McAfee, Inc.
Form 10-Q
May 12, 2008

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 March 31, 2008**
	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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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 April 30, 2008, 160,997,535 shares of the registrant s common stock, $0.01 par value, were outstanding.

MCAFEE, INC.
FORM 10-Q

March 31, 2008

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Amendment of Stock Option - Christopher Bolin
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1993 Stock Option Plan of Outside Directors, as Amended
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Certification of Chief Executive Officer and Chief Accounting Officer Pursuant to Section 906

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PART I: FINANCIAL INFORMATION

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

MCAFEE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2008	December 31, 2007
	(In thousands, except share data) (Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 454,312	$ 394,158
Short-term marketable securities	349,942	338,770
Accounts receivable, net of allowance for doubtful accounts of $5,905 and $4,076, respectively	195,113	232,056
Prepaid expenses and prepaid taxes	196,551	162,574
Deferred income taxes	249,701	256,188
Other current assets	25,909	24,000
Total current assets	1,471,528	1,407,746
Long-term marketable securities	488,830	585,874
Property and equipment, net	93,826	94,670
Deferred income taxes	299,690	321,342
Intangible assets, net	227,275	220,126
Goodwill	804,384	750,089
Other assets	49,651	34,256
Total assets	$ 3,435,184	$ 3,414,103
LIABILITIES		
Current liabilities:		
Accounts payable	$ 40,876	$ 45,858
Accrued income taxes	72,806	79,553
Accrued compensation	70,899	99,652
Other accrued liabilities	166,824	150,961
Deferred revenue	837,635	801,577
Total current liabilities	1,189,040	1,177,601
Deferred revenue, less current portion	243,109	242,936
Accrued taxes and other long-term liabilities	88,273	88,241

Total liabilities	1,520,422	1,508,778
Commitments and contingencies (Notes 11 and 12)		
STOCKHOLDERS EQUITY		
Preferred stock, $0.01 par value:		
Authorized: 5,000,000 shares; Issued and outstanding: none in 2008 and 2007		
Common stock, $0.01 par value:		
Authorized: 300,000,000 shares; Issued: 177,169,508 shares at March 31, 2008 and 173,148,853 shares at December 31, 2007		
Outstanding: 160,760,450 shares at March 31, 2008 and 160,545,422 shares at December 31, 2007	1,772	1,732
Treasury stock, at cost: 16,409,058 shares at March 31, 2008 and 12,603,431 shares at December 31, 2007	(430,445)	(303,270)
Additional paid-in capital	1,899,095	1,810,290
Accumulated other comprehensive income	50,096	32,498
Retained earnings	394,244	364,075
Total stockholders equity	1,914,762	1,905,325
Total liabilities and stockholders equity	$ 3,435,184	$ 3,414,103

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 March 31,	
	2008	2007
	(In thousands, except per share data) (Unaudited)	
Net revenue:		
Service and support	$ 188,218	$ 167,605
Subscription	160,974	128,368
Product	20,449	18,905
Total net revenue	369,641	314,878
Cost of net revenue:		
Service and support	14,844	12,393
Subscription	46,590	37,386
Product	14,942	11,905
Amortization of purchased technology and patents	13,560	8,369
Total cost of net revenue	89,936	70,053
Operating costs:		
Research and development	58,625	54,613
Marketing and sales	118,357	93,081
General and administrative	42,689	44,851
SEC and compliance costs	1,376	5,052
Amortization of intangibles	5,340	2,682
Restructuring charges	71	3,126
Total operating costs	226,458	203,405
Income from operations	53,247	41,420
Interest and other income, net	13,035	14,315
Gain on sale of investments, net	2,462	109
Income before provision for income taxes	68,744	55,844
Provision for income taxes	38,575	12,494
Net income	$ 30,169	$ 43,350
Other comprehensive income:		
Unrealized (loss) gain on marketable securities, net of reclassification adjustment for gains (losses) recognized on marketable securities during the period and income tax	$ (937)	$ 469
Foreign currency translation gain	18,535	436

Comprehensive income	$	47,767	$	44,255
Net income per share Basic	$	0.19	$	0.27
Net income per share Diluted	$	0.18	$	0.27
Shares used in per share calculation Basic		160,992		159,799
Shares used in per share calculation Diluted		164,867		163,174

