009. This guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

Subsequent Events

In May 2009, the FASB issued authoritative guidance which established general standards of accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, it established that we must evaluate subsequent events through the date the financial statements are issued, the circumstances under which a subsequent event should be recognized, and the circumstances for which a subsequent event should be disclosed. It also requires us to disclose the date through which we have evaluated subsequent events. This guidance was effective for us beginning April 1, 2009 and did not have an impact on our consolidated financial position, results of operations or cash flows.

Business Combinations

In December 2007, the FASB revised their guidance on business combinations. The new guidance requires an acquiring entity to measure and recognize identifiable assets acquired and liabilities assumed at the acquisition date fair value with limited exceptions. The changes also include the treatment of acquisition related transaction costs, the valuation of any noncontrolling interest at the acquisition date fair value, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals subsequent to the acquisition date and the recognition of changes in the acquirer s income tax valuation allowance (see Note 4). In April 2009, the FASB further revised their guidance regarding the accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. It amended the provisions in the December 2007 guidance for the recognition measurement and disclosures of asset and liabilities arising from contingencies in business combinations, and carries forward most of the previous provisions for acquired contingencies. This new guidance was effective for us beginning January 1, 2009.

3. Employee Stock Benefit Plans

We record compensation expense for stock-based awards issued to employees and outside directors in exchange for services provided based on the estimated fair value of the awards on their grant dates. Stock-based compensation expense is recognized over the required service or performance period of the awards. Our stock-based awards include stock options (options), restricted stock units (RSUs), restricted stock awards (RSAs), restricted stock units with performance-based vesting (PSUs) and employee stock purchase rights issued pursuant to our Employee Stock Purchase Plan (ESPP grants).

The following table summarizes stock-based compensation expense (in thousands):

	Three Months Ended September 30,	Nine Months Ended September 30,

	2009	2008	2009	2008
Amortization of fair value of options	$ 7,642	$ 6,802	$ 20,237	$ 18,179
Restricted stock awards and units	10,280	5,905	30,295	18,212
Restricted stock units with performance-based vesting	7,163	7,031	19,695	14,180
Employee Stock Purchase Plan	1,514	1,442	5,429	1,942
Cash settlement of certain options			6,058	(382)
Tender offer				601
Total stock-based compensation expense	$ 26,599	$ 21,180	$ 81,714	$ 52,732

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amortization of fair value of options. We recognize the fair value of options issued to employees and outside directors and assumed in acquisitions as stock-based compensation expense over the vesting period of the awards. The estimated fair value of options is based on the Black-Scholes pricing model.

Restricted stock awards and units. We recognize the fair value of RSAs and RSUs issued to employees and outside directors and assumed in acquisitions as stock-based compensation expense over the vesting period of the awards. Fair value is determined as the difference between the closing price of our common stock on the grant date or acquisition date and the purchase price of the RSAs and RSUs.

Restricted stock units with performance-based vesting. We recognize stock-based compensation expense for the fair value of PSUs issued to employees.

The PSUs can have performance-based vesting components that vest only if performance criteria are met for each respective performance period (performance component). Additionally, the PSUs can have service-based vesting components that have accelerated vesting provisions if performance criteria are met for each respective performance period (service component). The PSUs issued to employees have either performance components or service components or both.

If the performance criteria are not met for a performance period, then the related performance components that would have vested are forfeited and the related service components do not accelerate. Certain performance criteria allow for different vested amounts based on the level of achievement of the performance criteria.

For certain performance components, we do not communicate the performance criteria to the employees. For these awards, the accounting grant date does not occur until it is known whether the performance criteria are met, and such achievement or non-achievement is communicated to the employees. These awards are marked-to-market at the end of each reporting period through the accounting grant date, and recognized over the expected vesting period, provided we determine it is probable that the performance criteria will be met.

For performance components for which the performance criteria have been communicated to the employees, the accounting grant date is deemed to have occurred. Fair value has been measured on the grant date and is recognized over the expected vesting period, provided we determine it is probable that the performance criteria will be met.

For the service components, each tranche is accounted for as a separate award and the accounting grant date is the date the grant was communicated to the employees. Fair value is measured on the grant date, and is recognized over the expected vesting period for each tranche. The expected vesting period for each tranche is based on the service-based vesting period or the accelerated vesting period if the performance period has been set and we determine it is probable that the performance criteria will be met.

Employee Stock Purchase Plan. We recognize stock-based compensation expense for the fair value of ESPP grants. The estimated fair value of ESPP grants is based on the Black-Scholes pricing model. Expense is recognized ratably based on contributions and the total fair value of the ESPP grants estimated to be issued.

Cash settlement of certain options. We paid $6.1 million in June 2009 related to certain expired stock options.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes stock-based compensation expense recorded by condensed consolidated statements of income and comprehensive income line item (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Cost of net revenue service and support	$ 882	$ 533	$ 2,400	$ 1,261
Cost of net revenue subscription	332	244	886	561
Cost of net revenue product	384	355	1,120	780
Stock-based compensation expense included in cost of net revenue	1,598	1,132	4,406	2,602
Research and development	6,699	4,970	19,904	13,036
Sales and marketing	10,646	9,355	36,841	22,469
General and administrative	7,656	5,723	20,563	14,625
Stock-based compensation expense included in operating costs	25,001	20,048	77,308	50,130
Total stock-based compensation expense	26,599	21,180	81,714	52,732
Deferred tax benefit	(7,770)	(5,897)	(22,394)	(14,841)
Total stock-based compensation expense, net of tax	$ 18,829	$ 15,283	$ 59,320	$ 37,891

We had no stock-based compensation costs capitalized as part of the cost of an asset.

At September 30, 2009, the estimated fair value of all unvested options, RSUs, RSAs, PSUs and ESPP grants that have not yet been recognized as stock-based compensation expense was $143.4 million, net of expected forfeitures. We expect to recognize this amount over a weighted-average period of 2.3 years. This amount does not reflect stock-based compensation expense relating to 0.6 million PSUs for which the performance criteria had not been set as of September 30, 2009.

4. Business Combinations

2009 Acquisitions

On September 1, 2009, we acquired 100% of the outstanding shares of MX Logic, Inc. (MX Logic), a Software-as-a-Service provider of on-demand email, web security and archiving solutions for $138.5 million. The MX Logic purchase agreement provides for earn-out payments totaling up to $30.0 million contingent upon the achievement of certain MX Logic revenue targets. The $24.6 million fair value of the earn-out payments has been accrued for a total purchase price of $163.1 million.

The MX Logic contingent consideration arrangement requires payments up to $30.0 million that will be due and payable if certain criteria in relation to revenue recognized on the sale of MX Logic products are met during the three-year period subsequent to the close of the acquisition. The fair value of the contingent consideration arrangement of $24.6 million was determined using the income approach with significant inputs that are not observable in the market. Key assumptions include discount rates consistent with the level of risk of achievement and probability adjusted revenue amounts. The expected outcomes were recorded at net present value. Subsequent changes in the fair value of the liability will be recorded in earnings. As of September 30, 2009 the range of outcomes and the assumptions used to develop the estimates had not changed significantly, and the amount accrued in the financial statements increased by $1.0 million. The increase in fair value was due to expected achievement of the earn-out payments at an earlier date than originally assumed and an increase in the net present value of the liability due to the passage of time.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On June 1, 2009, we acquired 100% of the outstanding shares of Solidcore Systems, Inc. (Solidcore), a provider of whitelisting technology that controls and protects the applications installed on a computer, for $32.1 million. The Solidcore purchase agreement provides for earn-out payments totaling up to $14.0 million contingent upon the achievement of certain Solidcore financial and product delivery targets. The $8.4 million fair value of the earn-out payments has been accrued for a total purchase price of $40.5 million.

The Solidcore contingent consideration arrangement requires payments up to $14.0 million that will be due and payable if certain criteria in relation to amounts billed to customers for Solidcore products are met during the three-year period subsequent to the close of the acquisition and if certain criteria in relation to product development and integration are met within eighteen months of the acquisition. The fair value of the contingent consideration arrangement of $8.4 million was determined using the same approach described above for the MX Logic earn-out. As of September 30, 2009, the range of outcomes and the assumptions used to develop the estimates had not changed, and the amount accrued in the financial statements increased by $0.4 million. The increase in fair value was due to an increase in the net present value of the liability due to the passage of time.

The preliminary allocation of the purchase price was based upon preliminary estimates and assumptions that are subject to change within the purchase price allocation period (generally one year from the acquisition date). The primary areas of the purchase price allocation that are not yet finalized are related to certain tax elections for Solidcore, as well as the measurement of certain deferred tax assets and liabilities for both Solidcore and MX Logic. Our preliminary purchase price allocation for Solidcore and MX Logic are as follows (in thousands):

	Solidcore	MX Logic	Total 2009 Acquisitions
Technology	$ 14,100	$ 36,100	$ 50,200
Customer contracts and related relationships	600	34,500	35,100
Other intangibles	2,100	3,900	6,000
Goodwill	17,679	96,343	114,022
Deferred tax assets	20,996	22,458	43,454
Cash	892	320	1,212
Other assets	1,400	5,853	7,253
Total assets acquired	57,767	199,474	257,241
Accrued liabilities and other liabilities	1,972	2,215	4,187
Deferred revenue	2,435	1,817	4,252
Deferred tax liabilities	12,825	32,354	45,179
Total liabilities assumed	17,232	36,386	53,618
Net assets acquired	$ 40,535	$ 163,088	$ 203,623

Our management determined the purchase price allocations for these acquisitions based on estimates of the fair values of the tangible and intangible assets acquired and liabilities assumed. We utilized recognized valuation techniques, including the income approach for intangible assets and earn-out liabilities and the cost approach for certain tangible assets, and we used a discount rate reflective of the risk of the respective cash flows. Goodwill for Solidcore resulted primarily from our expectation that we will now be able to provide our customers with an end-to-end compliance solution that includes whitelisting and application trust technology, antivirus, antispyware, host intrusion prevention, policy auditing and firewall technologies. We intend to incorporate Solidcore s technologies into our vulnerability and risk management business, integrating it with our McAfee ePolicy Orchestrator in 2009. The goodwill for Solidcore may be deductible for tax purposes, depending on certain tax elections that have not been finalized. Goodwill for MX Logic resulted primarily from our expectation that we will be able to deliver a

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comprehensive cloud-based security portfolio to our customers. The goodwill for MX Logic is not deductible for tax purposes.

In January 2009, we acquired 100% of the outstanding shares of Endeavor Security, Inc. (Endeavor), an intrusion prevention and detection company, for $2.5 million. The Endeavor purchase agreement provides for an earn-out payment totaling $1.0 million contingent upon the achievement of certain Endeavor financial targets during the two-year period subsequent to the close of the acquisition. The fair value of the earn-out of $0.7 million at acquisition was accrued, for a total purchase price of $3.2 million. As of September 30, 2009 the range of outcomes and the assumptions used to develop the estimates had not changed, and the amount recognized in the financial statements increased by $0.1 million. The increase in fair value was due to an increase in the net present value of the liability due to the passage of time. We recorded $1.4 million of goodwill, which is not deductible for tax purposes. We did not provide the purchase price allocation for Endeavor in the table above because the effect of this acquisition was not material to our condensed consolidated balance sheets.

The results of operations for these acquisitions have been included in our results of operations since their respective acquisition dates. The financial impact of these results is not material to our condensed consolidated statements of income and comprehensive income. In connection with the MX Logic acquisition, we recognized $1.0 million of acquisition related costs that were expensed in the current period and are included in general and administrative expenses in our condensed consolidated statements of income and other comprehensive income for the period ended September 30, 2009.

2008 Acquisitions

In 2008, we acquired ScanAlert, Inc. (ScanAlert) for $54.9 million, Reconnex Corporation (Reconnex) for $46.6 million and Secure Computing Corporation (Secure Computing) for $490.1 million. The results of operations for these acquisitions have been included in our results of operations since their respective acquisition dates.

Our management determined the purchase price allocations for these acquisitions based on estimates of the fair values of the tangible and intangible assets acquired and liabilities assumed. These estimates were developed utilizing recognized valuation techniques. We are continuing to assess uncertain tax positions as well as continuing to assess measurement of certain deferred tax assets and liabilities of Secure Computing. In the nine months ended September 30, 2009, we had purchase price adjustments totaling $5.2 million, primarily adjustments to preliminary deferred tax balances for Secure Computing.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pro Forma Effect of Acquisitions

Pro forma results of operations have not been presented for Endeavor, MX Logic or ScanAlert because the effect of these acquisitions was not material to our results of operations. The following unaudited pro forma financial information presents our combined results with Solidcore as if the acquisition had occurred at the beginning of 2009 and our combined results with Solidcore, Secure Computing and Reconnex as if the acquisitions had occurred at the beginning of 2008 (in thousands, except per share data):

	Three Months Ended September 30,	Nine Months Ended September 30,	
	2008	2009	2008
Pro forma net revenue	$ 468,249	$ 1,403,326	$ 1,344,231
Pro forma net income	$ 38,069	$ 113,896	$ 39,647
Pro forma basic net income per share	$ 0.25	$ 0.73	$ 0.25
Pro forma diluted net income per share	$ 0.25	$ 0.72	$ 0.25
Shares used in per share calculation basic	152,347	155,580	157,350
Shares used in per share calculation diluted	155,006	158,250	160,590

The above unaudited pro forma financial information includes adjustments for amortization of identifiable intangible assets that were acquired, adjustments to interest income, adjustments for incremental stock-based compensation expense related to the unearned portion of Secure Computing s RSAs and RSUs assumed and converted, eliminations of intercompany transactions and related tax effects. The pro forma financial information excludes the effects of the SafeWord product line sold by Secure Computing in 2008, the effects of the in-process research and development charge for Secure Computing that was expensed immediately upon acquisition and the effects of the goodwill impairment charge recorded by Secure Computing in 2008. No effect has been given to cost reductions or synergies in this presentation. In management s opinion, the unaudited pro forma combined results of operations are not indicative of the actual results that would have occurred had the acquisitions been consummated at the beginning of 2008 and 2009, nor are they indicative of future operations of the combined companies.

5. Financial Instruments

Marketable Securities

Marketable securities, which are classified as available-for-sale, are summarized as follows (in thousands):

	September 30, 2009			
	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses(1)	Aggregate Fair Value
United States treasury and agency securities	$ 105,184	$ 465	$ (71)	$ 105,578
Foreign government securities	23,294	21		23,315
Certificates of deposit and time deposits	34,673			34,673
Corporate debt securities	82,805	577	(8)	83,374
Mortgage-backed securities	10,351	884	(916)	10,319
Asset-backed securities	8,096	2,407	(1,272)	9,231
	$ 264,403	$ 4,354	$ (2,267)	$ 266,490

(1) Reflects the reclassification of the $4.1 million non-credit component of other-than-temporary impairments recorded in earnings through March 31, 2009.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2008			
	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
United States treasury and agency securities	$ 48,922	$ 876	$	$ 49,798
Corporate debt securities	21,686	12	(66)	21,632
Mortgage-backed securities	12,884	2	(254)	12,632
Asset-backed securities	26,325	1,230	(1,194)	26,361
	$ 109,817	$ 2,120	$ (1,514)	$ 110,423

At September 30, 2009, $244.1 million of marketable debt securities had scheduled maturities of less than one year and are classified as current assets. Non-current marketable securities of $22.4 million have maturities greater than one year with most of the maturities being greater than ten years, and are classified as non-current assets.

The following table summarizes the fair value and gross unrealized losses, related to those available-for-sale securities that have unrealized losses, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at September 30, 2009 and December 31, 2008 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
As of September 30, 2009	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses(1)	Fair Value	Gross Unrealized Losses
United States agency securities	$ 999	$ (1)	$ 2,810	$ (70)	$ 3,809	$ (71)
Corporate debt securities	14,414	(8)			14,414	(8)
Mortgage-backed securities			6,080	(916)	6,080	(916)
Asset-backed securities			2,305	(1,272)	2,305	(1,272)
	$ 15,413	$ (9)	$ 11,195	$ (2,258)	$ 26,608	$ (2,267)

(1) Reflects the reclassification of the $4.1 million non-credit component of other-than-temporary impairments recorded in earnings through March 31, 2009.

Less Than 12 Months	Total

As of December 31, 2008	Fair Value	Gross Unrealized Losses	12 Months or Greater Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate debt securities	$ 12,691	$ (44)	$ 4,726	$ (22)	$ 17,417	$ (66)
Mortgage-backed securities	3,237	(2)	6,139	(252)	9,376	(254)
Asset-backed securities	10,870	(1,194)			10,870	(1,194)
	$ 26,798	$ (1,240)	$ 10,865	$ (274)	$ 37,663	$ (1,514)

We do not intend to sell the securities with unrealized losses and other-than-temporary impairments recorded in accumulated other comprehensive income and it is not more likely than not that we will be required to sell the securities before recovery of their amortized cost bases, which may be maturity. When assessing other-than-temporary impairments, we consider factors including: the likely reason for the unrealized loss, period of time and extent to which the fair value was below amortized cost, changes in the performance of the underlying collateral,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

changes in ratings, and market trends and conditions. We then evaluate whether amortized cost exceeds the net present value of expected future cash flows. We have recorded no other-than-temporary impairment since April 1, 2009. As of September 30, 2009, the amount of previously recognized credit losses remaining in retained earnings was $7.2 million.