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 CASH FLOWS

	Three Months Ended March 31,	
	2008	**2007**
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net income	$ 30,169	$ 43,350
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,489	20,278
Provision for (recovery of) doubtful accounts, net	302	(284)
Non-cash restructuring (benefit) charge	(281)	1,365
Discount amortization on marketable securities	(1,090)	(1,431)
Loss on sale of assets and technology	3	4
Gain on sale of investments	(2,462)	(109)
Deferred income taxes	34,587	6,668
Decrease in fair value of options accounted for as liabilities	(5,483)	
Non-cash stock-based compensation expense	11,657	20,707
Excess tax benefits from stock-based compensation	(9,520)	(12)
Changes in assets and liabilities, net of acquisitions and divestitures:		
Accounts receivable	45,321	24,882
Prepaid expenses, prepaid taxes and other assets	(10,823)	(3,223)
Accounts payable	(7,741)	1,102
Accrued taxes and other liabilities	(32,860)	(6,268)
Deferred revenue	(8,894)	(5,248)
Net cash provided by operating activities	71,374	101,781
Cash flows from investing activities:		
Purchase of marketable securities	(178,052)	(167,646)
Proceeds from sales of marketable securities	176,400	95,227
Proceeds from maturities of marketable securities	89,515	59,835
Acquisitions, net of cash acquired	(55,041)	
(Increase) decrease in restricted cash	(12)	352
Purchase of property, equipment and leasehold improvements	(10,493)	(10,150)
Proceeds from the sale of assets and technology		4,105
Net cash provided by (used in) investing activities	22,317	(18,277)
Cash flows from financing activities:		
Proceeds from issuance of common stock from option plans	53,677	
Excess tax benefits from stock-based compensation	9,520	12
Repurchase of common stock	(127,175)	(196)

Net cash used in financing activities		(63,978)		(184)
Effect of exchange rate fluctuations on cash		30,441		3,932
Net increase in cash and cash equivalents		60,154		87,252
Cash and cash equivalents at beginning of period		394,158		389,627
Cash and cash equivalents at end of period	$	454,312	$	476,879
Non-cash investing and financing activities:				
Unrealized (loss) gain on marketable securities, net	$	(937)	$	469
Accrual for purchase of property, equipment and leasehold improvements	$	1,382	$	3,928
Accrual for intangibles	$		$	9,300
Fair value of assets acquired in business combination, excluding cash acquired	$	64,274	$	
Liabilities assumed in business combination	$	13,973	$	
Accrued purchase price	$	1,268	$	
Modification of stock options reclassification from equity to liability	$		$	4,326
Exercise of stock options reclassification from liability to equity awards	$	16,994	$	
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	$	9,155	$	10,688
Cash received from income tax refunds	$	1,905	$	1,113

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 worldwide security technology company that secures systems and networks from known and unknown threats around the world. Our security solutions are offered primarily to large enterprises, governments, small and medium-sized businesses and consumers through a network of qualified partners. 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 and Basis of Presentation

The accompanying condensed consolidated financial statements include our accounts as of March 31, 2008 and December 31, 2007 and for the three months ended March 31, 2008 and March 31, 2007. 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, 2007 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 that all 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, 2007.

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 months ended March 31, 2008 are not necessarily indicative of the results to be expected for the full year or for any future periods.

Significant Accounting Policies

Inventory

Inventory, which consists primarily of finished goods held at fulfillment partner locations and inventory sold into our channel that has not been sold through to the end-user, is stated at the 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 in our condensed consolidated balance sheets and were $3.8 million as of March 31, 2008 and $3.0 million as of December 31, 2007.

Deferred Costs of Revenue

Deferred costs of revenue, which consist primarily of costs related to revenue-sharing arrangements and royalty arrangements, are included in prepaid expenses and other assets on our condensed consolidated balance sheets. We only defer direct and incremental costs related to revenue-sharing arrangements and recognize such deferred costs proportionate to the related revenue recognized. At March 31, 2008, our deferred costs were $99.2 million compared to $79.0 million at December 31, 2007.

SEC and Compliance Costs

SEC and compliance costs in 2008 include ongoing legal expenses arising as a result of our historical investigation into our stock option granting practices and in 2007 include various expenses related to our historical investigation into our stock option granting practices.

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Fair Value Measurements

On January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements regarding fair value measurement. We hold financial assets, such as available for sale securities and foreign currency contracts, subject to valuation under SFAS 157. The following table details the fair value measurements within the fair value hierarchy of our financial assets (in thousands):

		Fair Value Measurements at March 31, 2008 Using		
Description	March 31, 2008	Quoted Prices in Active Markets Using Identical Assets (Level 1)(1)	Significant Other Observable Inputs (Level 2)(2)	Significant Unobservable Inputs (Level 3)(3)
Available-for-sale securities:				
The United States (U.S.) Government notes and bonds(4)	$ 398,873	$ 302,108	$ 96,765	$
Corporate notes and bonds(4)	250,232		250,232	
Asset-backed securities(4)	156,077		156,077	
Mortgage-backed securities(4)	33,590		33,590	
Cash and cash equivalents(5)	15,157		15,157	
Total available-for-sale securities	853,929	302,108	551,821	
Foreign exchange derivatives(6)	13,064	13,064		
Total	$ 866,993	$ 315,172	$ 551,821	$

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

(2) Level 2 classification is applied to assets that have evaluated prices received from fixed income vendors where the data inputs to these valuations, which are observable either directly or indirectly, but do not represent quoted prices from an active market.

(3) Level 3 classification is applied to assets when prices are not derived from existing market data.

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

(5) Included in cash and cash equivalents on our condensed consolidated balance sheets.

(6) Included in accounts receivable and other accrued liabilities on our condensed consolidated balance sheets.

In February 2008, the Financial Accounting Standard Board (FASB) issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities that are not remeasured at fair value on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. Any amounts recognized upon adoption of this rule as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. FSP 157-2 is effective for us beginning January 1, 2009. We continue to assess the impact that FSP 157-2 may have on our consolidated financial position and results of operations.

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Fair Value Option

On January 1, 2008, we adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 1* (SFAS 159). SFAS 159 permits entities to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. We did not elect the fair value measurement option for any of our financial assets or liabilities. Therefore, the adoption of SFAS 159 did not impact our consolidated financial position, results of operations or cash flows.

Recent Accounting Pronouncements

Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), to expand disclosures about an entity s derivative instruments and hedging activities, but does not change SFAS 133 s scope of accounting. SFAS 161 is effective for us beginning January 1, 2009.

Noncontrolling Interests

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* (SFAS 160). SFAS 160 amends Accounting Research Bulletin No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for us beginning January 1, 2009. We do not expect the adoption of SFAS 160 to have a material impact on our consolidated financial position, results of operations or cash flows.

Business Combinations

In December 2007, the FASB revised SFAS No. 141, *Business Combinations* (SFAS 141(R)), to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141(R) establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in an acquisition, at their fair value as of the acquisition date. SFAS 141(R) is effective for us beginning January 1, 2009. We will assess how the adoption of SFAS 141(R) will impact our consolidated financial position, results of operations and cash flows if we complete an acquisition after the date of adoption. The accounting treatment related to pre-acquisition uncertain tax positions will change when SFAS 141(R) becomes effective. At such time, any changes to the recognition or measurement of uncertain tax positions related to pre-acquisition periods will be recorded through income tax expense, whereas currently the accounting treatment would require any adjustment to be recognized through the purchase accounting.

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. Compensation expense is recognized over the required service or performance period of the awards. Our stock-based awards include stock options, restricted stock awards (RSAs), restricted stock units (RSUs), restricted stock units with performance-based

vesting (PSUs) and our Employee Stock Purchase Plan (ESPP).

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

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Amortization of fair value of options	$ 5,577	$ 5,058
Extension of post-termination exercise period		10,738
(Benefit) expense related to cash settlement of options	(382)	231
Restricted stock awards and units	5,825	4,911
Restricted stock units with performance-based vesting	255	
Tender offer	601	
Total stock-based compensation expense	$ 11,876	$ 20,938

Amortization of fair value of options. We recognize the fair value of stock options issued to employees and outside directors as stock-based compensation expense over the vesting period of the awards. As we adopted SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)) using the modified prospective method, these charges include compensation expense for stock options granted prior to January 1, 2006 but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for stock options granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R).