Prior to April 1, 2009, any other-than-temporary decline in value was reported in earnings and a new cost basis for the marketable security was established. We had $0.7 million of other-than-temporary impairments in the nine months ended September 30, 2009 for impairments recorded in the first quarter of 2009. In the three and nine months ended September 30, 2008, we recorded other-than-temporary impairments on marketable securities totaling $12.4 million and $14.9 million, respectively.

We recognized gains (losses) upon the sale of investments using the specific identification cost method. The following table summarizes the gross realized gains (losses) for the periods indicated and does not reflect other-than-temporary impairments recognized within the interest and other income line item on our condensed consolidated statements of income and comprehensive income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Realized gains	$ 42	$ 677	$ 269	$ 5,979
Realized losses	(1)	(14)	(2)	(66)
Net realized gain	$ 41	$ 663	$ 267	$ 5,913

Derivative Financial Instruments

We conduct business globally. As a result, we are exposed to movements in foreign currency exchange rates. From time to time we enter into forward exchange contracts to reduce exposures associated with certain nonfunctional monetary assets and liabilities such as accounts receivable and accounts payable denominated in the Euro, British Pound, and Canadian Dollar. The forward contracts typically range from one to three months in original maturity. We recognize derivatives, which are included in other current assets and other accrued liabilities on the condensed consolidated balance sheets, at fair value. On the condensed consolidated statements of cash flows, the derivatives offset the increase or decrease in cash related to the underlying asset or liability. In general, we do not hedge anticipated foreign currency cash flows, nor do we enter into forward contracts for trading or speculative purposes.

The forward contracts do not qualify for hedge accounting and accordingly are marked to market at the end of each reporting period with any unrealized gain or loss being recognized in interest and other income on our condensed consolidated statements of income and comprehensive income.

Forward contracts outstanding are presented below (in thousands):

	September 30, 2009			December 31, 2008		
	Notional U.S. Dollar Equivalent	Asset Fair Value	Liability Fair Value	Notional U.S. Dollar Equivalent	Asset Fair Value	Liability Fair Value
Euro	$ 31,165	$ 1	$ (154)	$ 31,944	$ 56	$ (757)
British Pound	9,313	40		8,503	26	(1,659)
Canadian Dollar	3,366		(3)	2,954		(55)
	$ 43,844	$ 41	$ (157)	$ 43,401	$ 82	$ (2,471)

In the three months ended September 30, 2009 and 2008, we recorded a $0.4 million and $10.3 million net realized gain, respectively, on derivatives. In the nine months ended September 30, 2009 and 2008, we recorded a

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$1.3 million net realized loss and a $1.0 million net realized gain, respectively, on derivatives. These amounts are recognized in interest and other income on our condensed consolidated statements of income and comprehensive income along with the remeasurement of the assets and liabilities.

6. Goodwill and Other Intangible Assets

Goodwill by geographic region is as follows (in thousands):

	December 31, 2008	Goodwill Acquired	Adjustment	Effects of Foreign Currency Exchange	September 30, 2009
North America	$ 807,040	$ 109,074	$ (4,157)	$ 1,059	$ 913,016
EMEA	253,748	661	(1,461)	5,442	258,390
Japan	35,607	6,184	(201)		41,590
Asia-Pacific (excluding Japan)	52,414	143	(259)		52,298
Latin America	20,807	73	(83)	429	21,226
Total	$ 1,169,616	$ 116,135	$ (6,161)	$ 6,930	$ 1,286,520

The goodwill acquired during the nine months ended September 30, 2009 is due to the acquisitions of MX Logic, Solidcore and Endeavor. The adjustments to goodwill are primarily a result of purchase accounting adjustments to deferred taxes for the Secure Computing acquisition.

The components of intangible assets are as follows (in thousands):

		September 30, 2009			December 31, 2008		
	Weighted Average Useful Life	Gross Carrying Amount	Accumulated Amortization (Including Effects of Foreign Currency Exchange)	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization (Including Effects of Foreign Currency Exchange)	Net Carrying Amount
Other intangible assets:							
Purchased technologies	4.2 years	$ 445,697	$ (235,273)	$ 210,424	$ 385,915	$ (176,072)	$ 209,843
Trademarks and patents	5.1 years	43,188	(37,099)	6,089	42,282	(35,639)	6,643
Customer base and other intangibles	5.7 years	222,679	(114,829)	107,850	182,282	(82,965)	99,317

	$ 711,564	$ (387,201)	$ 324,363	$ 610,479	$ (294,676)	$ 315,803

The aggregate amortization expenses for the intangible assets listed above totaled $29.9 million and $19.1 million in the three months ended September 30, 2009 and 2008, respectively, and $87.8 million and $57.0 million in the nine months ended September 30, 2009 and 2008, respectively.

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Expected future intangible asset amortization expense as of September 30, 2009 is as follows (in thousands):

Fiscal years:	
Remainder of 2009	$ 30,824
2010	111,831
2011	86,883
2012	48,294
2013	22,348
Thereafter	24,183
	$ 324,363

7. Restructuring

We have initiated certain restructuring actions to reduce our cost structure and enable us to invest in certain strategic growth initiatives to enhance our competitive position.

During 2009 (the 2009 Restructuring), we continued our efforts to consolidate and took the following measures: (i) realigned our sales and marketing workforce and staffing across various departments, (ii) disposed of excess facilities and (iii) eliminated redundant positions related to acquisitions.

During 2008 (the 2008 Restructuring), we took the following measures: (i) eliminated redundant positions related to the SafeBoot Holdings B.V. (SafeBoot) and Secure Computing acquisitions, (ii) realigned our sales force and (iii) realigned staffing across various departments.

During 2006 (the 2006 Restructuring), we took the following measures: (i) reduced our workforce and (ii) continued our efforts to consolidate and dispose of excess facilities. We paid the remaining $0.2 million of lease termination costs and severance and other benefits related to the 2006 Restructuring during the nine months ended September 30, 2009.

During 2004 and 2003 (the 2004 and 2003 Restructurings), we took the following measures: (i) reduced our workforce, (ii) consolidated and disposed of excess facilities, (iii) moved our European headquarters to Ireland and vacated a leased facility in Amsterdam, (iv) consolidated operations formerly housed in three leased facilities in Dallas, Texas into our regional headquarters facility in Plano, Texas, (v) relocated employees from the Santa Clara, California headquarters site to our Plano facility as part of the consolidation activities and (vi) sold our Sniffer and Magic product lines in 2004. During the nine months ended September 30, 2009, we recorded a $2.8 million decrease to the liability. We have no outstanding accrual balance related to the 2004 and 2003 Restructurings as of September 30, 2009 as we have occupied or plan to occupy the previously vacated space.

Restructuring charges in the nine months ended September 30, 2009 totaled $10.9 million, consisting of $10.2 million related to the 2009 Restructuring, a $3.0 million additional accrual over the service period for our 2008 elimination of certain positions at Secure Computing, including accretion on facility restructurings, partially offset by a $2.4 million

restructuring benefit related to the 2004 and 2003 Restructurings.

Restructuring charges in the nine months ended September 30, 2008 totaled $0.5 million, consisting of a $5.5 million charge related to the 2008 Restructuring offset by a $5.0 million benefit, net of accretion, related to the 2004 and 2003 Restructuring.

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2009 Restructuring

Activity and liability balances related to our 2009 Restructuring are as follows (in thousands):

	Lease Termination Costs	Severance and Other Benefits	Total
Balance, January 1, 2009	$	$	$
Restructuring accrual	1,523	8,674	10,197
Cash payments	(360)	(7,253)	(7,613)
Adjustment to liability		(2)	(2)
Effects of foreign currency exchange		30	30
Accretion	6		6
Balance, September 30, 2009	$ 1,169	$ 1,449	$ 2,618

Of the total 2009 restructuring charge, $3.3 million, $6.6 million, and $0.3 million was recorded in EMEA, North America and Asia-Pacific, respectively. Lease termination costs and severance and other benefits are expected to be paid through 2009. Accretion relates to lease termination costs.

2008 Restructuring

Activity and liability balances related to our 2008 Restructuring are as follows (in thousands):

	Lease Termination Costs	Severance and Other Benefits	Total
Balance, January 1, 2008	$	$	$
Restructuring accrual	6,142	6,621	12,763
Cash payments		(5,419)	(5,419)
Adjustment to liability		(25)	(25)
Effects of foreign currency exchange		(2)	(2)
Accretion	29		29
Balance, December 31, 2008	6,171	1,175	7,346
Restructuring accrual		2,961	2,961
Cash payments	(2,557)	(3,917)	(6,474)

Adjustment to liability	306	(180)	126
Effects of foreign currency exchange	213	(7)	206
Accretion	202		202
Balance, September 30, 2009	$ 4,335	$ 32	$ 4,367

Of the total 2009 restructuring charge for severance, $0.3 million and $2.7 million was recorded in EMEA and North America, respectively. In 2008, the $6.1 million accrual for lease termination costs was recorded on the opening balance sheet for Secure Computing for costs associated with permanently vacated facilities. In the nine months ended September 30, 2009, we recorded a $0.3 million purchase price adjustment for additional lease related costs associated with permanently vacated facilities. The 2009 accretion relates to these lease termination costs. Lease termination costs will be paid through 2015 and severance and other benefits will be paid in 2009. Accretion relates to lease termination costs.

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8. Credit Facilities

On December 22, 2008, we entered into a credit agreement with a group of financial institutions (the Credit Facility). The Credit Facility provides for a $100.0 million unsecured term loan and a $100.0 million unsecured revolving credit facility with a $25.0 million letter of credit sublimit. The Credit Facility also contains an expansion option permitting us to arrange up to an aggregate of $200.0 million in additional commitments from existing lenders and/or new lenders at the lenders discretion.

Loans may be made in U.S. Dollars, Euros or other currencies agreed to by the lenders. Loans will bear interest at our election at the prime rate or at an adjusted LIBOR rate plus a margin (ranging from 2.00% to 2.50%) that varies with our consolidated leverage ratio (a eurocurrency loan). Our interest rate was 2.3% as of September 30, 2009. Interest on the loans is payable quarterly in arrears with respect to prime rate loans and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of eurocurrency loans. Commitment fees range from 0.25% to 0.45% of the unused portion on the credit facility depending on our consolidated leverage ratio.

In January 2009, we borrowed $100.0 million against the term loan in the Credit Facility. The principal together with any accrued interest on the term loan is due on December 22, 2009. No balances were outstanding under the Credit Facility as of December 31, 2008.

The Credit Facility, which is subject to certain quarterly financial covenants, terminates on December 22, 2011, on which date all outstanding principal of, together with accrued interest on, any revolving loans will be due. We may prepay the loans and terminate the commitments at any time, without premium or penalty, subject to reimbursement of certain costs in the case of eurocurrency loans. At September 30, 2009 and December 31, 2008, we were in compliance with all covenants in the Credit Facility.

In addition, we have a 14 million Euro credit facility with a bank (the Euro Credit Facility). The Euro Credit Facility is available on an offering basis, meaning that transactions under the Euro Credit Facility will be on such terms and conditions, including interest rate, maturity, representations, covenants and events of default, as mutually agreed between us and the bank at the time of each specific transaction. The Euro Credit Facility is intended to be used for short-term credit requirements, with terms of one year or less. The Euro Credit Facility can be canceled at any time. No balances were outstanding under the Euro Credit Facility as of September 30, 2009 and December 31, 2008.

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9. Net Income Per Share

A reconciliation of the numerator and denominator of basic and diluted net income per share is provided as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Numerator basic and diluted net income	$ 36,789	$ 48,808	$ 118,898	$ 126,803
Denominator basic				
Basic weighted average common stock outstanding	157,186	152,347	155,580	157,350
Denominator diluted				
Basic weighted average common stock outstanding	157,186	152,347	155,580	157,350
Effect of dilutive securities(1)	2,739	2,659	2,670	3,240
Diluted weighted average shares	159,925	155,006	158,250	160,590
Net income per share basic	$ 0.23	$ 0.32	$ 0.76	$ 0.81
Net income per share diluted	$ 0.23	$ 0.31	$ 0.75	$ 0.79

(1) In the three months ended September 30, 2009 and 2008, 3.2 million and 4.8 million options and RSUs, respectively, were excluded from the calculation since the effect was anti-dilutive. In addition, we excluded 1.0 million and 1.2 million PSUs for the three months ended September 30, 2009 and 2008, respectively because they are contingently issuable shares.

In the nine months ended September 30, 2009 and 2008, 5.4 million and 5.2 million options and RSUs, respectively, were excluded from the calculation since the effect was anti-dilutive. In addition, we excluded 1.0 million and 1.2 million PSUs for the nine months ended September 30, 2009 and 2008, respectively, because they are contingently issuable shares.

10. Income Taxes

We estimate our annual effective tax rate based on year to date operating results and our forecast of operating results for the remainder of the year, by jurisdiction, and apply this rate to the year to date operating results. If our actual results, by jurisdiction, differ from each successive interim period s forecasted operating results or if we change our forecast of operating results for the remainder of the year, our effective tax rate will change accordingly, affecting tax

expense for both that successive interim period as well as year-to-date interim results.

Our consolidated provision for income taxes for the three months ended September 30, 2009 and 2008 was $6.8 million and $5.1 million, respectively, reflecting an effective tax rate of 16% and 9%, respectively. The effective tax rate for the three months ended September 30, 2009 differs from the U.S. federal statutory rate (statutory rate) primarily due to the benefit of lower tax rates in certain foreign jurisdictions as well as tax benefits recognized in the third quarter as a result of statute expirations in various jurisdictions. The effective tax rate for the three months ended September 30, 2008 differs from the statutory rate primarily due to the benefit of lower taxes rates in certain foreign jurisdictions and the resultant quarterly adjustment necessary to adjust year to date expense to the revised estimate of our annual effective rate.

Our consolidated provision for income taxes for the nine months ended September 30, 2009 and 2008 was $33.8 million and $60.7 million, respectively, reflecting an effective tax rate of 22% and 32%, respectively. The effective tax rate for the nine months ended September 30, 2009 differs from the U.S. federal statutory rate primarily

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

due to the benefit of lower tax rates in certain foreign jurisdictions. The effective tax rate for the nine months ended September 30, 2008 differs from the statutory rate primarily due to the benefit of lower tax rates in certain jurisdictions, offset by the negative impact resulting from certain acquisition integration activities, which, on a year-to-date basis, accounted for 14 percentage points of our effective tax rate. In October of 2008, we were granted administrative relief by the U.S. Internal Revenue Service from the negative tax consequences associated with certain acquisition integration activities. As a result, we reversed the tax expense in the fourth quarter of 2008.

The earnings from our foreign operations in India are subject to a tax holiday. In August 2009, the Indian government extended the period through which the holiday would be effective to March 31, 2011. The tax holiday provides for zero percent taxation on certain classes of income and requires certain conditions to be met. We were in compliance with these conditions as of September 30, 2009.

We account for uncertainties in income taxes by applying a more-likely-than-not recognition threshold for all tax uncertainties. Accounting guidance only allows the recognition of those tax benefits that have a greater than 50% likelihood of being sustained upon examination by the taxing authorities. We believe it is reasonably possible that, in the next 12 months, the amount of unrecognized tax benefits related to the resolution of federal, state and foreign matters could be reduced by $2.2 million to $12.6 million as audits close and statutes expire.

The Internal Revenue Service is presently conducting an examination of our federal income tax returns for the calendar years 2006 and 2007. We are also currently under examination by the State of California for the years 2004 and 2005 and in Germany for the years 2002 to 2007. We cannot reasonably determine if these examinations will have a material impact on our financial statements. We concluded pre-filing discussions with the Dutch tax authorities with respect to the 2004 tax year in January 2009. As a result, a tax benefit of approximately $2.2 million is reflected in the nine months ended September 30, 2009. In addition, the statute of limitations related to various domestic and foreign jurisdictions expired in the nine months ended September 30, 2009, resulting in a tax benefit of approximately $13.6 million.

11. Business Segment Information

We have one business and operate in one industry. We develop, market, distribute and support computer and network security solutions for large enterprises, governments, and small and medium-sized business and consumer users, as well as resellers and distributors. Management measures operations based on our five operating segments: North America; EMEA; Japan; Asia-Pacific, excluding Japan; and Latin America. Our chief operating decision maker is our chief executive officer.

We market and sell anti-virus and security software, hardware and services through our geographic regions. These products and services are marketed and sold worldwide primarily through resellers, distributors, systems integrators, retailers, original equipment manufacturers, internet service providers and directly by us. In addition, we offer on our web site suites of online products and services personalized for the user based on the users personal computer configuration, attached peripherals and resident software. We also offer managed security and availability applications to corporations and governments on the internet.