Extension of post-termination exercise period. From July 2006, when we announced that we might have to restate our historical financial statements as a result of our ongoing stock option granting practices investigation, through December 21, 2007, the date we became current on our reporting obligations under the Securities Exchange Act of 1934, as amended, (blackout period), we imposed restrictions on our ability to issue any shares, including those pursuant to stock option exercises. In January 2007, we extended the post-termination exercise period for vested options held by 640 former employees and outside directors that would expire during the blackout period. As a result of this modification, we recognized $10.7 million of stock-based compensation expense in the three months ended March 31, 2007, based on the fair value of the modified options. The expense was calculated in accordance with the guidance in SFAS 123(R). The options were deemed to have no value prior to the extension of the life beyond the blackout period.

Based on the guidance in SFAS 123(R) and related FASB Staff Positions, after the January 2007 modification, stock options held by former employees and outside directors that terminated prior to such modification became subject to the provisions of EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock*, (EITF 00-19). As a result, in January 2007, these options were reclassified as liability awards within current liabilities. Accordingly, at the end of each reporting period, we determined the fair value of these options utilizing the Black-Scholes valuation model and recognized any change in fair value of the options in our condensed consolidated statements of income and comprehensive income in the period of change.

In November 2007, due to a delay in our becoming current in our reporting obligations, we extended the post-termination exercise period for options held by 690 former employees and outside directors whose service to us terminated subsequent to the January 2007 modification and those previously modified in January 2007 as discussed above, until the earlier of (i) the ninetieth (90th) calendar day after December 21, 2007, the date we became current in our reporting obligations under the Securities Exchange Act of 1934, as amended, (ii) the expiration of the contractual

terms of the options, or (iii) December 31, 2008. Based on the guidance in SFAS 123(R) and related FASB Staff Positions, after the November 2007 modification, stock options held by the former employees and outside directors that terminated subsequent to the January 2007 modification and prior to November 2007 became subject to the provisions of EITF 00-19. As a result, in November 2007, these options were reclassified as liability awards within current liabilities. Accordingly, at the end of each reporting period, we determined the fair value of these options utilizing the Black-Scholes valuation model and recognized any change in fair value of the options in our condensed consolidated statements of income and comprehensive income in the period of change.

As of March 31, 2008, the January 2007 and November 2007 modified options had been exercised or had expired. The fair values of the options that had been exercised during the three months ended March 31, 2008 were remeasured on the respective date of exercise and recorded as an increase to additional paid-in capital. The options that expired were remeasured to have no fair value. We recognized a total benefit of $5.5 million related to the change in fair value of these options in the three months ended March 31, 2008. We did not recognize any expense related to the change in fair value of these options in the three months ended March 31, 2007 as our stock price did not change significantly from the January 2007 modification through March 31, 2007. Such amounts are included in general and administrative expense in our condensed consolidated statements of income and comprehensive income, and are not reflected as stock-based compensation expense.

Cash settlement of options. Certain stock options held by terminated employees expired during the blackout period as they could not be exercised during the 90-day period subsequent to termination. In January 2007, we determined that we would settle these options in cash. In the three months ended March 31, 2007, we recorded a liability of approximately $0.2 million, based on the intrinsic value of options held by current employees that expired during the blackout period. As of December 31, 2007, we recorded a liability of $5.7 million based on the intrinsic value of these options using our December 31, 2007 closing stock price. We paid $5.2 million in January 2008 to settle these options based on the average closing price of our common stock subsequent to December 21, 2007, the date we became current on our reporting obligations under the Securities Exchange Act of 1934, as amended. We recognized a benefit for the difference between the December 31, 2007 liability and the amount paid in the three months ended March 31, 2008.

Restricted stock awards and units. We recognize stock-based compensation expense for the fair value of RSAs and RSUs. Fair value is determined as the difference between the closing price of our common stock on the grant date and the purchase price of the RSAs and RSUs. The fair value of these awards is recognized to expense over the requisite service period of the awards.

Restricted stock units with performance-based vesting. We recognize stock-based compensation for the fair value of PSUs. These awards vest as follows: 50% vest only if performance criteria are met (performance component) and 50% cliff vest four years from the date of grant, with accelerated vesting if performance criteria are met (service component). Certain executive grants have only the performance component. The performance component will vest one-third each year from the date of grant, provided that the performance criteria are met for each respective year. If the performance criteria is not met in any one year, then the options that would have vested in that year are forfeited. The performance component is being recognized as expense one-third each year provided we determine it is probable that the performance criteria will be met. For certain of the PSUs, we have not communicated the performance criteria to the employees. For these awards, the accounting grant date will 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 will be marked-to-market at the end of each reporting period through the accounting grant date, and recognized over the expected vesting period. For the awards for which the performance criteria have been communicated, stock-based compensation expense has been measured on the grant date, and is being recognized over the expected vesting period.