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Our chief operating decision maker evaluates financial performance by geographic region based on income from operations, which includes only cost of revenue and selling expenses directly attributable to a sale. Historically, the measure of segment income from operations included the allocation of cost of revenues, research and development and certain sales and marketing expenses. We revised the segment information for the three and nine months ended September 30, 2008 to conform to the 2009 presentation for comparative purposes. Summarized financial information concerning our net revenue and income from operations by geographic region is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net revenue by region:				
North America	$ 273,464	$ 218,365	$ 793,295	$ 612,333
EMEA	136,034	130,513	385,984	385,101
Japan	33,135	28,524	102,547	83,695
Asia-Pacific, excluding Japan	26,087	18,435	69,372	55,718
Latin America	16,551	13,842	50,468	39,231
Net revenue	$ 485,271	$ 409,679	$ 1,401,666	$ 1,176,078
Income from operations by region:				
North America	$ 205,158	$ 165,653	$ 585,481	$ 463,588
EMEA	106,649	101,328	301,834	292,966
Japan	25,925	20,453	79,756	60,992
Asia-Pacific, excluding Japan	16,004	10,900	44,818	34,913
Latin America	11,139	9,231	36,152	26,542
Corporate and other	(322,370)	(258,202)	(897,890)	(721,994)
Income from operations	$ 42,505	$ 49,363	$ 150,151	$ 157,007

Corporate and other includes research and development expenses, cost of revenues and sales and marketing expenses not directly related to the sale of our products and services, general and administrative expenses, stock-based compensation, amortization of purchased technology and other intangibles and restructuring (benefit) charges. These expenses are not attributable to any specific geographic region and are not included in the segment measure of income from operations reviewed by our chief operating decision maker. The difference between income from operations and income before provision for income taxes is reflected on the face of our condensed consolidated statements of income and comprehensive income.

12. Litigation

Settled Cases

In July 2001, certain investment bank underwriters and McAfee, along with certain of our officers and directors were named in a putative class action for alleged violation of federal securities laws (United States District Court for the Southern District of New York, In re McAfee.com Corp. Initial Public Offering Securities Litigation, 01 Civ.7034 (SAS)). This was one of a number of cases challenging underwriting practices in the initial public offerings of more than 300 companies. A global settlement between all parties was reached and approved by the court in October 2009, and we are not required to make any payment. An appeal has been filed by certain members of the putative class, not to the settlement itself, but rather in relation to the scope of those considered to be part of the class.

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Open Cases

While we cannot predict the likelihood of future claims or inquiries, we expect that new matters may be initiated against us from time to time. As of September 30, 2009, we had accrued aggregate liabilities of approximately $38.9 million for all of our litigation matters. The results of claims, lawsuits and investigations cannot be predicted, and it is possible that the ultimate resolution of these matters, individually and in the aggregate, may have a material adverse effect on our business, financial condition, results of operations or cash flows.

In June 2006, Finjan Software, Ltd. filed a complaint in the United States District Court for the District of Delaware against Secure Computing, which we acquired in November 2008, alleging Webwasher Secure Content Management suite and CyberGuard TSP infringe three Finjan patents. In March 2008, a jury found that Secure Computing willfully infringed certain claims of three Finjan patents and awarded $9.2 million in damages. This was recorded as an assumed liability in the allocation of the purchase price for Secure Computing. In August 2009, the judge amended the jury damages award to include additional infringing sales through March 2008 as well as specified pre-judgment and post-judgment interest. The judge also awarded enhanced damages in the amount of 50% of the amended jury damages award and enjoined Secure Computing from infringing the asserted claims of the Finjan patents. We have accrued the amended jury damages. We have filed a notice of appeal and will vigorously challenge the verdict and post-trial rulings.

We have other patent infringement cases pending against us and we intend to vigorously defend these claims.

In addition, we are engaged in other legal and administrative proceedings incidental to our normal business activities.

13. Warranty Accrual and Guarantees

Unless local law dictates a longer period, we offer a 90 day warranty on our hardware and software products and record a liability for the estimated future costs associated with warranty claims, which is based upon historical experience and our estimate of the level of future costs. A reconciliation of the change in our warranty obligation as of September 30, 2009 and December 31, 2008 follows (in thousands):

	Warranty Accrual
Balance, January 1, 2008	$ 489
Additional accruals	4,236
Costs incurred during the period	(3,615)
Balance, December 31, 2008	1,110
Additional accruals	2,776
Costs incurred during the period	(2,570)
Balance, September 30, 2009	$ 1,316

The following is a summary of certain guarantee and indemnification agreements as of September 30, 2009:

Under the indemnification provision of our software license agreements and selected managed service agreements, we agree that in the event the software sold infringes upon any patent, copyright, trademark, or any other proprietary right of a third-party, we will indemnify our customer against any loss, expense, or liability from any damages that may be awarded against our customer. We have not incurred any significant expense or recorded any liability associated with this indemnification.

Under the indemnification provision of certain vendor agreements we have agreed that in the event the service provided to the customer by the vendor on behalf of us infringes upon any patent, copyright, trademark, or any other proprietary right of a third-party, we will indemnify our vendor against any loss,

MCAFEE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expense, or liability from any damages. We have not incurred any significant expense or recorded any liability associated with this indemnification. The estimated fair value of these indemnification clauses is minimal.

Under the indemnification provision of our agreements to sell Magic in January 2004, Sniffer in July 2004, and McAfee Labs assets in December 2004, we agreed to indemnify the purchasers for breach of any representation or warranty as well as for any liabilities related to the assets prior to sale incurred by the purchaser that were not expressly assumed in the purchase. Subject to limited exceptions, the maximum liability under these indemnifications is $10.0 million, $200.0 million and $1.5 million, respectively. Subject to limited exceptions, the representations and warranties made in these agreements have expired. We have not paid any amounts, incurred any significant expense or recorded any accruals under these indemnifications. We believe the estimated fair value of these indemnification clauses is minimal.

We indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. Our maximum potential liability under these indemnification agreements is not limited; however, we have director and officer insurance coverage that we believe will enable us to recover a portion or all of any future amounts paid.

Under the indemnification provision of the agreement entered into by Secure Computing in July 2008 to sell its SafeWord assets, we are obligated to indemnify the purchaser for breach of any representation or warranty as well as for any liabilities related to the assets prior to sale incurred by the purchaser that were not expressly assumed in the purchase. Subject to limited exceptions, the maximum potential liability under this indemnification is $64.3 million. We have not paid any amounts, incurred any significant expense or recorded any accruals related to this indemnification. The purchaser has made claims against the escrow and we are currently evaluating the validity of these claims.

If we believe a liability associated with any of our indemnifications becomes probable and the amount of the liability is reasonably estimable or the minimum amount of a range of loss is reasonably estimable, then an appropriate liability will be established.

14. Subsequent Events

We have evaluated subsequent events through November 6, 2009, the basis for that date being the day the financial statements were issued.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Forward-Looking Statements; Trademarks

This Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are statements that look to future events and consist of, among other things, statements about our anticipated future income including the amount and mix of revenue among type of product, category of customer, geographic region and distribution method and our anticipated future expenses and tax rates. Forward-looking statements include our business strategies and objectives and include statements about the expected benefits of our strategic alliances and acquisitions, our plans for the integration of acquired businesses, our continued investment in complementary businesses, products and technologies, our expectations regarding product acceptance, product and pricing competition, cash requirements and the amounts and uses of cash and working capital that we expect to generate, as well as statements involving trends in the security risk management market and statements including such words as may, believe, plan, expect, anticipat could, estimate, predict, goals, continue, project, and similar expressions or the negative of these terms or oth comparable terminology. These forward-looking statements speak only as of the date of this Report on Form 10-Q and are subject to business and economic risks, uncertainties and assumptions that are difficult to predict, including those discussed in Risk Factors in Part II, Item 1A in this quarterly report and in Item 1, *Business,* Item 1A, *Risk Factors* and Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations* in our annual report on Form 10-K for the fiscal year ended December 31, 2008. Therefore, our actual results may differ materially and adversely from those expressed in any forward-looking statements. We cannot assume responsibility for the accuracy and completeness of forward-looking statements, and we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

This report includes registered trademarks and trade names of McAfee and other corporations. Trademarks or trade names owned by McAfee and/or its affiliates include, but are not limited to: McAfee, VirusScan, Total Protection, SafeBoot, and ScanAlert. Any other non-McAfee related products, registered and/or unregistered trademarks contained herein are only by reference and are the sole property of their respective owners.

The following discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report. The results shown herein are not necessarily indicative of the results to be expected for the full year or any future periods.

Overview and Executive Summary

We are a leading dedicated security technology company that secures systems and networks from known and unknown threats around the world. We empower home users, businesses, government agencies, service providers and our partners with the ability to block attacks, prevent disruptions, enforce policy and continuously track and improve their security and compliance. We apply business discipline and a pragmatic approach to security that is based on four principles of security risk management (identify and prioritize assets; determine acceptable risk; protect against threats; enforce and measure compliance). We incorporate some or all of these principles into our solutions. Our solutions protect systems and networks, blocking immediate threats while proactively providing protection from future threats.

Security has emerged as one of the most critical concerns facing businesses and consumers. Security breaches have risen dramatically in the past few years, fueled in part by the proliferation of mobile devices such as laptop computers, cell phones and smart phones with email and web-surfing capabilities. For corporations, the increasing frequency of security breaches has coincided with expanding regulatory compliance requirements relating to security and more specifically, to privacy. Failure to comply with these requirements, and with the requirements of internal security

policies and procedures, creates an additional level of enterprise risk. For consumers, the increasing frequency of online fraud and security concerns discourages customers from transacting online for example, visiting and purchasing from e-commerce sites, using online banking services and preparing taxes online. All of these trends point toward a growing demand for effective security solutions.

We have one business and operate in one industry, developing, marketing, distributing and supporting computer security solutions for large enterprises, governments, small and medium-sized businesses and consumers either directly or through a network of qualified distribution partners. We derive our revenue from three sources: (i) service and support revenue, which includes support and maintenance, training and consulting revenue; (ii) subscription revenue, which consists of revenue from customers who purchase licenses for products for the term of the subscription; and (iii) product revenue, which includes revenue from perpetual licenses (those with a one-time license fee) and hardware product sales. In the three months ended September 30, 2009, service and support revenue accounted for 52%, subscription revenue accounted for 38% and product revenue accounted for 10% of total net revenue, respectively. In the nine months ended September 30, 2009, service and support revenue accounted for 51%, subscription revenue accounted for 40% and product revenue accounted for 9% of total net revenue, respectively.

Operating Results and Trends

We evaluate our consolidated financial performance utilizing a variety of indicators to evaluate the growth and health of our business, including net revenue, operating income and net income.

Net Revenue. As discussed more fully below, our net revenue in the three months ended September 30, 2009 grew by $75.6 million, or 18%, to $485.3 million from $409.7 million in the three months ended September 30, 2008. Our net revenue is directly impacted by corporate information technology, government and consumer spending levels. Net revenue from our 2008 and 2009 acquisitions contributed $65.4 million in the three months ended September 30, 2009. Changes in the U.S. Dollar compared to foreign currencies negatively impacted our revenue growth by $9.8 million in the three months ended September 30, 2009 when compared to the three months ended September 30, 2008.

Our net revenue in the nine months ended September 30, 2009 grew by $225.6 million, or 19%, to $1,401.7 million from $1,176.1 million in the nine months ended September 30, 2008. Net revenue from our 2008 and 2009 acquisitions contributed $161.8 million in the nine months ended September 30, 2009. Changes in the U.S. Dollar compared to foreign currencies negatively impacted our revenue growth by $46.8 million in the nine months ended September 30, 2009 when compared to the nine months ended September 30, 2008.

Operating Income. The $6.9 million decrease in operating income in the three months ended September 30, 2009 compared to the three months ended September 30, 2008 was primarily attributable to the overall growth of our company, including increased revenue, offset by the following factors: (i) a $10.7 million increase in amortization expense as a result of purchased technology and intangibles acquired in recent acquisitions, (ii) a $12.0 million increase in settlement costs and legal expenses associated with patent infringement lawsuits and (iii) a $30.2 million increase in salaries and benefits due to an increase in headcount, primarily as a result of our Secure Computing acquisition.

The $6.9 million decrease in operating income in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 was primarily attributable to the overall growth of our company, including increased revenue, offset by the following factors: (i) a $30.8 million increase in amortization expense as a result of purchased technology and intangibles acquired in recent acquisitions, (ii) a $10.4 million increase in restructuring charges due to eliminating redundant positions from our Secure Computing acquisition and reorganization of our sales and marketing workforce and (iii) a $93.2 million increase in salaries and benefits due to an increase in headcount, primarily as a result of our Secure Computing acquisition.

Our operating income as a percentage of revenue was 9% for the three months ended September 30, 2009 compared to 12% for the three months ended September 30, 2008. This decrease in margin is driven by an increase in amortization expense as a result of purchased technology and intangibles acquired in recent acquisitions, an increase in settlement

costs and legal expenses and an increase in salaries and benefits due to an increase in headcount, primarily as a result of our Secure Computing acquisition.

Our operating income as a percentage of revenue was 11% for the nine months ended September 30, 2009 compared to 13% for the nine months ended September 30, 2008. This decrease in margins is driven by an increase in amortization expense as a result of purchased technology and intangibles acquired in recent acquisitions,

restructuring charges due to eliminating redundant positions from our Secure Computing acquisition and reorganization of our sales and marketing workforce, and an increase in salaries and benefits due to an increase in headcount, primarily as a result of our Secure Computing acquisition.

Net Income. The $12.0 million decrease in net income in the three months ended September 30, 2009 compared to the three months ended September 30, 2008 was primarily attributable to items discussed above under operating income as well as an increase in our effective tax rate discussed more fully in Provision for Income Taxes below and a $15.2 million decrease in interest and other income primarily attributable to lower yields and lower cash and marketable securities balances and decreased net foreign currency transaction gains, offset slightly by a $12.4 million decrease in marketable security impairment charges. In the three months ended September 30, 2009, we had no marketable security impairments compared to $12.4 million of marketable security impairments in the three months ended September 30, 2008.

The $7.9 million decrease in net income in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 was primarily attributable to items discussed above under operating income as well as a $36.5 million decrease in interest and other income primarily attributable to lower yields and lower cash and marketable securities balances and decreased foreign currency transaction gains, offset by a decrease in our effective tax rate discussed more fully in Provision for Income Taxes below and a $14.2 million decrease in marketable security impairment charges. In the nine months ended September 30, 2009, we had $0.7 million of marketable security impairments compared to $14.9 million in the nine months ended September 30, 2008.

Acquisitions. We continue to focus our efforts on building a full line of system and network protection solutions and technologies that support our multi-platform strategy of personal computer, internet and mobile security solutions. In the third quarter of 2009, we acquired MX Logic for $138.5 million. With the MX Logic acquisition, we plan to deliver a comprehensive cloud-based security portfolio. In the second quarter of 2009, we acquired Solidcore for $32.1 million. With the Solidcore acquisition, we plan to couple Solidcore s whitelisting and compliance enforcement technology with our compliance mapping and policy auditing to deliver an end-to-end compliance solution. In the fourth quarter of 2008, we acquired Secure Computing for $490.1 million. With the Secure Computing acquisition, we plan to deliver a complete network security solution to organizations of all sizes. We expect that the acquisitions of Secure Computing, Solidcore, and MX Logic will have a dilutive impact in the remainder of 2009, primarily due to the amortization of intangibles.

Net Revenue by Product Groups and Customer Category. Transactions from our corporate business include the sale of product offerings intended for enterprise, mid-market and small business use. Net revenue from our corporate products increased $61.9 million, or 25%, to $308.6 million during the three months ended September 30, 2009 from $246.7 million in the three months ended September 30, 2008. The year-over-year increase in revenue was due to a $52.8 million increase in revenue from our network offerings, which includes new revenue integrated from our Secure Computing acquisition, a $5.1 million increase in revenue from our end point solutions offerings and a $4.0 million increase in revenue primarily from our services offerings.

Net revenue from our corporate products increased $172.8 million, or 25%, to $876.0 million during the nine months ended September 30, 2009 from $703.1 million in the nine months ended September 30, 2008. The year-over-year increase in revenue was due to a $147.8 million increase in revenue from our network offerings, which includes new revenue integrated from our Secure Computing acquisition, a $19.9 million increase in revenue primarily from our services offerings and a $5.2 million increase in revenue from our end point solutions offerings.

Transactions from our consumer business include the sale of product offerings primarily intended for consumer use, as well as any revenue or activities associated with providing an overall safe consumer experience on the internet or cellular networks. Net revenue from our consumer security market increased $13.7 million, or 8%, to $176.7 million

in the three months ended September 30, 2009 from $163.0 million in the three months ended September 30, 2008. Net revenue from our consumer security market increased $52.8 million, or 11%, to $525.7 million in the nine months ended September 30, 2009 from $473.0 million in the nine months ended September 30, 2008. Net revenue from our consumer market increased during the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 primarily due to (i) an increase in our online customer base, (ii) increased online renewal subscriptions from a larger customer base and

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(iii) increased up-sell to higher level suites with higher price points. We continued to strengthen our relationships with strategic channel partners, such as Acer, Dell, Sony Computer, and Toshiba.

Deferred Revenue. Our deferred revenue balance at September 30, 2009 increased 3% to $1,333.8 million, compared to $1,293.1 million at December 31, 2008. Our deferred revenue balance was positively impacted as a result of (i) the weaker U.S. dollar against the Euro on September 30, 2009 compared to December 31, 2008 and (ii) acquired deferred revenue totaling $4.4 million from our acquisitions in 2009. In addition, our deferred revenue continued to increase as a result of growing sales of maintenance renewals from our expanding customer base and increased sales of subscription-based products. We receive up front payments for maintenance and subscriptions but we recognize revenue over the service or subscription term. Our deferred revenue consists of amounts that have been invoiced but have not been recognized as revenue. We monitor our deferred revenue balance because it represents a significant portion of revenue to be recognized in future periods. Approximately 75 to 85% of our total net revenue during 2008 and the first three quarters of 2009 came from prior-period deferred revenue. As with revenue, we believe that deferred revenue is a key indicator of the growth and health of our business.

Macro Economic Conditions. While we have recently experienced growth in revenue, economic conditions and financial markets continue to be negative, and national and global economies and financial markets have experienced a severe downturn stemming from a multitude of factors, including adverse credit conditions impacted by the sub-prime mortgage crisis, slower economic activity, concerns about inflation and deflation, fluctuating energy costs, high unemployment, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns and other factors. The U.S. and many other countries have been experiencing slowed or receding economic growth and disruptions in the financial markets. The severity or length of time these economic and financial market conditions may persist is unknown. During challenging economic times, high unemployment, and tight credit markets, many customers may delay or reduce technology purchases. This could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition. In addition, weakness in the end-user market could negatively affect the cash flow of our distributors and resellers who could, in turn, delay paying their obligations to us. This would increase our credit risk exposure and cause delays in our recognition of revenue on future sales to these customers. Specific economic trends, such as declines in the demand for or change in mix of our product shipments, or softness in corporate information technology spending, could have a more direct impact on our business. Any of these events would likely harm our business, including decreasing our revenues, decreasing cash provided by operating activities and negatively impacting our liquidity.

Foreign Exchange Fluctuations. We are unable to predict the extent to which revenue in future periods will be impacted by changes in foreign exchange rates. If international sales become a greater portion of our total sales in the future, changes in foreign currency rates may have a potentially greater impact on our revenue and operating results. The Euro and Japanese Yen are the two predominant non-U.S. currencies that affect our financial statements. As the U.S. Dollar strengthens against foreign currencies, our revenues from transactions outside the U.S. and operating income may be negatively impacted. As the U.S. Dollar weakens against foreign currencies, our revenues may be positively impacted. During the three and nine months ended September 30, 2009, on an average quarterly exchange basis, the U.S. Dollar strengthened against the Euro and weakened against the Yen compared to the three and nine months ended September 30, 2008. Overall, the U.S. Dollar strengthening against the Euro had the most significant impact to our financial statements and this has resulted in a decrease in the revenue and expense amounts in certain foreign countries in our statements of income for the three and nine months ended September 30, 2009 as compared to the same prior-year periods.

Critical Accounting Policies and Estimates

Pursuant to recently issued accounting guidance, we separate our other-than-temporary impairments between the credit and non-credit components. The credit loss component is recognized in earnings and the non-credit loss component is recognized in accumulated other comprehensive income (loss). This resulted in a cumulative effect adjustment to retained earnings for the non-credit component, as discussed more fully in Note 2 to the condensed consolidated financial statements. Other than this change, we have had no significant changes in our critical accounting policies and estimates during the nine months ended September 30, 2009 as compared to the critical

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accounting policies and estimates disclosed in *Management s Discussion and Analysis of Financial Condition and Results of Operations* included in our annual report on Form 10-K for the year ended December 31, 2008.

Results of Operations

Net Revenue

The following table sets forth, for the periods indicated, a year-over-year comparison of the key components of our net revenue:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
Net revenue:								
Service and support	$ 250,851	$ 208,773	$ 42,078	20%	$ 713,630	$ 596,745	$ 116,885	20%
Subscription	184,129	166,752	17,377	10	556,802	491,969	64,833	13
Product	50,291	34,154	16,137	47	131,234	87,364	43,870	50
Total net revenue	$ 485,271	$ 409,679	$ 75,592	18%	$ 1,401,666	$ 1,176,078	$ 225,588	19%
Net revenue by geography:								
North America	$ 273,464	$ 218,365	$ 55,099	25%	$ 793,295	$ 612,333	$ 180,962	30%
EMEA	136,034	130,513	5,521	4	385,984	385,101	883	
Japan	33,135	28,524	4,611	16	102,547	83,695	18,852	23
Asia-Pacific, excluding Japan	26,087	18,435	7,652	42	69,372	55,718	13,654	25
Latin America	16,551	13,842	2,709	20	50,468	39,231	11,237	29
Total net revenue	$ 485,271	$ 409,679	$ 75,592	18%	$ 1,401,666	$ 1,176,078	$ 225,588	19%
Net service and support revenue:								
Support and maintenance	$ 226,174	$ 191,550	$ 34,624	18%	$ 645,541	$ 553,616	$ 91,925	17%
Consulting, training and other services	24,677	17,223	7,454	43	68,089	43,129	24,960	58
Total service and support	$ 250,851	$ 208,773	$ 42,078	20%	$ 713,630	$ 596,745	$ 116,885	20%

revenue

Net product revenue:													
Licenses	$	19,123	$	14,365	$	4,758	33%	$	47,044	$	41,070	$	5,974	15%
Hardware		27,943		16,218		11,725	72		72,010		38,308		33,702	88
Retail and other		3,225		3,571		(346)	(10)		12,180		7,986		4,194	53
Total product revenue	$	50,291	$	34,154	$	16,137	47%	$	131,234	$	87,364	$	43,870	50%

Our net revenue in a specific period is an aggregation of thousands of transactions ranging from high-volume, low-dollar transactions to high-dollar, multiple-element transactions that are individually negotiated. The impact of pricing and volume changes on revenue is complex as substantially all of our transactions contain multiple elements, primarily software licenses and post-contract support (PCS). Additionally, approximately 75 to 85% of our revenue in a specific period is derived from prior-period transactions for which revenue has been deferred and is being amortized into income over the period of the arrangement. Therefore, the impact of pricing and volume changes on revenue in a specific period results from transactions in multiple prior periods.

Net Revenue by Geography

Net revenue outside of North America accounted for approximately 44% and 43% of net revenue in the three and nine months ended September 30, 2009 and approximately 47% and 48% of net revenue in the three and nine months ended September 30, 2008, respectively. Net revenue from North America and EMEA has historically comprised between 80% and 90% of our total net revenue and we expect this trend to continue.

The increase in total net revenue in North America during the three months ended September 30, 2009 compared to the three months ended September 30, 2008 was primarily attributable to (i) a $49.5 million increase in corporate revenue due to increased revenue from our network security offerings, which includes new revenue from products integrated from our Secure Computing acquisition, and our end point solutions offerings and (ii) a $5.6 million increase in our consumer revenue.

The increase in total net revenue in North America during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 was primarily attributable to (i) a $153.6 million increase in corporate revenue due to increased revenue from our network security offerings, which includes new revenue from products integrated from our Secure Computing acquisition, increased revenue from our end point solutions and our services offerings and (ii) a $27.3 million increase in our consumer revenue.

The increase in net revenue in EMEA was attributable to revenue growth from both our consumer and corporate offerings, offset by the negative impact of the U.S. Dollar strengthening against the Euro on an average exchange basis in both the three and nine months ended September 30, 2009 compared to the same prior-year periods. The foreign exchange impact resulted in an approximate $13.4 million and $55.9 million reduction to EMEA net revenue in the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008.

Net revenue from Japan was positively impacted by the weakening U.S. Dollar against the Japanese Yen, which resulted in an approximate $3.7 million and $9.7 million contribution to Japan net revenue in the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008. The increase in net revenue from Asia Pacific, excluding Japan, and Latin America during the three and nine months ended September 30, 2009 compared to the same periods in 2008 was primarily attributable to increased revenue from our corporate offerings in Asia-Pacific, excluding Japan, and increased revenue from our consumer and corporate offerings in Latin America.

Service and Support Revenue

The increases in service and support revenue in the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 was attributable to an increase in support and maintenance primarily due to an increase in sales of support renewals to existing and new customers and to amortization of previously deferred revenue from support arrangements. In addition, we have expanded our support offerings to include premium-level services. Revenue from consulting increased due to growth in integration and implementation services.

Although we expect our service and support revenue to continue to increase, our growth rate and net revenue depend significantly on renewals of support arrangements as well as our ability to respond successfully to the pace of technological change and our ability to expand our customer base. If our renewal rate or our pace of new customer acquisition slows, our net revenue and operating results would be adversely affected.

Subscription Revenue

The increases in subscription revenue in the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 was attributable to (i) increases in our online subscription arrangements due to our continued relationships with strategic partners, such as Acer, Dell, Sony Computer and Toshiba, (ii) increases in revenue from our McAfee Total Protection Service for small and mid-market businesses and (iii) increases in royalties from sales by our strategic channel. Subscription revenue continues to be positively impacted by McAfee Consumer Suites, including McAfee VirusScan Plus, McAfee Internet Security, and McAfee Total Protection Solutions, as these suites utilize a subscription-based model.

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Product Revenue

The increases in product revenue for the three and nine months ended September 30, 2009, compared to the three and nine months ended September 30, 2008, were attributable to (i) increased revenue from our network security solutions which have a higher hardware content and, therefore, more upfront revenue realization and (ii) increased revenue from our data protection solutions and upgrade initiatives related to our total protection solutions.

Cost of Net Revenue

The following table sets forth, for the periods indicated a comparison of cost of net revenue:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
Cost of net revenue:								
Service and support	$ 27,558	$ 17,031	$ 10,527	62%	$ 78,627	$ 47,460	$ 31,167	66%
Subscription	51,192	48,245	2,947	6	148,526	141,210	7,316	5
Product	28,660	19,623	9,037	46	70,702	48,981	21,721	44
Amortization of purchased technology	19,360	13,610	5,750	42	57,193	40,527	16,666	41
Total cost of net revenue	$ 126,770	$ 98,509	$ 28,261	29%	$ 355,048	$ 278,178	$ 76,870	28%
Components of gross margin:								
Service and support	$ 223,293	$ 191,742			$ 635,003	$ 549,285		
Subscription	132,937	118,507			408,276	350,759		
Product	21,631	14,531			60,532	38,383		
Amortization of purchased technology	(19,360)	(13,610)			(57,193)	(40,527)		
Total gross margin	$ 358,501	$ 311,170			$ 1,046,618	$ 897,900		
Total gross margin percentage	74%	76%			75%	76%		

Cost of Service and Support Revenue

Cost of service and support revenue consists principally of salaries, benefits and stock-based compensation related to employees, as well as expenses related to professional service subcontractors, customer and technical support, training and consulting services. The cost of service and support revenue increased for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 due to increased professional services costs related to consulting services and increased costs related to customer and technical support. The cost of service and support revenue as a percentage of service and support revenue for the three and nine months ended September 30, 2009 increased compared to the same period in 2008 primarily attributable to the addition of Secure Computing customer support, training and consulting personnel, mitigated in part by increased service contracts and support renewals.

We anticipate the cost of service and support revenue will increase in absolute dollars driven primarily by additional growth in our consulting services, which provide end users with product design, user training, and deployment support and the expected impact related to the acquisition of Secure Computing.

Cost of Subscription Revenue

Cost of subscription revenue consists primarily of costs related to the sale of online subscription arrangements, the majority of which include revenue-share arrangements and royalties paid to our strategic partners, costs of customer support for subscription arrangements and the costs of media, manuals and packaging related to McAfee

Consumer Suites, as these suites utilize a subscription-based model. The increase in subscription costs for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 was primarily attributable to an increase in the cost of customer support driven primarily by increased volume of online subscription arrangements. The cost of subscription revenue as a percentage of subscription revenue decreased slightly for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 primarily attributable to lower costs per transaction from sales originating with our strategic partners.

We anticipate that the cost of subscription revenue will increase in absolute dollars due to expected increased demand for our subscription-based products with associated royalty and revenue-sharing costs.

Cost of Product Revenue

Cost of product revenue consists primarily of the cost of media, manuals and packaging for products distributed through traditional channels and, with respect to hardware-based security products, the cost of computer platforms, other hardware and embedded third-party components and technologies. The cost of product revenue for the three and nine months ended September 30, 2009 increased compared to the three and nine months ended September 30, 2008 due primarily to additional product-related transactions related to the acquisition of Secure Computing. Cost of product revenue for the three months ended September 30, 2009 compared to the three months ended September 30, 2008 remained consistent primarily attributable to an increase in both the number and size of higher margin corporate transactions sold to customers through a solution selling approach, offset by increased costs of embedded third-party technologies related to patent infringement lawsuits. Cost of product revenue for the nine months ended September 30, 2009 decreased as a percentage of product revenue compared to the same periods in 2008, as the result of an increase in both the number and size of higher margin corporate transactions.

We anticipate that cost of product revenue will increase in absolute dollars due to mix and size of certain enterprise-related transactions.

Amortization of Purchased Technology

The increase in amortization of purchased technology in the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 was primarily driven by the acquisition of Secure Computing in December 2008. Amortization of purchased technology related to this acquisition was $6.9 million and $20.8 million in the three and nine months ended September 30, 2009, respectively.

We expect amortization of purchased technology to increase in absolute dollars when comparing 2009 to 2008 as a result of our 2008 and 2009 acquisitions.

Gross Margin

Our gross margins decreased slightly for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008 due primarily to increased cost of service and support revenue and increased amortization of purchased technology related to acquisitions made during 2008.

Gross margins may fluctuate in the future due to various factors, including the mix of products sold, upfront revenue realization, sales discounts, revenue-sharing and royalty arrangements, material and labor costs, warranty costs and amortization of purchased technology.

Stock-based Compensation Expense

Stock-based compensation expense consists of expense associated with all stock-based awards made to our employees and outside directors. Our stock-based awards include options, RSUs, RSAs, PSUs and ESPP grants.

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The following table sets forth, for the periods indicated, a comparison of our stock-based compensation expenses:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
Stock-based compensation expense	$ 26,599	$ 21,180	$ 5,419	26%	$ 81,714	$ 52,732	$ 28,982	55%

The $5.4 million increase in stock-based compensation expense during the three months ended September 30, 2009 compared to the three months ended September 30, 2008 was primarily attributable to (i) a $4.4 million increase in expense relating to increased grants of RSUs and assumed RSAs and RSUs from the 2008 acquisition of Secure Computing and (ii) a $0.8 million increase in expense relating to options. See Note 3 to the condensed consolidated financial statements for additional information.

The $29.0 million increase in stock-based compensation expense during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 was primarily attributable to (i) a $12.1 million increase in expense relating to increased grants of RSUs and assumed RSAs and RSUs from the 2008 acquisition of Secure Computing, (ii) a $6.1 million increase in expense relating to the cash settlement of certain expired options, (iii) a $5.5 million increase in expense relating to increased grants of PSUs, of which a significant portion were granted in February 2008, (iv) a $3.5 million increase in expense related to reinstating our ESPP in June 2008 and (v) a $2.1 million increase in expense relating to options. See Note 3 to the condensed consolidated financial statements for additional information.

Operating Costs

Research and Development

The following table sets forth, for the periods indicated, a comparison of our research and development expenses:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
Research and development(1)	$ 82,248	$ 64,478	$ 17,770	28%	$ 240,407	$ 185,101	$ 55,306	30%
Percentage of net revenue	17%	16%			17%	16%		

(1) Includes stock-based compensation charges of $6,699 and $4,970 in the three months ended September 30, 2009 and 2008, respectively, and $19,904 and $13,036 in the nine months ended September 30, 2009 and 2008, respectively.

Research and development expenses consist primarily of salary, benefits, and stock-based compensation for our development staff and a portion of our technical support staff, contractors fees and other costs associated with the enhancements of existing products and services and development of new products and services. The increase in research and development expenses in the three months ended September 30, 2009 was primarily attributable to (i) a $14.1 million increase in salary and benefit expense for individuals performing research and development activities due to an increase in headcount primarily from our Secure Computing acquisition, (ii) a $1.7 million increase in stock-based compensation expense and (iii) increases in various other expenses associated with research and development activities, offset by a $2.4 million decrease due to the net impact of foreign exchange rates, primarily driven by the strengthening of the U.S. Dollar against foreign currencies during the three months ended September 30, 2009 compared to the three months ended September 30, 2008.

The increase in research and development expenses in the nine months ended September 30, 2009 was primarily attributable to (i) a $39.0 million increase in salary and benefit expense for individuals performing research and development activities due to an increase in headcount primarily from our Secure Computing acquisition, (ii) a $6.9 million increase in stock-based compensation expense, (iii) a $3.7 million increase in equipment and depreciation expense and (iv) increases in various other expenses associated with research and

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development activities, offset by a $10.8 million decrease due to the net impact of foreign exchange rates, primarily driven by the average U.S. Dollar exchange rate strengthening against foreign currencies during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

We believe that continued investment in product development is critical to attaining our strategic objectives. We expect research and development expenses will increase in absolute dollars during the remainder of 2009.

Sales and Marketing

The following table sets forth, for the periods indicated, a comparison of our sales and marketing expenses:

	Three Months Ended September 30,		**2009 vs. 2008**		**Nine Months Ended September 30,**		**2009 vs. 2008**	
	2009	**2008**	**$**	**%**	**2009**	**2008**	**$**	**%**
	(Dollars in thousands)							
Sales and marketing(1)	$ 155,594	$ 139,264	$ 16,330	12%	$ 465,182	$ 392,061	$ 73,121	19%
Percentage of net revenue	32%	34%			33%	33%		

(1) Includes stock-based compensation charges of $10,646 and $9,355 in the three months ended September 30, 2009 and 2008, respectively, and $36,841 and $22,469 in the nine months ended September 30, 2009 and 2008, respectively.