The service component will cliff vest four years from the grant date, with an acceleration provision based on the same performance criteria as the performance component. If the performance criteria are met for each respective year, the awards will vest one-third each year from the grant date. The accounting grant date is deemed to have occurred and stock-based compensation has been measured on the grant date, and will be recognized over the expected vesting period.

Tender offer. In January 2008, after we became current with our reporting obligations under the Securities Exchange Act of 1934, as amended, we filed a Tender Offer Statement on Schedule TO with the SEC. The tender offer extended an offer by us to holders of certain outstanding stock options to amend the exercise price on certain of their

outstanding options. The purpose of the tender offer was to amend the exercise price on options to have the same price as the fair market value on the revised measurement dates that were identified during the investigation of our historical stock option grant practices. As part of this tender offer, we will pay a cash bonus of $1.7 million, of which $0.4 million was paid to Canadian employees in the three months ended March 31, 2008, and $1.3 million will be paid to U.S. employees in 2009, to reimburse optionees who elected to participate in the tender offer for any

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increase in the exercise price of their options resulting from the amendment. The impact of the cash bonus, as recorded during the three months ended March 31, 2008, resulted in stock-based compensation expense of $0.6 million and a decrease to additional paid-in capital of $1.1 million.

The following table summarizes pre-tax stock-based compensation expense recorded in our condensed consolidated statements of income and comprehensive income by line item in the three months ended March 31, 2008 and 2007 (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Cost of net revenue service and support	$ 202	$ 599
Cost of net revenue subscription	98	358
Cost of net revenue product	144	258
Stock-based compensation expense included in cost of net revenue	444	1,215
Research and development	3,621	4,972
Marketing and sales	3,748	8,513
General and administrative	4,063	6,238
Stock-based compensation expense included in operating costs	11,432	19,723
Total stock-based compensation expense	11,876	20,938
Deferred tax benefit	(3,207)	(6,785)
Total stock-based compensation expense, net of tax	$ 8,669	$ 14,153

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

At March 31, 2008, the estimated fair value of all unvested stock options, RSUs, PSUs and RSAs that have not yet been recognized as compensation expense was $113.2 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 compensation expense relating to 0.8 million PSUs for which the performance criteria has not been set.

Under SFAS 123(R), we used the Black-Scholes model to estimate the fair value of our option awards. The key assumptions used in the model during the three months ended March 31, 2008 and 2007, respectively, are provided below:

	Three Months Ended March 31,	
	2008	**2007**
Stock option grants:		
Risk free interest rate	2.9%	4.8%
Weighted average expected lives (years)	5.9	5.9

Volatility	39.0%	27.0%
Dividend yield		

During the three months ended March 31, 2008 and 2007, we did not have any ESPP grants.

We derive the expected term of our options through the use of a lattice model that factors in historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Since January 1, 2006, we have used the implied volatility of options traded on our stock with a term of one year or more to calculate the expected volatility of our option grants. We have not declared any dividends on our stock in the past and do not expect to do so in the foreseeable future.

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Internal Revenue Code Section 409A

Adverse tax consequences resulted from our revision of accounting measurement dates during our restatement due to our investigation into our stock option granting practices for stock options that vested subsequent to December 31, 2004 (409A affected options). These adverse tax consequences included a penalty tax payable by the option holder under Internal Revenue Code (IRC) Section 409A (and, as applicable, similar penalty taxes under state tax laws). As virtually all holders of options with revised measurement dates were not involved in or aware of their incorrect option exercise prices, we took certain actions to deal with the adverse tax consequences that were incurred by the holders of such options.

Section 16(a) Officers and Directors

In December 2006, our board of directors approved the amendment of 409A affected options for those who were Section 16(a) officers at the time they received 409A affected options to increase the exercise price to the fair market value of our common stock on the revised measurement date. These amended options are not subject to taxation under IRC Section 409A. Under Internal Revenue Service (IRS) regulations, these option amendments had to be completed by December 31, 2006 for anyone subject to Section 16(a) requirements upon receipt of the 409A affected options. There were no costs associated with this action, as the modifications increased the exercise price, which resulted in no incremental expense.

In the three months ended March 31, 2008, for one executive officer, we amended the exercise price on options to have the same price as the fair market value on the revised measurement dates that were identified during the investigation of our historical stock option grant practices. We will pay this executive officer a cash bonus of $0.1 million in 2009 as reimbursement for the increase in the exercise price of his options resulting from the amendment.

IRS Announcement 2007-18 Compliance

In February 2007, our board of directors approved our participation in a voluntary program under IRS Announcement 2007-18 and a similar state of California Announcement, whereby we paid additional 409A taxes on behalf of certain former U.S. employees who had already exercised 409A affected options for the additional taxes they incur under IRC Section 409A (and, as applicable, similar state of California tax law). Current and former Section 16(a) officers and directors were specifically excluded from the program. Through March 31, 2007, we recorded $1.3 million of expense associated with this program for Section 409A affected options exercised during this period. We had no expense associated with this program in the three months ended March 31, 2008.

Certain Former Employees Future Exercises of 409A Affected Options

In May 2007, our board of directors approved cash payments as necessary to certain former employees who exercised 409A affected options during 2006 or that may exercise 409A affected options in the future.

In November 2007, our board of directors approved the unilateral amendment of 409A affected options held by certain former employees who did not exercise 409A affected options during 2006 to increase the exercise price to the fair market value of our common stock on the revised measurement date, and to make cash payments as compensation for the increase in the exercise prices of amended options. These amended options would not be subject to taxation under IRC 409A.

In the three months ended March 31, 2008, we recorded no costs associated with former employees exercises of certain Section 409A affected options. The following table summarizes for the three months ended March 31, 2007 costs associated with actions taken by us with respect to IRC Section 409A (in thousands):

	Three Months Ended March 31, 2007
Cost of net revenue	$
Research and development	789
Marketing and sales	321
General and administrative	194
Costs associated with IRC Section 409A	$ 1,304

4. Business Combinations

ScanAlert

In January 2008, we acquired 100% of the outstanding shares of ScanAlert, Inc. (ScanAlert), a provider of a vulnerability assessment and certification services for e-commerce sites, for $54.9 million. The purchase price consisted of the following (in thousands):

Cash paid to shareholders	$ 42,098
Escrow deposit	6,382
Payment to third party for use of patent	4,500
Hold-back recorded as a liability	1,268
Direct acquisition costs	660
Total purchase price	$ 54,908

In the fourth quarter of 2007, we paid $4.5 million to a third party to settle prior alleged patent infringement claims against ScanAlert and for a fully paid future license for the use of the patent until its expiration. We have accounted for this entire amount as part of the ScanAlert purchase price as the arrangement with the third party was entered into as a result of the pending ScanAlert acquisition. Of the total $4.5 million payment, $0.9 million was allocated to the assumption of the patent infringement liability and $3.6 million was allocated to prepaid license fees to be amortized over five years. We have recorded a $1.3 million long-term liability on our consolidated balance sheet as of March 31, 2008 for a portion of the purchase price held-back for future indemnification claims. The amount will be paid out, net of any claims, in July 2009. Excluding these two items from the total purchase price, cash paid for the acquisition in the first quarter of 2008 was $49.1 million.

The purchase agreement provides for two earn-out payments totaling $29.5 million contingent upon the achievement of ScanAlert net bookings targets during the three-year period subsequent to the close of the acquisition. The first earn-out payment is $12.5 million and the second earn-out payment is $17.0 million. We have not accrued any portion of the earn-out payments as purchase price as achievement of the earn-out targets is not determinable beyond a reasonable doubt. Approximately $1.3 million and $1.8 million of the first and second earn-out payments,

respectively, are subject to certain employees providing future service. Therefore, the $1.3 million and $1.8 million portion of the first and second earn-outs, respectively, will be accounted for as post-acquisition compensation expense to the extent the earn-out targets are probable of being met. We have assessed the first earn-out target as being probable and the second earn-out target as not being probable. We are recognizing the $1.3 million compensatory portion of the first earn-out as compensation expense from the close of the acquisition through the end of 2009, resulting in $0.2 million of compensation expense being recognized in the quarter ended March 31, 2008.