Sales and marketing expenses consist primarily of salary, commissions, stock-based compensation and benefits and costs associated with travel for sales and marketing personnel, advertising and promotions. The increase in sales and marketing expenses during the three months ended September 30, 2009 compared to the three months ended September 30, 2008 reflected (i) a $15.0 million increase in salary and benefit expense, including commissions, for individuals performing sales and marketing activities due to an increase in headcount primarily from our Secure Computing acquisition and increased commissions, (ii) a $1.3 million increase in stock-based compensation expense and (iii) increases in various other expenses associated with sales and marketing activities, offset by a $3.1 million decrease due to the net impact of foreign exchange rates, primarily driven by the average U.S. Dollar exchange rate strengthening against foreign currencies during the three months ended September 30, 2009 compared to the three months ended September 30, 2008.

The increase in sales and marketing expenses during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 reflected (i) a $38.0 million increase in salary and benefit expense, including commissions, for individuals performing sales and marketing activities due to an increase in headcount primarily from our Secure Computing acquisition and increased commissions, (ii) a $20.3 million increase related to agreements with certain PC OEM partners, (iii) a $14.4 million increase in stock-based compensation expense and (iv) increases in various other expenses associated with sales and marketing activities, offset by a $20.6 million decrease due to the net impact of foreign exchange rates, primarily driven by the average U.S. Dollar exchange rate strengthening against foreign currencies during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

We anticipate that sales and marketing expenses will increase in absolute dollars primarily due to agreements with our strategic partners, primarily our PC OEM partners, where we have seen growth in volume and an increase in the number of partner agreements, our planned branding initiatives and our additional investment in sales capacity.

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General and Administrative

The following table sets forth, for the periods indicated, a comparison of our general and administrative expenses:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
General and administrative(1)	$ 65,948	$ 49,888	$ 16,060	32%	$ 149,359	$ 146,721	$ 2,638	2%
Percentage of net revenue	14%	12%			11%	12%		

(1) Includes stock-based compensation charges of $7,656 and $5,723 in the three months ended September 30, 2009 and 2008, respectively, and $20,563 and $14,625 in the nine months ended September 30, 2009 and 2008, respectively.

General and administrative expenses consist principally of salary, stock-based compensation and benefit costs for executive and administrative personnel, professional services and other general corporate activities. The increase in general and administrative expenses during the three months ended September 30, 2009 compared to the three months ended September 30, 2008 reflected (i) a $12.0 million increase in settlement costs and legal expenses associated with patent infringement lawsuits, partially offset by decreased indemnification costs related to our current and former officers and directors, (ii) a $1.9 million increase in stock-based compensation expense and (iii) increases in various other expenses associated with general and administrative activities.

The increase in general and administrative expenses during the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 reflected a (i) a $5.9 million increase in stock-based compensation expense, (ii) a $5.5 million benefit recognized in the three months ended March 31, 2008 related to the change in fair value of certain stock options and (iii) increases in various other expenses associated with general and administrative activities, offset by $14.7 million decrease in legal expenses and settlement costs, primarily related to decreases in costs associated with indemnification of our current and former officers and directors, as well as a $6.5 million reimbursement from an insurance carrier for legal fees incurred related to cost of defense incurred in connection with our stock option investigation that commenced in May 2006.

We anticipate that general and administrative expenses will increase in absolute dollars during the remainder of 2009.

Amortization of Intangibles

The following table sets forth, for the periods indicated, a comparison of the amortization of intangibles:

Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
2009	2008	$	%	2009	2008	$	%
(Dollars in thousands)							

Amortization of intangibles	$ 10,492	$ 5,502	$ 4,990	91%	$ 30,600	$ 16,478	$ 14,122	86%

Intangibles consist of identifiable intangible assets such as trademarks and customer lists. The increase in amortization of intangibles was primarily attributable to our acquisition of Secure Computing in December 2008. Amortization of intangibles related to Secure Computing was $5.2 million and $15.8 million in the three and nine months ended September 30, 2009.

We expect amortization of intangibles to increase in absolute dollars during the remainder of 2009 when compared to 2008 as a result of our 2008 and 2009 acquisitions.

Restructuring Charges

Restructuring charges in the three months ended September 30, 2009 totaled $1.7 million, which was primarily related to our 2009 restructuring of two facilities. Restructuring charges in the three months ended September 30, 2008 totaled $2.7 million, which related to the realignment of our sales force and staffing across all departments.

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Restructuring charges in the nine months ended September 30, 2009 totaled $10.9 million, of which $8.7 million primarily related to the realignment of our sales and marketing workforce and staffing across various other departments and an accrual over the service period for our elimination of certain positions related to acquisitions, $3.0 million primarily related to additional accrual over the service period for our 2008 elimination of certain positions at Secure Computing and accretion of lease exit costs, $1.5 million primarily related to our 2009 restructuring of two facilities, partially offset by a $2.4 million restructuring benefit related to the termination of the final sublease agreement and extinguishment of the remaining 2004 and 2003 Restructurings.

Restructuring charges in the nine months ended September 30, 2008 totaled $0.5 million. We recorded a charge of $5.5 million related to the elimination of certain positions at SafeBoot that were redundant to positions at McAfee and the realignment of our sales force, offset by a $5.0 million benefit related primarily to (i) the reversal of a portion of the 2004 and 2003 Restructurings and (ii) revisions to previous estimates of base rent and sublease income for the Santa Clara lease, which was restructured in 2003 and 2004. See Note 7 to our condensed consolidated financial statements for a description of restructuring activities.

Interest and Other Income

The following table sets forth, for the periods indicated, a comparison of our interest and other income:

	Three Months Ended September 30,		**2009 vs. 2008**		**Nine Months Ended September 30,**		**2009 vs. 2008**	
	2009	**2008**	**$**	**%**	**2009**	**2008**	**$**	**%**
	(Dollars in thousands)							
Interest and other income	$ 1,028	$ 16,242	$ (15,214)	(94)%	$ 2,982	$ 39,529	$ (36,547)	(92)%

Interest and other income includes interest earned on investments, as well as net foreign currency transaction gains or losses and net forward contract gains and losses. The decrease in interest income for the three months ended September 30, 2009 was primarily due to (i) a decrease in our average cash, cash equivalents and marketable securities of approximately $159.7 million in the three months ended September 30, 2009 compared to the three months ended September 30, 2008 and (ii) a lower average rate of annualized return on our investments from approximately 3% in the three months ended September 30, 2008 to 1% in the three months ended September 30, 2009.

The decrease in interest income for the nine months ended September 30, 2009 was primarily due to (i) a decrease in our average cash, cash equivalents and marketable securities of approximately $378.3 million in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 and (ii) a lower average rate of annualized return on our investments from approximately 4% in the nine months ended September 30, 2008 to 1% in the nine months ended September 30, 2009.

We recorded a net foreign currency transaction gain of less than $0.1 million during the three months ended September 30, 2009 in our condensed consolidated statements of income and comprehensive income compared to a net gain of $7.4 million during the three months ended September 30, 2008. We recorded a net foreign currency transaction loss of $0.5 million during the nine months ended September 30, 2009 in our condensed consolidated statements of income and comprehensive income compared to a gain of $5.9 million during the nine months ended September 30, 2008.

We anticipate that interest and other income will decrease during 2009 as a result of lower cash balances in 2009 due to acquisitions and our stock repurchases during 2008, the declining interest rate environment and our shifting a large percentage of our investment portfolio to shorter-term and U.S. government guaranteed investments which have lower yields.

Impairment of Marketable Securities

During the three months ended September 30, 2009, we recorded no other-than-temporary impairments on our marketable securities. During the nine months ended September 30, 2009, we recorded impairments on certain of our marketable securities of $0.7 million. In the three and nine months ended September 30, 2008, we recorded impairments on certain of our marketable securities of $12.4 million and $14.9 million, respectively. The 2009 and 2008 other-than-temporary impairments were recorded on certain of our asset-backed and mortgage-backed

securities which had significant declines in fair value, as well as one corporate debt security due to the issuer declaring bankruptcy. Pursuant to accounting guidance effective in the second quarter of 2009, other-than-temporary impairment on our marketable securities is now based on our determination of whether the security will be sold prior to recovery or if our cost basis in the securities will be recovered. Further deterioration in the underlying collateral of our asset-backed and collateralized mortgage securities could result in additional impairment charges, as will collectability issues on our corporate debt securities.

Gain on Sale of Investments, Net

During the three months ended September 30, 2009 and 2008, we recognized net gains on the sale of marketable securities of less than $0.1 million and $0.7 million, respectively. During the nine months ended September 30, 2009 and 2008, we recognized net gains on the sale of marketable securities of $0.3 million and $5.9 million, respectively. Our investments are classified as available-for-sale and we may sell securities from time to time to move funds into investments with higher yields, for liquidity purposes, or into investments that are considered more conservative. We do not plan on selling any securities in a loss position.

Provision for Income Taxes

The following table sets forth, for the periods indicated, a comparison of our provision for income taxes:

	Three Months Ended September 30,		2009 vs. 2008		Nine Months Ended September 30,		2009 vs. 2008	
	2009	2008	$	%	2009	2008	$	%
	(Dollars in thousands)							
Provision for income taxes	$ 6,785	$ 5,104	$ 1,681	33%	$ 33,792	$ 60,720	$ (26,928)	(44)%
Effective tax rate	16%	9%			22%	32%		

We estimate our annual effective tax rate based on year to date operating results and our forecast of operating results for the remainder of the year, by jurisdiction, and apply this rate to the year to date operating results. If our actual results, by jurisdiction, differ from each successive interim period s forecasted operating results or if we change our forecast of operating results for the remainder of the year, our effective tax rate will change accordingly, affecting tax expense for both that successive interim period as well as year-to-date interim results.

The effective tax rate for the three months ended September 30, 2009 differs from the U.S. federal statutory rate (statutory rate) primarily due to the benefit of lower tax rates in certain foreign jurisdictions as well as tax benefits recognized in the third quarter as a result of statute expirations in various jurisdictions. The effective tax rate for the three months ended September 30, 2008 differs from the statutory rate primarily due to the benefit of lower taxes rates in certain foreign jurisdictions and the resultant quarterly adjustment necessary to adjust year to date expense to the revised estimate of our annual effective rate.

The effective tax rate for the nine months ended September 30, 2009 differs from the statutory rate primarily due to the benefit of lower tax rates in certain foreign jurisdictions. The effective tax rate for the nine months ended September 30, 2008 differs from the statutory rate primarily due the benefit of lower tax rates in certain jurisdictions, offset by the negative impact resulting from certain acquisition integration activities, which, on a year-to-date basis, accounted for 14 percentage points of our effective tax rate. The decrease in the effective tax rate for the nine months

ended September 30, 2009 as compared to the prior period is primarily due to the impact of negative tax consequences associated with certain acquisition integration activities in the nine months ended September 30, 2008. In October of 2008, we were granted administrative relief by the U.S. Internal Revenue Service from the negative tax consequences associated with certain acquisition integration activities. As a result, we reversed the tax expense in the fourth quarter of 2008.

The earnings from our foreign operations in India are subject to a tax holiday. In August 2009, the Indian government extended the period through which the holiday would be effective to March 31, 2011. The tax holiday provides for zero percent taxation on certain classes of income and requires certain conditions to be met. We were in compliance with these conditions as of September 30, 2009.

The U.S. Internal Revenue Service is presently conducting an examination of our federal income tax returns for the calendar years 2006 and 2007. We are also currently under examination by the State of California for the years 2004 and 2005 and in Germany for the years 2002 to 2007. We cannot reasonably determine if these examinations will have a material impact on our financial statements. We concluded pre-filing discussions with the Dutch tax authorities with respect to the 2004 tax year in January 2009. As a result, a tax benefit of approximately $2.2 million is reflected in the nine months ended September 30, 2009. In addition, the statute of limitations related to various domestic and foreign jurisdictions expired in the nine months ended September 30, 2009, resulting in a tax benefit of approximately $13.6 million.

Recent Accounting Pronouncements

See Note 2 to the condensed consolidated financial statements.

Liquidity and Capital Resources

	Nine Months Ended September 30,	
	2009	**2008**
	(In thousands)	
Net cash provided by operating activities	$ 351,219	$ 238,478
Net cash (used in) provided by investing activities	(367,555)	383,893
Net cash provided by (used in) financing activities	152,505	(381,966)

Overview

At September 30, 2009, our cash, cash equivalents and marketable securities totaled $905.9 million. Our principal sources of liquidity were our existing cash, cash equivalents and short-term marketable securities of $883.5 million and our operating cash flows. Our principal uses of cash were operating costs, which consist primarily of employee-related expenses, such as compensation and benefits, as well as other general operating expenses, partner and OEM arrangements, acquisitions and purchases of marketable securities.

During the nine months ended September 30, 2009, we had net income of $118.9 million, proceeds of $100.0 million from the draw down under an unsecured term loan and $70.5 million of proceeds from the issuance of common stock under our stock option and stock purchase plans. We used $171.6 million for the acquisitions of Endeavor, Solidcore and MX Logic, net of cash acquired, and $4.9 million for payment of a portion of the accrued purchase price for Securify, Inc. which we assumed in the acquisition of Secure Computing in 2008. We also used $151.7 million for the net purchase of marketable securities, $44.4 million for purchases of property and equipment and $21.7 million to repurchase shares of common stock in connection with our obligation to holders of RSUs, RSAs and PSUs to withhold the number of shares required to satisfy the holders   tax liabilities in connection with the vesting of such shares.

During the nine months ended September 30, 2008, we had $521.9 million of net proceeds from the sale or maturity of marketable securities, we had net income of $126.8 million and we received $117.3 million of proceeds from the issuance of common stock under our stock option and stock purchase plans. We paid $95.2 million, net of cash received, for our acquisitions of ScanAlert and Reconnex, $6.0 million for direct acquisition costs accrued at December 31, 2007 for our acquisition of SafeBoot and $2.0 million to acquire an intangible asset from Lockdown Networks. In addition, we used $515.6 million for repurchases of our common stock, including commissions, and

$34.7 million for purchases of property and equipment. Of the $515.6 million used for stock repurchases, $500.0 million was used for share repurchases in the open market and $15.6 million was used to repurchase shares of common stock in connection with our obligation to holders of RSUs, RSAs and PSUs to withhold the number of shares required to satisfy the holders tax liabilities in connection with the vesting of such shares.

We classify our investment portfolio as available-for-sale, and our investments are made with a policy of capital preservation and liquidity as the primary objectives. We generally hold investments in money market, U.S. government fixed income, U.S. government agency fixed income and investment grade corporate fixed income securities to maturity. We currently hold some asset-backed securities and CMO securities purchased in prior

periods but do not plan to acquire these types of securities in future periods. We may sell an investment at any time if the quality rating of the investment declines, the yield on the investment is no longer attractive or we are in need of cash. We expect to continue our investing activities, including holding investment securities of a short-term and long-term nature. During the current challenging markets, we are investing new cash in instruments with short to medium-term maturities of highly-rated issuers, including U.S. government and FDIC guaranteed investments.

On December 22, 2008, we entered into a credit agreement by and among us, certain of our subsidiaries as guarantors, the lenders from time to time party thereto and Bank of America, N.A., as administrative agent and letter of credit issuer (Credit Facility). The Credit Facility provides for a $100.0 million unsecured term loan and a $100.0 million unsecured revolving credit facility with a $25.0 million letter of credit sublimit. The Credit Facility also contains an expansion option permitting us to arrange up to an aggregate of $200.0 million in additional commitments from existing lenders and/or new lenders at the lenders discretion. We borrowed $100.0 million under the term loan portion of the Credit Facility in January 2009.

Our management continues to monitor the financial markets and general global economic conditions as a result of the recent distress in the financial markets. As we monitor market conditions, our liquidity position and strategic initiatives, we may seek either short-term or long-term financing from external credit sources in addition to the credit facilities discussed herein. Our ability to raise funds may be adversely affected by a number of factors, including factors beyond our control, such as the current weakness in the economic conditions in the markets in which we operate and into which we sell our products, and increased uncertainty in the financial, capital and credit markets. There can be no assurance that additional financing would be available on terms acceptable to us, if at all.

Our management plans to use our cash and cash equivalents for future operations, potential acquisitions, earn-out payments related to current acquisitions and payment of principal and accrued interest on our term loan. We may in the future repurchase our common stock on the open market. We believe that our cash and cash equivalent balances and cash that we generate over time from operations, along with amounts available for borrowing under the Credit Facility, will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for at least the next 12 months and the foreseeable future.

Operating Activities

Net cash provided by operating activities in the nine months ended September 30, 2009 was primarily the result of cash collections on accounts receivable and our net income of $118.9 million. Net cash provided by operating activities in the nine months ended September 30, 2008 was primarily the result of our net income of $126.8 million. Working capital uses of cash included increased prepaid expenses and other assets primarily due to increased partner payments and decreased accrued taxes and other liabilities primarily due to payments of our derivative lawsuit settlement, taxes and commissions. The amounts for changes in assets and liabilities presented in the condensed consolidated statements of cash flows reflect adjustments to exclude certain asset items that have not been paid in the current period.

Our cash and marketable securities balances are held in numerous locations throughout the world, including substantial amounts held outside the United States. As of September 30, 2009 and December 31, 2008, approximately $514.5 million and $364.5 million, respectively, were held outside the United States. We utilize a variety of planning and financing strategies to ensure that our worldwide cash is available in the locations in which it is needed.

In the ordinary course of business, we enter into various agreements with minimum contractual commitments including telecom contracts, advertising, software licensing, royalty and distribution-related agreements. In 2009, we entered into royalty and distribution-related agreements totaling approximately $172.0 million payable in installments beginning in the fourth quarter of 2009 through 2011. These commitments are in the ordinary course of business and

we expect to meet our obligations as they become due through available cash, borrowings under the Credit Facility, and internally generated funds. We expect to continue generating positive working capital through our operations. However, we cannot predict whether current trends and conditions will continue or what the effect on our business might be from the competitive environment in which we operate. In addition, we currently cannot predict the outcome of the litigation described in Note 12 to the condensed consolidated financial statements.

Investing Activities

Net cash used in investing activities was $367.6 million during the nine months ended September 30, 2009 as compared to net cash provided by investing activities of $383.9 million during the nine months ended September 30, 2008.

During the nine months ended September 30, 2009, the primary uses of cash in investing activities included $171.6 million for acquisitions, $151.7 million of net purchases of marketable securities and $44.4 million for purchases of property and equipment.

Our cash used for acquisitions increased to $171.6 million for the nine months ended September 30, 2009 compared to $103.2 million for the nine months ended September 30, 2008. During the nine months ended September 30, 2009, we paid $137.9 million, $31.2 million and $2.5 million, net of cash acquired, to purchase MX Logic, Solidcore and Endeavor, respectively. During the nine months ended September 30, 2008, we paid $46.2 million and $49.0 million, net of cash acquired, to purchase Reconnex and ScanAlert, respectively, and $6.0 million for direct acquisition costs accrued at December 31, 2007 for our acquisition of SafeBoot.

Our cash used for purchases of property and equipment increased to $44.4 million for the nine months ended September 30, 2009 compared to $34.7 million for the nine months ended September 30, 2008. The property and equipment purchased during the nine months ended September 30, 2009 was primarily for upgrades of our existing systems and purchases of computers, equipment and software and for leasehold improvements at various offices. The property and equipment purchased during the nine months ended September 30, 2008 was primarily for purchases of computers, equipment and software. We expect to continue to have slight increases in capital expenditures compared to the prior year.

Financing Activities

Net cash provided by financing activities was $152.5 million during the nine months ended September 30, 2009 compared to net cash used in financing activities of $382.0 million during the nine months ended September 30, 2008. During the nine months ended September 30, 2009, primary sources of cash provided by financing activities included $100.0 million borrowed under the term loan portion of the Credit Facility and proceeds from the issuance of common stock under our stock option and stock purchase plans. During the nine months ended September 30, 2009, we received proceeds of $70.5 million compared to $117.3 million during the nine months ended September 30, 2008 from issuance of stock under such plans. During the nine months ended September 30, 2009 and 2008, we used $21.7 million and $15.6 million, respectively, to repurchase shares of our common stock in connection with our obligation to holders of RSUs, RSAs and PSUs to withhold the number of shares required to satisfy the holders tax liabilities in connection with the vesting of such shares. These shares were not part of the publicly announced repurchase program.

We had no repurchases of our common stock in the open market during the nine months ended September 30, 2009. As of September 30, 2009, we do not have authorization for repurchases of our common stock. During the nine months ended September 30, 2008, we used $500.0 million for repurchases of our common stock in the open market.

While we expect to continue to receive proceeds from our stock option and stock purchase plans in future periods, the timing and amount of such proceeds are difficult to predict and are contingent on a number of factors including the type of equity awards we grant to our employees, the price of our common stock, the number of employees participating in the plans and general market conditions.

Credit Facilities

In December 2008, we entered into a Credit Facility that provides for a $100.0 million unsecured term loan and a $100.0 million unsecured revolving credit facility with a $25.0 million letter of credit sublimit. The Credit Facility also contains an expansion option permitting us to arrange up to an aggregate of $200.0 million in additional commitments from existing lenders and/or new lenders.

Loans may be made in U.S. Dollars, Euros or other currencies agreed to by the lenders. Loans will bear interest at our election at the prime rate or at an adjusted LIBOR rate plus a margin (ranging from 2.0% to 2.5%) that varies with our consolidated leverage ratio (a eurocurrency loan). Our interest rate was 2.3% as of September 30, 2009. Interest on the loans is payable quarterly in arrears with respect to prime rate loans and at the end of an interest period (or at each three month intervals in the case of loans with interest periods greater than three months) in the case of eurocurrency loans. In December 2008, we paid $2.0 million of debt issuance costs related to the Credit Facility. Commitment fees range from 0.25% to 0.45% of the unused portion on the credit facility depending on our consolidated leverage ratio. The Credit Facility contains financial covenants, measured at the end of each of our quarters, providing that our consolidated leverage ratio (as defined in the credit agreement) cannot exceed 2.0 to 1.0 and our consolidated interest coverage ratio (as defined in the credit agreement) cannot be less than 3.0 to 1.0. Additionally, the Credit Facility contains affirmative covenants, including covenants regarding the payment of taxes, maintenance of insurance, reporting requirements and compliance with applicable laws. The Credit Facility contains negative covenants, among other things, limiting our ability and our subsidiaries ability to incur debt, liens, make acquisitions, make certain restricted payments and sell assets. The events of default under the Credit Facility include payment defaults, cross defaults with certain other indebtedness, breaches of covenants, judgment defaults, bankruptcy events and the occurrence of a change in control (as defined in the credit agreement). At September 30, 2009 and December 31, 2008, we had $3.0 million of restricted cash deposited at one of our lenders. This amount will be reduced to $1.5 million when the term loan is repaid in full. The deposit will be restricted until we have repaid the outstanding balance on the term loan and on the expiration of the revolving credit facility.

The principal and accrued interest on the term loan is due on December 22, 2009 and we intend to pay on or before this date. The revolving credit facility terminates on December 22, 2011, on which date all outstanding principal of, together with accrued interest on, any revolving loans will be due. We may prepay the loans and terminate the commitments at any time, without premium or penalty, subject to reimbursement of certain costs in the case of eurocurrency loans.

We borrowed $100.0 million under the term loan portion of the Credit Facility in January 2009. No balances were outstanding under the Credit Facility as of December 31, 2008. At September 30, 2009 and December 31, 2008, we were in compliance with all covenants in the Credit Facility.

In addition, we have a 14.0 million Euro credit facility with a bank, (the Euro Credit Facility). The Euro Credit Facility is available on an offering basis, meaning that transactions under the Euro Credit Facility will be on such terms and conditions, including interest rate, maturity, representations, covenants and events of default, as mutually agreed between us and the bank at the time of each specific transaction. The Euro Credit Facility is intended to be used for short-term credit requirements, with terms of one year or less. The Euro Credit Facility can be canceled at any time. No balances were outstanding under the Euro Credit Facility as of September 30, 2009 or December 31, 2008.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

Our market risks at September 30, 2009, are consistent with those discussed in Item 7A of our annual report on Form 10-K for the year ended December 31, 2008 filed with the SEC. During 2008, there were significant disruptions in the financial markets. The market disruption has resulted in a lack of liquidity in the credit markets and a decline in the market value of debt securities. As a result of these effects, in the nine months ended September 30, 2009, we recorded additional impairment on previously impaired marketable securities totaling $0.7 million for continued declines in fair value. In the nine months ended September 30, 2008, we recorded an other-than-temporary impairment charge of $14.9 million related to marketable securities. We had a net unrealized gain of $2.1 million on marketable securities at September 30, 2009, after the cumulative effect adjustment of $4.1 million pursuant to recently issued accounting guidance, compared with a net unrealized gain of $0.6 million at December 31, 2008.

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Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) and concluded that our disclosure controls and procedures were effective as of September 30, 2009.

A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within our company have been detected. These inherent limitations include the reality that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. The design of any control system is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Controls Over Financial Reporting

We have had no changes in our internal control over financial reporting during the three months ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1. *Legal Proceedings*

Information with respect to this item is incorporated by reference to Note 12 to our condensed consolidated financial statements included in this Form 10-Q, which information is incorporated into this Part II, Item 1 by reference.

Item 1A. *Risk Factors*

Investing in our common stock involves a high degree of risk. Some but not all of the risks we face are described below. Any of the following risks could materially adversely affect our business, operating results, financial condition and cash flows and reduce the value of an investment in our common stock.

Adverse conditions in the national and global economies and financial markets may adversely affect our business and financial results.

National and global economies and financial markets have experienced a severe downturn stemming from a multitude of factors, including adverse credit conditions impacted by the sub-prime mortgage crisis, slower or receding economic activity, concerns about inflation and deflation, fluctuating energy costs, high unemployment, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns and other factors. The U.S. and many other countries have been experiencing slowed or receding economic growth and disruptions in the financial markets. The severity or length of time these economic and financial market conditions may persist is unknown. During challenging economic times, high unemployment and in tight credit markets, many customers may delay or reduce technology purchases. This could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies, lower renewal rates, and increased price competition. In addition, weakness in the end-user market could negatively affect the cash flow of our distributors and resellers who could, in turn, delay paying their obligations to us. This would increase our credit risk exposure and cause delays in our recognition of revenue on future sales to these customers. Specific economic trends, such as declines in the demand for PCs, servers, and other computing devices, or softness in corporate information technology spending, could have a more direct impact on our business. Any of these events would likely harm our business, operating results, cash flows and financial condition.

We face intense competition and we expect competitive pressures to increase in the future. This competition could have a negative impact on our business and financial results.

The markets for our products are intensely competitive and we expect both product and pricing competition to increase. If our competitors gain market share in the markets for our products, our sales could grow more slowly or decline. Competitive pressures could also lead to increases in expenses such as advertising expenses, product rebates, product placement fees, and marketing funds provided to our channel partners.

Advantages of larger competitors. Our principal competitors in each of our product categories are described in *Business Competition* of our annual report on Form 10-K for the fiscal year ended December 31, 2008. Our competitors include some large enterprises such as Microsoft, Cisco Systems, Symantec, IBM and Google. Large vendors of hardware or operating system software increasingly incorporate system and network protection functionality into their products, and enhance that functionality either through internal development or through strategic alliances or acquisitions. Some of our competitors have longer operating histories, more extensive international operations, greater name recognition, larger technical staffs, established relationships with more distributors and hardware vendors, significantly greater product development and acquisition budgets, and/or greater financial, technical and marketing resources than we do.

Consumer business competition. More than 35% of our revenue comes from our consumer business. Our growth of this business relies on direct sales and sales through relationships with ISPs such as AOL, Cox, Comcast, Verizon and AT&T and PC OEMs, such as Acer, Dell, Sony Computer and Toshiba. As competition in this market increases, we have and will continue to experience pricing pressures that could have a negative effect on our ability

to sustain our revenue and market share growth. As our consumer business becomes increasingly more dependent upon the partner model, our retail businesses may continue to decline. Further, as penetration of the consumer anti-virus market through the ISP model increases, we expect that pricing and competitive pressures in this market will become even more acute.

Low-priced or free competitive products. Security protection is increasingly being offered by third parties at significant discounts to our prices or, in some cases is bundled for free. For example, in September 2009 Microsoft began offering a free anti-malware consumer product named Security Essentials. The widespread inclusion of lower-priced or free products that perform the same or similar functions as our products within computer hardware or other companies software products could reduce the perceived need for our products or render our products unmarketable even if these incorporated products are inferior or more limited than our products. It is possible that a major competitor may offer a free anti-malware enterprise product. Purchasers of mini notebooks or netbooks, which generally are sold at a lower price than laptops, may place a greater emphasis on price in making their security purchasing decision as they did in making their computer purchasing decision. The expansion of these competitive trends could have a significant negative impact on our sales and financial results.

We also face competition from numerous smaller companies, shareware and freeware authors and open source projects that may develop competing products, as well as from future competitors, currently unknown to us, who may enter the markets because the barriers to entry are fairly low. Smaller and/or newer companies often compete aggressively on price.

We face product development risks due to rapid changes in our industry. Failure to keep pace with these changes could harm our business and financial results.

The markets for our products are characterized by rapid technological developments, continually-evolving industry trends and standards and ongoing changes in customer requirements. Our success depends on our ability to timely and effectively keep pace with these developments.

Keeping pace with industry changes. We must enhance and expand our product offerings to reflect industry trends, new technologies and new operating environments as they become increasingly important to customer deployments. For example, we must expand our offerings for virtual computer environments; we must continue to expand our security technologies for mobile environments to support a broader range of mobile devices such as mobile phones and personal digital assistants; we must develop products that are compatible with new or otherwise emerging operating systems, while remaining compatible with popular operating systems such as Linux, Sun s Solaris, UNIX, Macintosh OS_X, and Windows XP, NT, Vista and 7; and we must continue to expand our business models beyond traditional software licensing and subscription models, specifically, software-as-a-service is becoming an increasingly important method and business model for the delivery of applications. We must also continuously work to ensure that our products meet changing industry certifications and standards. Failure to keep pace with any changes that are important to our customers could cause us to lose customers and could have a negative impact on our business and financial results.

Impact of product development delays or competitive announcements. Our ability to adapt to changes can be hampered by product development delays. We may experience delays in product development as we have at times in the past. Complex products like ours may contain undetected errors or version compatibility problems, particularly when first released, which could delay or adversely impact market acceptance. We may also experience delays or unforeseen costs associated with integrating products we acquire with products we develop because we may be unfamiliar with errors or compatibility issues of products we did not develop ourselves. We may choose not to deliver a partially-developed product, thereby increasing our development costs without a corresponding benefit. This could negatively impact our business.

<u>If our products do not work properly, we could experience negative publicity, damage to our reputation, legal liability, declining sales and increased expenses.</u>

Failure to protect against security breaches. Because of the complexity of our products, we have in the past found errors in versions of our products that were not detected before first introduced, or in new versions or enhancements, and we may find such errors in the future. Because of the complexity of the environments in which

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our products operate, our products may have errors or defects that customers identify after deployment. Failures, errors or defects in our products could result in security breaches or compliance violations for our customers, disruption or damage to their networks or other negative consequences and could result in negative publicity, damage to our reputation, declining sales, increased expenses and customer relation issues. Such failures could also result in product liability damage claims against us by our customers, even though our license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims. Furthermore, the correction of defects could divert the attention of engineering personnel from our product development efforts. A major security breach at one of our customers that is attributable to or not preventable by our products could be very damaging to our business. Any actual or perceived breach of network or computer security at one of our customers, regardless of whether the breach is attributable to our products, could adversely affect the market s perception of our security products and our stock price.

False alarms. Our system protection software products have in the past, and these products and our intrusion protection products may at times in the future, falsely detect viruses or computer threats that do not actually exist. These false alarms, while typical in the security industry, would likely impair the perceived reliability of our products and may therefore adversely impact market acceptance of our products. In addition, we have in the past been subject to litigation claiming damages related to a false alarm, and similar claims may be made in the future.

Our email and web solutions (anti-spam, anti-spyware and safe search products) may falsely identify emails, programs or web sites as unwanted spam , potentially unwanted programs or unsafe. They may also fail to properly identify unwanted emails, programs or unsafe web sites, particularly because spam emails, spyware or malware are often designed to circumvent anti-spam or spyware products and to incorrectly identify legitimate web sites as unsafe. Parties whose emails or programs are incorrectly blocked by our products, or whose web sites are incorrectly identified as unsafe or as utilizing phishing techniques, may seek redress against us for labeling them as spammers or unsafe and/or for interfering with their businesses. In addition, false identification of emails or programs as unwanted spam or potentially unwanted programs may discourage potential customers from using or continuing to use these products.

Customer misuse of products. Our products may also not work properly if they are misused or abused by customers or non-customer third parties who obtain access and use of our products. These situations may arise where an organization uses our products in a manner that impacts their end users or employees privacy or where our products are misappropriated to censor private access to the internet. Any of these situations could impact the perceived reliability of our products, result in negative press coverage, negatively affect our reputation and adversely impact our financial results.

We face risks associated with past and future acquisitions.

We may buy or make investments in complementary or competitive companies, products and technologies. We may not realize the anticipated benefits from these acquisitions. Future acquisitions could result in significant acquisition-related charges and dilution to our stockholders. In addition, we face a number of risks relating to our acquisitions, including the following, any of which could harm our ability to achieve the anticipated benefits of our past or future acquisitions.

Integration. Integration of an acquired company or technology is a complex, time consuming and expensive process. The successful integration of an acquisition requires, among other things, that we integrate and retain key management, sales, research and development and other personnel; integrate the acquired products into our product offerings from both an engineering and sales and marketing perspective; integrate and support pre-existing suppliers, distribution and customer relationships; coordinate research and development efforts; and consolidate duplicate facilities and functions and integrate back-office accounting, order processing and support functions. If we do not

successfully integrate an acquired company or technology, we may not achieve the anticipated revenue or cost reduction synergies.

The geographic distance between the companies, the complexity of the technologies and operations being integrated and the disparate corporate cultures being combined may increase the difficulties of integrating an acquired company or technology. Management s focus on the integration of operations may distract attention from our day-to-day business and may disrupt key research and development, marketing or sales efforts. In addition, it is

common in the technology industry for aggressive competitors to attract customers and recruit key employees away from companies during the integration phase of an acquisition. If integration of our acquired businesses or assets is not successful, we may experience adverse financial or competitive effects.

Internal controls, policies and procedures. Acquired companies or businesses are likely to have different standards, controls, contracts, procedures and policies, making it more difficult to implement and harmonize company-wide financial, accounting, billing, information and other systems. Acquisitions of privately held and/or non-US companies are particularly challenging because their prior practices in these areas may not meet the requirements of the Sarbanes-Oxley Act and public accounting standards.