Our management determined the purchase price allocation based on estimates of the fair values of the tangible and intangible assets acquired and liabilities assumed. These estimates were arrived at utilizing recognized valuation techniques. We recorded $42.7 million of goodwill, which is deductible for tax purposes due to a Section 338(h)(10) election under the IRC. Goodwill resulted primarily from our expectation that we will be able to

provide ScanAlert s service offerings to our customers and enhance our existing products with those of ScanAlert. We plan to incorporate ScanAlert s technology into our existing SiteAdvisor web rating system. We recorded no in-process research and development related to this acquisition.

The intangible assets, other than goodwill, are being amortized over their useful lives of 1.0 to 6.0 years or a weighted-average period of 5.5 years. As part of the acquisition, we did not assume any outstanding stock options or warrants. A performance and retention plan, which covers two employees and provides for payment of up to $1.5 million through January 2011, was established at the close of the acquisition. At March 31, 2008, $0.1 million had been expensed and no amounts had been paid related to this performance plan.

The following is a summary of the assets acquired and liabilities assumed in the acquisition of ScanAlert as based on our preliminary allocation (in thousands). This purchase price allocation is preliminary and subject to adjustment:

Technology	$ 4,759
Other intangibles	14,505
Goodwill	42,655
Deferred tax assets	1,970
Cash	107
Prepaid license fees	3,627
Other assets	1,258
Total assets acquired	68,881
Accrued liabilities	8,894
Deferred revenue	5,079
Total liabilities assumed	13,973
Net assets acquired	$ 54,908

The results of operations for ScanAlert have been included in our results of operations since the date of acquisition. Pro forma results of operations have not been presented because the effect of this acquisition was not material to our results of operations.

SafeBoot

In November 2007, we acquired 100% of the outstanding shares of SafeBoot Holding B.V. (SafeBoot) an enterprise security software vendor for data protection via encryption and access control, for $348.3 million. The purchase price consisted of the following (in thousands):

Cash paid as of December 31, 2007	$ 294,887
Escrow deposit	43,750
Direct acquisition and other costs paid in the three months ended March 31, 2008	6,007
Fair value of options assumed	3,611
Total purchase price before imputed interest	348,255
Imputed interest	(1,002)

Total purchase price	$ 347,253

For convenience, we designated October 31, 2007 as the effective date for this acquisition, which resulted in $1.0 million of imputed interest being charged to results of operations.

Our management determined the purchase price allocation based on estimates of the fair values of the tangible and intangible assets acquired and liabilities assumed. These estimates were arrived at utilizing recognized valuation techniques. On the acquisition date, we recorded $215.8 million of goodwill, which is deductible for tax purposes. Goodwill resulted primarily from our expectation that we will now be able to provide our customers with

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comprehensive data protection, including endpoint, network, web, email and data security, as well as risk and compliance solutions. We have integrated SafeBoot technology into our centralized management console for enterprise customers. We recorded no in-process research and development related to this acquisition.

The intangible assets, other than goodwill, are being amortized over their useful lives of 1.0 to 8.0 years or a weighted-average period of 4.5 years. As part of the acquisition, we assumed approximately 0.5 million outstanding stock options.

The following is a summary of the assets acquired and liabilities assumed in the acquisition of SafeBoot as adjusted for purchase price adjustments (in thousands):

Technology	$ 102,340
Other intangibles	41,800
Goodwill	216,588
Cash	9,760
Other assets	23,865
Total assets acquired	394,353
Accrued liabilities	25,904
Deferred revenue	9,394
Deferred tax liabilities	11,802
Total liabilities assumed	47,100
Net assets acquired	$ 347,253

A performance and retention plan, which provides for payment of up to $0.3 million through 2008, was established at the closing of the acquisition. At March 31, 2008, $0.2 million had been expensed and no amounts had been paid related to this performance plan.

The following unaudited pro forma financial information presents our combined results with SafeBoot as if the acquisition had occurred at the beginning of 2007 (in thousands, except per share data):

		Three Months Ended March 31, 2007
Pro forma net revenue	$	325,073
Pro forma net income	$	34,458
Pro forma basic net income per share	$	0.22
Pro forma diluted net income per share	$	0.21
Shares used in per share calculation basic		159,799

Shares used in per share calculation diluted	163,174

5. Goodwill and Other Intangible Assets

We perform our annual impairment review as of October 1 of each year or earlier if indicators of impairment exist. In 2007, this analysis indicated that goodwill was not impaired. The fair value of the reporting units was estimated using the average of the expected present value of future cash flows and of the market multiple value. We will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting units below their carrying amounts.