Use of cash and securities. Our available cash and securities may be used to acquire or invest in companies or products. Moreover, when we acquire a company, we may have to incur or assume that company s liabilities, including liabilities that may not be fully known at the time of acquisition. To the extent we continue to make acquisitions, we will require additional cash and/or shares of our common stock as payment. The use of securities would cause dilution for our existing stockholders.

Key employees from acquired companies may be difficult to retain and assimilate. The success of many acquisitions depends to a great extent on our ability to retain key employees from the acquired company. This can be challenging, particularly in the highly competitive market for technical personnel. Retaining key executives for the long-term can also be difficult due to other opportunities available to them. Disputes that may arise out of earn-outs, escrows and other arrangements related to an acquisition of a company in which a key employee was a principal may negatively affect the morale of the employee and make retaining the employee more difficult. It could be difficult, time consuming and expensive to replace any key management members or other critical personnel that do not accept employment with McAfee following the acquisition. In addition to retaining key employees, we must integrate them into our company, which can be difficult and costly. Changes in management or other critical personnel may be disruptive to our business and might also result in our loss of some unique skills and the departure of existing employees and/or customers.

Accounting charges. Acquisitions may result in substantial accounting charges for restructuring and other expenses, amortization of intangible assets and stock-based compensation expense, any of which could materially adversely affect our operating results.

Potential goodwill and intangible impairment. We perform an impairment analysis on our goodwill balances on an annual basis or whenever events occur that may indicate impairment. If the fair value of each of our reporting units is less than the carrying amount of the reporting unit, then we must write down goodwill to its estimated fair value. We perform an impairment analysis on our intangible assets whenever events occur that may indicate impairment. If the undiscounted cash flow expected to be derived from the intangible asset is less than its carrying amount, then we must write down the intangible asset to its estimated fair value. We cannot be certain that a future downturn in our business, changes in market conditions or a long-term decline in the quoted market price of our stock will not result in an impairment of goodwill or intangible assets and the recognition of resulting expenses in future periods, which could adversely affect our results of operations for those periods.

Establishment of VSOE. Following an acquisition, we may be required to defer the recognition of revenue that we receive from the sale of products that we acquired, or from the sale of a bundle of products that includes products that we acquired, if we have not established vendor specific objective evidence (VSOE) of the separate value of the acquired product. A delay in the recognition of revenue from sales of acquired products or bundles that include acquired products may cause fluctuations in our quarterly financial results and may adversely affect our operating margins. Similarly, companies that we acquire may operate with different cost and margin structures, which could further cause fluctuations in our operating results and adversely affect our operating margins. If our quarterly financial

results or our predictions of future financial results fail to meet the expectations of securities analysts and investors, our stock price could be negatively affected.

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Our international operations involve risks that could divert the time and attention of management, increase our expenses and otherwise adversely impact our business and financial results.

Our international operations increase our risks in several aspects of our business, including but not limited to risks relating to revenue, legal and compliance, currency exchange and interest rate, and general operating. Net revenue in our operating regions outside of North America represented 43% of total net revenue in the nine months ended September 30, 2009 compared to 48% in the nine months ended September 30, 2008. The risks associated with our continued focus on international operations could adversely affect our business and financial results.

Revenue risks. Revenue risks include, among others, longer payment cycles, greater difficulty in collecting accounts receivable, tariffs and other trade barriers, seasonality, currency fluctuations, and the high incidence of software piracy and fraud in some countries. The primary product development risk to our revenue is our ability to deliver new products in a timely manner and to successfully localize our products for a significant number of international markets in different languages.

Legal and compliance risks. We face a variety of legal and compliance risks. For example, international operations pose a compliance risk with the Foreign Corrupt Practices Act (FCPA). Some countries have a reputation for businesses to engage in prohibited practices with government officials to consummate transactions. Although we have implemented training along with policies and procedures designed to ensure compliance with this and similar laws, there can be no assurance that all employees and third-party intermediaries will comply with anti-corruption laws. Any such violation could have a material adverse effect on our business.

Another legal risk is that some of our computer security solutions incorporate encryption technology that is governed by U.S. export regulations. The cost of compliance with those regulations can affect our ability to sell certain products in certain markets and could have a material adverse effect on our international revenue and expense. If we, or our resellers, fail to comply with applicable laws and regulations, we may become subject to penalties and fines or restrictions that may adversely affect our business.

Other legal risks include international labor laws and our relationship with our employees and regional work councils; compliance with more stringent consumer protection and privacy laws; unexpected changes in regulatory requirements; and compliance with our code of conduct and other internal policies. Our principal tax risks are potentially adverse tax consequences due to foreign value-added taxes, restrictions on the repatriation of earnings and changes in tax laws.

Currency exchange and interest rate risks. A significant portion of our transactions outside of the U.S. are denominated in foreign currencies. We translate revenues and costs from these transactions into U.S. dollars for reporting purposes. As a result, our future operating results will continue to be subject to fluctuations in foreign currency rates. This combined with economic instability, such as higher interest rates in the U.S. and inflation, could reduce our customers ability to obtain financing for software products, or could make our products more expensive or could increase our costs of doing business in certain countries. We recorded a net foreign currency transaction gain of $0.5 million during the nine months ended September 30, 2009 in our condensed consolidated statements of income and comprehensive income versus a gain of $5.9 million during the nine months ended September 30, 2008. We may be positively or negatively affected by fluctuations in foreign currency rates in the future, especially if international sales continue to grow as a percentage of our total sales. Additionally, fluctuations in currency exchange rates will impact our deferred revenue balance, which is a key financial metric at each period end.

General operating risks. More general risks of international business operations include the increased costs of establishing, managing and coordinating the activities of geographically dispersed and culturally diverse operations (particularly sales and support and shared service centers) located on multiple continents in a wide range of time

zones.

We face a number of risks related to our product sales through distributors and other third parties.

We sell substantially all of our products through third-party intermediaries such as distributors, value-added resellers, PC OEMs, ISPs and other distribution channel partners (referred to collectively as distributors). Reliance on third parties for distribution exposes us to a variety of risks, some of which are described below, that could have a material adverse impact on our business and financial results.

Limited control over timing of product delivery. We have limited control over the timing of the delivery of our products to customers by third-party distributors. We generally do not require our resellers and OEM partners to meet minimum sales volumes, so their sales may vary significantly from period to period. For example, the volume of our products shipped by our OEM partners depends on the volume of computers shipped by the PC OEMs, which is outside of our control. These factors can make it difficult for us to forecast our revenue accurately and they also can cause our revenue to fluctuate unpredictably.

Competitive aspects of distributor relationships. Our distributors may sell other vendors products that compete with our products. Although we offer our distributors incentives to focus on sales of our products, they often give greater priority to products of our competitors, for a variety of reasons. In order to maximize sales of our products rather than those of our competitors, we must effectively support these partners with, among other things, appropriate financial incentives to encourage them to invest in sales tools, such as online sales and technical training and product collateral needed to support their customers and prospects. If we do not properly support our partners, they may focus more on our competitors products, and their sales of our products would decline.

A significant portion of our revenue is derived from sales through our OEM partners that bundle our products with their products. Our reliance on this sales channel is significantly affected by our partners sales of new products into which our products are bundled. Our revenue from sales through our OEM partners is affected by the number of personal computers on which our products are bundled and the rate at which consumers purchase or subscribe for the bundled products. Adverse developments in global economic conditions, competitive risks and other factors have adversely affected personal computer sales and if this trend continues, could continue to adversely affect our sales and financial results. Decreases in the conversion rates also would adversely affect our sales and financial results.

Our PC OEM partners are also in a position to exert competitive pricing pressure. Competition for OEMs business continues to increase, and it gives the OEMs leverage to demand lower product prices from us in order to secure their business. Even if we negotiate what we believe are favorable pricing terms when we first establish a relationship with an OEM, at the time of the renewal of the agreement, we may be required to renegotiate our agreement with them on less favorable terms. Lower net prices for our products would adversely impact our operating margins.

Reliance on a small number of distributors. A significant portion of our net revenue is attributable to a fairly small number of distributors. Our top ten distributors represented 34% and 38% of our net revenue in the nine months ended September 30, 2009 and 2008, respectively. Reliance on a relatively small number of third parties for a significant portion of our distribution exposes us to significant risks to net revenue and net income if our relationship with one or more of our key distributors is terminated for any reason.

Risk of loss of distributors. We invest significant time, money and resources to establish and maintain relationships with our distributors, but we have no assurance that any particular relationship will continue for any specific period of time. The agreements we have with our distributors can generally be terminated by either party without cause with no or minimal notice or penalties. If any significant distributor terminates its agreement with us, we could experience a significant interruption in the distribution of our products and our revenue could decline. We could also lose the benefit of our investment of time, money and resources in the distributor relationship.

Although a distributor can terminate its relationship with us for any reason, one factor that may lead to termination is a divergence of our business interests and those of our distributors and potential conflicts of interest. For example, our acquisition activity has resulted in the termination of distributor relationships that no longer fit with the distributors business priorities. Future acquisition activity could cause similar termination of, or disruption in, our distributor relationships, which could adversely impact our revenue.

Credit risk. Some of our distributors may experience financial difficulties, which could adversely impact our collection of accounts receivable. Our allowance for doubtful accounts was approximately $5.6 million as of September 30, 2009. We regularly review the collectability and credit-worthiness of our distributors to determine an appropriate allowance for doubtful accounts. Our uncollectible accounts could exceed our current or future allowances, which could adversely impact our financial results.

Other. We also face legal and compliance risks with respect to our use of third party intermediaries operating outside the United States. As described above in *Our international operations involve risks that could divert the time and attention of management, increase our expenses and otherwise adversely impact our business and financial results,* any violations by such third party intermediaries of FCPA or similar laws could have a material adverse effect on our business.

We face numerous risks relating to the enforceability of our intellectual property rights and our use of third-party intellectual property, many of which could result in the loss of our intellectual property rights as well as other material adverse impacts on our business and financial results and condition.

Limited protection of our intellectual property rights against potential infringers. We rely on a combination of contractual rights, trademarks, trade secrets, patents and copyrights to establish and protect proprietary rights in our technology. However, the steps we have taken to protect our proprietary technology may not deter its misuse, theft or misappropriation. Competitors may independently develop technologies or products that are substantially equivalent or superior to our products or that inappropriately incorporate our proprietary technology into their products. Competitors may hire our former employees who may misappropriate our proprietary technology. We are aware that a number of users of our security products have not paid license, technical support, or subscription fees to us. Certain jurisdictions may not provide adequate legal infrastructure for effective protection of our intellectual property rights. Changing legal interpretations of liability for unauthorized use of our software or lessened sensitivity by corporate, government or institutional users to refraining from intellectual property piracy or other infringements of intellectual property could also harm our business.

Frequency, expense and risks of intellectual property litigation in the network and system security market. Litigation may be necessary to enforce and protect our trade secrets, patents and other intellectual property rights. Similarly, we may be required to defend against claimed infringement by others.

The security technology industry has increasingly been subject to patent and other intellectual property rights litigation, particularly from special purpose entities that seek to monetize their intellectual property rights by asserting claims against others. We expect this trend to continue and that in the future as we become a larger and more profitable company, we can expect this trend to accelerate and that we will be required to defend against this type of litigation. The litigation process is subject to inherent uncertainties, so we may not prevail in litigation matters regardless of the merits of our position. In addition to the expense and distraction associated with litigation, adverse determinations could cause us to lose our proprietary rights, prevent us from manufacturing or selling our products, require us to obtain licenses to patents or other intellectual property rights that our products are alleged to infringe (licenses may not be available on reasonable commercial terms or at all), and subject us to significant liabilities.

If we acquire technology to include in our products from third parties, our exposure to infringement actions may increase because we must rely upon these third parties to verify the origin and ownership of such technology. Similarly, we face exposure to infringement actions if we hire software engineers who were previously employed by competitors and those employees inadvertently or deliberately incorporate proprietary technology of our competitors into our products despite efforts by our competitors and us to prevent such infringement.

Litigation may be necessary to enforce and protect our trade secrets, patents and other intellectual property rights.

Potential risks of using open source software. Like many other software companies, we use and distribute open source software in order to expedite development of new products. Open source software is generally licensed by its authors or other third parties under open source licenses, including, for example, the GNU General Public License. These license terms may be ambiguous, in many instances have not been interpreted by the courts and could be interpreted in a manner that results in unanticipated obligations regarding our products. Depending upon how the open

source software is deployed by our developers, we could be required to offer our products that use the open source software for no cost, or make available the source code for modifications or derivative works. Any of these obligations could have an adverse impact on our intellectual property rights and revenue from products incorporating the open source software.

Our use of open source code could also result in us developing and selling products that infringe third-party intellectual property rights. It may be difficult for us to accurately determine the developers of the open source code and whether the code incorporates proprietary software. We have processes and controls in place that are designed to address these risks and concerns, including a review process for screening requests from our development organizations for the use of open source. However, we cannot be sure that all open source is submitted for approval prior to use in our products.

We also have processes and controls in place to review the use of open source in the products developed by companies that we acquire. Despite having conducted appropriate due diligence prior to completing the acquisition, products or technologies that we acquire may nonetheless include open source software that was not identified during the initial due diligence. Our ability to commercialize products or technologies of acquired companies that incorporate open source software or to otherwise fully realize the anticipated benefits of any acquisition may be restricted for the reasons described in the preceding two paragraphs.

Pending or future litigation could have a material adverse impact on our results of operation, financial condition and liquidity.

In addition to intellectual property litigation, from time to time, we have been, and may be in the future, subject to other litigation including stockholder derivative actions or actions brought by current or former employees. If we continue to make acquisitions in the future, we are more likely to be subject to acquisition related shareholder derivative actions. Where we can make a reasonable estimate of the liability relating to pending litigation and determine that an adverse liability resulting from such litigation is probable, we record a related liability. As additional information becomes available, we assess the potential liability and revise estimates as appropriate. However, because of the inherent uncertainties relating to litigation, the amount of our estimates could be wrong. In addition to the related cost and use of cash, pending or future litigation could cause the diversion of management s attention. Managing, defending and indemnity obligations related to these actions have caused significant diversion of management s and the board of directors time and resulted in material expense to us. See Note 12 to the condensed consolidated financial statements for additional information with respect to certain currently pending legal matters.

Our financial results can fluctuate significantly, making it difficult for us to accurately estimate operating results.

Impact of fluctuations. Over the years our revenue, gross margins and operating results, which we disclose from time to time on a GAAP and non-GAAP basis, have fluctuated significantly from quarter to quarter and from year to year, and we expect this to continue in the future. Thus, our operating results for prior periods may not be effective predictors of our future performance. These fluctuations make it difficult for us to accurately forecast operating results. We try to adjust expenses based in part on our expectations regarding future revenue, but in the short term expenses are relatively fixed. This makes it difficult for us to adjust our expenses in time to compensate for any unexpected revenue shortfall in a given period.

Volatility in our quarterly financial results may make it more difficult for us to raise capital in the future or pursue acquisitions that involve issuances of our stock. If our quarterly financial results or our predictions of future financial results fail to meet the expectations of securities analysts and investors, our stock price could be negatively affected.

Factors that may cause our revenue, gross margins and other operating results to fluctuate significantly from period to period, include, but are not limited to, the following:

Establishment of VSOE. We may in the future sell products for which we have not established VSOE and would be required to delay the recognition of revenue. A delay in the recognition of revenue from sales of products may cause fluctuations in our quarterly financial results and may adversely affect our operating margins.

Timing of product orders. A significant portion of our revenue in any quarter comes from previously deferred revenue, which is a somewhat predictable component of our quarterly revenue. However, a

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meaningful part of revenue depends on contracts entered into or orders booked and shipped in the current quarter. Typically we generate the most orders in the last month of each quarter and significant new orders generally close at the end of the quarter. Some customers believe they can enhance their bargaining power by waiting until the end of our quarter to place their order. Also, personnel limitations and system processing constraints could adversely impact our ability to process the large number of orders that typically occur near the end of a quarter. Any failure or delay in closing significant new orders in a given quarter could have a material adverse impact on our results for that quarter.

Reliability and timeliness of expense data. We increasingly rely upon third-party manufacturers to manufacture our hardware-based products; therefore, our reliance on their ability to provide us with timely and accurate product cost information exposes us to risk, negatively impacting our ability to accurately and timely report our operating results.

Issues relating to third-party distribution, manufacturing and fulfillment relationships. We rely heavily on third parties to manufacture and distribute our products. Any changes in the performance of these relationships can impact our operating results. Changes in our supply chain could result in product fulfillment delays that contribute to fluctuations in operating results from period to period. We have in the past and may in the future make changes in our product delivery network, which may disrupt our ability to timely and efficiently meet our product delivery commitments, particularly at the end of a quarter. As a result, we may experience increased costs in the short term as temporary delivery solutions are implemented to address unanticipated delays in product delivery. In addition, product delivery delays may negatively impact our ability to recognize revenue if shipments are delayed at the end of a quarter.

Product and geographic mix. Another source of fluctuations in our operating results and, in particular, gross profit margins, is the mix of products we sell and services we offer, as well as the mix of countries in which our products and services are sold, including the mix between corporate versus consumer products; hardware-based compared to software-based products; perpetual licenses versus subscription licenses; and maintenance and support services compared to consulting services or product revenue. Product and geographic mix can impact operating expenses as well as the amount of revenue and the timing of revenue recognition, so our profitability can fluctuate significantly.

Timing of new products and customers. The timing of the introduction and adoption of new products, product upgrades or updates can have a significant impact on revenue from period to period. For example, revenue tends to be higher in periods shortly after we introduce new products compared to periods without new products. Our revenue may decline after new product introductions by competitors. In addition, the volume, size, and terms of new customer licenses can cause fluctuations in our revenue.

Additional cash and non-cash sources of fluctuations. A number of other factors that are peripheral to our core business operations also contribute to variability in our operating results. These include, but are not limited to, expenses related to our acquisition and disposition activities, arrangements with minimum contractual commitments including royalty and distribution-related agreements, stock-based compensation expense, unanticipated costs associated with litigation or investigations, costs related to Sarbanes-Oxley compliance efforts, costs and charges related to certain extraordinary events such as restructurings, substantial declines in estimated values of long-lived assets below the value at which they are reflected in our financial statements, and changes in generally accepted accounting principles, such as increased use of fair value measures and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards (IFRS), new guidance relating to generally accepted accounting principles, such as the guidance issued by the Financial Accounting Standards Board in October 2009 on software revenue recognition and on revenue arrangements with multiple deliverables and changes in tax laws.

Material weaknesses in our internal control and financial reporting environment may impact the accuracy, completeness and timeliness of our external financial reporting.

Section 404 of the Sarbanes-Oxley Act requires that management report annually on the effectiveness of our internal control over financial reporting and identify any material weaknesses in our internal control and financial reporting environment. If management identifies any material weaknesses, their correction could require remedial

measures which could be costly and time-consuming. In addition, the presence of material weaknesses could result in financial statement errors which in turn could require us to restate our operating results. This in turn could damage investor confidence in the accuracy and completeness of our financial reports, which could affect our stock price and potentially subject us to litigation.

Our strategic alliances and our relationships with manufacturing partners expose us to a range of business risks and uncertainties that could have a material adverse impact on our business and financial results.

Uncertainty of realizing anticipated benefit of strategic alliances. We have entered into strategic alliances with numerous third parties to support our future growth plans. For example, these relationships may include technology licensing, joint technology development and integration, research cooperation, co-marketing activities and sell-through arrangements. We face a number of risks relating to our strategic alliances, including those described below. These risks may prevent us from realizing the desired benefits from our strategic alliances on a timely basis or at all, which could have a negative impact on our business and financial results.

Challenges relating to integrated products from strategic alliances. Strategic alliances require significant coordination between the parties involved, particularly if an alliance requires that we integrate their products with our products. This could involve significant time and expenditure by our technical staff and the technical staff of our strategic partner. The integration of products from different companies may be more difficult than we anticipate, and the risk of integration difficulties, incompatible products and undetected programming errors or defects may be higher than that normally associated with new products. The marketing and sale of products that result from strategic alliances might also be more difficult than that normally associated with new products. Sales and marketing personnel may require special training, as the new products may be more complex than our other products.

We invest significant time, money and resources to establish and maintain relationships with our strategic partners, but we have no assurance that any particular relationship will continue for any specific period of time. Generally, our strategic alliance agreements are terminable without cause with no or minimal notice or penalties. If we lose a significant strategic partner, we could lose the benefit of our investment of time, money and resources in the relationship. In addition, we could be required to incur significant expenses to develop a new strategic alliance or to determine and implement an alternative plan to pursue the opportunity that we targeted with the former partner.

We rely on a limited number of third parties to manufacture some of our hardware-based network protection and system protection products. We expect the number of our hardware-based products and our reliance on third-party manufacturers to increase as we continue to expand these types of solutions. We also rely on third parties to replicate and package our boxed software products. This reliance on third parties involves a number of risks that could have a negative impact on our business and financial results.

Less control of the manufacturing process and outcome with third party manufacturing relationships. Our use of third-party manufacturers result in a lack of control over the quality and timing of the manufacturing process, limited control over the cost of manufacturing, and the potential absence or unavailability of adequate manufacturing capacity.

Risk of inadequate capacity with third party manufacturing relationships. If any of our third-party manufacturers fails for any reason to manufacture products of acceptable quality, in required volumes, and in a cost-effective and timely manner, it could be costly as well as disruptive to product shipments. We might be required to seek additional manufacturing capacity, which might not be available on commercially reasonable terms or at all. Even if additional capacity was available, the process of qualifying a new vendor could be lengthy and could cause significant delays in product shipments and could strain partner and customer relationships. In addition, supply disruptions or cost increases could increase our costs of goods sold and negatively impact our financial performance. Our risk is

relatively greater in situations where our hardware products contain critical components supplied by a single or a limited number of third parties. Any significant shortage of components could lead to cancellations of customer orders or delays in placement of orders, which would adversely impact revenue.

Risk of hardware obsolescence and excess inventory with third party manufacturing relationships. Hardware-based products may face greater obsolescence risks than software products. We could incur losses or other

charges in disposing of obsolete hardware inventory. In addition, to the extent that our third-party manufacturers upgrade or otherwise alter their manufacturing processes, our hardware-based products could face supply constraints or risks associated with the transition of hardware-based products to new platforms. This could increase the risk of losses or other charges associated with obsolete inventory. We determine the quantities of our products that our third-party manufacturers produce and we base these orders upon our expected demand for our products. Although we order products as close in time to the actual demand as we can, if actual demand is not what we project, we may accumulate excess inventory which may adversely affect our financial results.

Our global operations may expose us to tax risk.

We are generally required to account for taxes in each jurisdiction in which we operate. This process may require us to make assumptions, interpretations and judgments with respect to the meaning and application of promulgated tax laws and related administrative and judicial interpretations. The positions that we take and our interpretations of the tax laws may differ from the positions and interpretations of the tax authorities in the jurisdictions in which we operate. We are presently under examination in many jurisdictions, including notably the U.S., California, and Germany. An adverse outcome in one or more of these ongoing examinations, or in any future examinations that may occur, could have a significant negative impact on our cash position and net income. Although we have established reserves for these examination contingencies, there can be no assurance that the reserves will be sufficient to cover our ultimate liabilities.

Our provision for income taxes is subject to volatility and can be adversely affected by a variety of factors, including but not limited to changes in tax laws and regulations (including various current proposals related to U.S. taxation of non-U.S. income) and accounting principles (including accounting for uncertain tax positions), or interpretations of those changes. Significant judgment is required to determine the recognition and measurement attributes prescribed in certain accounting guidance. This guidance applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes or recorded goodwill.

Critical personnel may be difficult to attract, assimilate and retain.

Our success depends in large part on our ability to attract and retain senior management personnel, as well as technically qualified and highly-skilled sales, consulting, technical, finance and marketing personnel. Other than members of executive management who have at will employment agreements, our employees are not typically subject to an employment agreement or non-competition agreement. It could be difficult, time consuming and expensive to locate, replace and integrate any key management member or other critical personnel. Changes in management or other critical personnel may be disruptive to our business and might also result in our loss of unique skills and the departure of existing employees and/or customers.

Other personnel related issues that we may encounter include:

Competition for personnel; need for competitive pay packages. Competition for qualified individuals in our industry is intense and we must provide competitive compensation packages, including equity awards. Increases in shares available for issuance under our equity incentive plans require stockholder approval, and there may be times, as we have seen in the past, where we may not obtain the necessary approval. If we are unable to attract and retain qualified individuals, our ability to compete in the markets for our products could be adversely affected, which would have a negative impact on our business and financial results.

Risks relating to senior management changes and new hires. From 2006 to 2008, we experienced significant changes in our senior management team as a number of officers resigned or were terminated and several key management

positions were vacant for a significant period of time. We may continue to experience changes in senior management going forward.

We continue to hire in key areas and have added a number of new employees in connection with our acquisitions. For new employees, including senior management, there may be reduced levels of productivity as it takes time for new hires to be trained or otherwise assimilated into the company.

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Increased customer demands on our technical support services may adversely affect our relationships with our customers and negatively impact our financial results.

We offer technical support services with many of our products. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. We also may be unable to modify the format of our support services to compete with changes in support services provided by competitors or successfully integrate support for our customers. Further customer demand for these services, without corresponding revenue, could increase costs and adversely affect our operating results.

We have outsourced a substantial portion of our worldwide consumer support functions to third-party service providers. If these companies experience financial difficulties, service disruptions, do not maintain sufficiently skilled workers and resources to satisfy our contracts, or otherwise fail to perform at a sufficient level under these contracts, the level of support services to our customers may be significantly disrupted, which could materially harm our relationships with these customers.

We face risks related to customer outsourcing to system integrators.

Some of our customers have outsourced the management of their information technology departments to large system integrators. If this trend continues, our established customer relationships could be disrupted and our products could be displaced by alternative system and network protection solutions offered by system integrators that do not bundle our solutions. Significant product displacements could negatively impact our revenue and have a material adverse effect on our business.

If we fail to effectively upgrade or modify our information technology system, we may not be able to accurately report our financial results or prevent fraud.

We may experience difficulties in transitioning to new or upgraded information technology systems and in applying maintenance patches to existing systems, including loss of data and decreases in productivity as personnel become familiar with new, upgraded or modified systems. Our management information systems will require modification and refinement as we grow and as our business needs change, which could prolong the difficulties we experience with systems transitions, and we may not always employ the most effective systems for our purposes. If we experience difficulties in implementing new or upgraded information systems or experience significant system failures, or if we are unable to successfully modify our management information systems and respond to changes in our business needs, our operating results could be harmed or we may fail to meet our reporting obligations. We may also experience similar results if we have difficulty applying routine maintenance patches to existing systems in a timely manner.

Computer hackers may damage our products, services and systems.

Due to our high profile in the network and system protection market, we have been a target of computer hackers who have, among other things, created viruses to sabotage or otherwise attack our products and services, including our various web sites. For example, we have seen the spread of viruses, or worms, that intentionally delete anti-virus and firewall software. Similarly, hackers may attempt to penetrate our network security and misappropriate proprietary information or cause interruptions of our internal systems and services. Also, a number of web sites have been subject to denial of service attacks, where a web site is bombarded with information requests eventually causing the web site to overload, resulting in a delay or disruption of service. If successful, any of these events could damage users or our own computer systems. In addition, since we do not control disk duplication by distributors or our independent agents, media containing our software may be infected with viruses.

Business interruptions may impede our operations and the operations of our customers.

We are continually updating or modifying our accounting and other internal and external facing business systems. Modifications of these types of systems are often disruptive to business and may cause us to incur higher costs than we anticipate. Failure to properly manage this process could materially harm our business operations.

In addition, we and our customers face a number of potential business interruption risks that are beyond our respective control. Natural disasters or other events could interrupt our business or the business of our customers, and each of us is reliant on external infrastructure that may be antiquated. Our corporate headquarters in California is located near a major earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure and overall operations is not known, but could be quite severe. Despite business interruption and disaster recovery programs that have been implemented, an earthquake could seriously disrupt our entire business process. We are largely uninsured for losses and business disruptions caused by an earthquake and other natural disasters.

Our investment portfolio is subject to volatility, losses and liquidity limitations. Continued negative conditions in the global credit markets could impair the value of or limit our access to our investments.

Investment income has been a significant component of our net income. The ability to achieve our investment objectives is affected by many factors, some of which are beyond our control. We invest our cash, cash equivalents and marketable securities in a variety of investment vehicles in a number of countries with and in the custody of financial institutions with high credit ratings. While our investment policy and strategy attempt to manage interest rate risk, limit credit risk, and only invest in what we view as very high-quality debt securities, the outlook for our investment holdings is dependent on general economic conditions, interest rate trends and volatility in the financial marketplace, which can all affect the income that we receive, the value of our investments, and our ability to sell them. Current economic conditions have had widespread negative effects on the financial markets and global economies. During these challenging markets, we are investing new cash in instruments with short to medium-term maturities of highly-rated issuers, including U.S. government guaranteed investments. We do not hold any auction rate securities or structured investment vehicles. The underlying collateral for certain of our mortgage-backed and asset-backed securities is comprised of some sub-prime mortgages, as well as prime and Alt-A mortgages. We are no longer purchasing mortgage-backed or asset-backed securities.

The outlook for our investment income is dependent on the amount of any acquisitions that we effect and the amount of cash flows from operations that are available for investment. Our investment income is also affected by the yield on our investments and our recent shift to a larger percentage of our investment portfolio to shorter-term and U.S. government guaranteed investments. This shift may negatively impact our income from our investment portfolio in light of declining yields. Any significant decline in our investment income or the value of our investments could have an adverse effect on our results of operations or financial condition.

During 2008, we recorded an other-than-temporary impairment charge of $18.5 million related to marketable securities. During the nine months ended September 30, 2009, we recorded additional impairment on previously impaired marketable securities totaling $0.7 million. We believe that our investment securities are carried at fair value. However, over time the economic and market environment may provide additional insight regarding the fair value of certain securities which could change our judgment regarding impairment. This could result in realized losses relating to other-than-temporary declines being charged against future income. Given the current market conditions involved, there is continuing risk that further declines in fair value may occur and additional impairments may be charged to income in future periods, resulting in realized losses.

Most of our cash and investments held outside the U.S. are subject to fluctuations in currency exchange rates. A repatriation of these non-U.S. investment holdings to the U.S. under current law could be subject to foreign and U.S. federal income and withholding taxes, less any applicable foreign tax credits. These tax limitations, local regulations and potential further capital market turmoil could limit our ability to utilize these offshore funds.

Our stock price has been volatile and is likely to remain volatile.

During 2008 and through October 30, 2009, our stock price was highly volatile, ranging from a high of $45.68 to a low of $24.72. On October 30, 2009, our stock s closing price was $41.88. Announcements, business developments, such as material acquisitions or dispositions, litigation developments and our ability to meet the expectations of investors with respect to our operating and financial results, may contribute to current and future stock price volatility. In addition, third-party announcements such as those made by our partners and competitors may contribute to current and future stock price volatility. For example, future announcements by major

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competitors related to consumer and corporate security solutions may contribute to future volatility in our stock price. Certain types of investors may choose not to invest in stocks with this level of stock price volatility.

Our stock price may also experience volatility that is completely unrelated to our performance or that of the security industry. For the past year, the major U.S. and international stock markets have been extremely volatile. Fluctuations in these broad market indices can impact our stock price regardless of our performance.

Our charter documents and Delaware law may impede or discourage a takeover, which could lower our stock price.

Under our certificate of incorporation, our board of directors has the authority to issue up to 5.0 million shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by our stockholders. The issuance of preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock and could have the effect of discouraging a change of control of the company or changes in management.

Delaware law and other provisions of our certificate of incorporation and bylaws could also delay or make a merger, tender offer or proxy contest involving us or changes in our board of directors and management more difficult. For example, any stockholder wishing to make a stockholder proposal (including director nominations) at our 2010 annual meeting must meet the qualifications and follow the procedures specified under both the Securities Exchange Act of 1934 and our bylaws. In addition, we have a classified board of directors; however, our board of directors will be declassified over the three year period ending with our annual meeting of stockholders in 2012.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

Common Stock Repurchases

In July 2009, our authorization by our board of directors for repurchases of our common stock in the open market or through privately negotiated transactions expired. During the three months ended on September 30, 2009, we repurchased shares of our common stock for approximately $2.0 million in connection with our obligation to holders of RSUs, RSAs and PSUs to withhold the number of shares required to satisfy the holders tax liabilities in connection with the vesting of such shares. These shares were not part of the publicly announced repurchase program.

The table below sets forth all repurchases by us of our common stock during the three months ended September 30, 2009:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Repurchase Program	Approximate Dollar Value of Shares That May yet be Purchased Under Our Stock Repurchase Program
		(In thousands, except price per share)		
July 1, 2009 July 31, 2009	6	$ 41.75		$ 250,290
August 1, 2009 through August 31, 2009	29	44.35		

September 1, 2009 through September 30, 2009	11	41.95
Total	46	$ 43.46

Item 3. ***Defaults upon Senior Securities***

None.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

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Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

(a) *Exhibits.* The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Report

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

McAfee Inc.

/s/ Albert A. Rocky Pimentel
Albert A. Rocky Pimentel
Chief Financial Officer and Chief Operating Officer

November 6, 2009

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EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference				Filed with this 10-Q
		Form	File Number	Exhibit Number	Filing Date	
3.1	Third Amended and Restated Certificate of Incorporation of the Registrant, as amended on April 27, 2009	8-K	001-31216	3.1	May 1, 2009	
3.2	Certificate of Ownership and Merger between Registrant and McAfee, Inc.	10-Q	001-31216	3.2	November 8, 2004	
3.3	Fourth Amended and Restated Bylaws of the Registrant.	8-K	001-31216	3.2	May 1, 2009	
3.4	Certificate of Designation of Series A Preferred Stock of the Registrant	10-Q	000-20558	3.3	November 14, 1996	
3.5	Certificate of Designation of Rights, Preferences and Privileges of Series B Participating Preferred Stock of the Registrant	8-K	000-20558	5.0	October 22, 1998	
10.1	Letter Agreement, dated October 25, 1999 between Todd Gebhart and the Registrant.					X
10.2	Letter Agreement, dated October 5, 2007 between Gerhard Watzinger and the Registrant.					X
31.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101	The following materials from McAfee, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income and Comprehensive Income, (iii) the Condensed Consolidated Statements of Cash					X

Flows, and (iv) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.