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

	December 31, 2007	Goodwill Acquired	Adjustments	Effects of Foreign Currency Exchange	March 31, 2008
North America	$ 511,491	$ 41,459	$ 356	$ (241)	$ 553,065
EMEA	162,174	1,196	321	10,516	174,207
Japan	25,787		82		25,869
Asia-Pacific (excluding Japan)	34,217		26		34,243
Latin America	16,420		16	564	17,000
Total	$ 750,089	$ 42,655	$ 801	$ 10,839	$ 804,384

The goodwill acquired during the three months ended March 31, 2008 is due to the acquisition of ScanAlert. The adjustments to goodwill are a result of purchase accounting adjustments for the SafeBoot acquisition.

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

		March 31, 2008			December 31, 2007		
	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	4.3 years	$ 289,579	$ (141,225)	$ 148,354	$ 282,293	$ (129,082)	$ 153,211
Trademarks and patents	5.0 years	43,392	(34,779)	8,613	42,922	(33,956)	8,966
Customer base and other intangibles	5.7 years	135,292	(64,984)	70,308	117,731	(59,782)	57,949
		$ 468,263	$ (240,988)	$ 227,275	$ 442,946	$ (222,820)	$ 220,126

The aggregate amortization expenses for the intangible assets listed above totaled $18.9 million and $11.1 million in the three months ended March 31, 2008 and 2007, respectively.

Expected future intangible asset amortization expense as of March 31, 2008 is as follows (in thousands):

Fiscal years:

Remainder of 2008	$ 55,962
2009	62,843
2010	53,695
2011	35,373
2012	12,040
Thereafter	7,362
	$ 227,275

6. Restructuring Charges

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 2008 (the 2008 Restructuring), we took the following measures:

- eliminated redundant positions related to the SafeBoot acquisition; and
- realigned sales force.

During 2006 (the 2006 Restructuring), we took the following measures:

- reduced our workforce; and
- continued our efforts to consolidate and dispose of excess facilities.

During 2004 and 2003 (the 2004 and 2003 Restructurings), we took the following measures:

- reduced our workforce;
- continued our efforts to consolidate and dispose of excess facilities;
- moved our European headquarters to Ireland and substantially vacated a leased facility in Amsterdam;
- consolidated operations formerly housed in three leased facilities in Dallas, Texas into our regional headquarters facility in Plano, Texas;
- relocated employees from Santa Clara, California headquarters site to our Plano facility as part of the consolidation activities; and
- sold our Sniffer and Magic product lines in 2004.

Restructuring charges in the three months ended March 31, 2008 totaled $0.1 million, consisting of $2.5 million related to 2008 restructuring charges partially offset by a $2.4 million revision related primarily to previous estimates of base rent and sublease income for the Santa Clara lease which was restructured in 2003, net of accretion.

2008 Restructuring

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

	Severance
Balance, January 1, 2008	$
Restructuring accrual	2,477
Cash payments	(283)
Balance, March 31, 2008	$ 2,194

In the three months ended March 31, 2008, we recorded a restructuring charge of $0.7 million related to the elimination of certain positions at SafeBoot that were redundant to positions at McAfee. This charge was recorded in our EMEA operating segment. We also recorded a $1.8 million restructuring charge related to the realignment of our

sales force, of which $0.5 million and $1.3 million were recorded in our North America and EMEA operating segments, respectively.

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2006 Restructuring

Activity and liability balances related to our 2006 restructuring are as follows (in thousands):

	Lease Termination Costs	Severance and Other benefits	Total
Balance, January 1, 2007	$	$ 2,390	$ 2,390
Restructuring accrual	330	2,634	2,964
Adjustment to liability	(24)	(196)	(220)
Cash payments	(233)	(4,542)	(4,775)
Effects of foreign currency exchange	4	7	11
Balance, December 31, 2007	77	293	370
Cash payments	(8)		(8)
Balance, March 31, 2008	$ 69	$ 293	$ 362

During 2007, we completed the restructuring activities that we began in the fourth quarter of 2006 when we permanently vacated several leased facilities and recorded a $0.3 million accrual for estimated lease related costs associated with the permanently vacated facilities. We also recorded a restructuring charge of $2.6 million in 2007 related to a reduction in headcount of 33 marketing and sales employees, of which $0.2 million, $2.3 million and $0.1 million was recorded in our North America, EMEA and Asia-Pacific operating segments, respectively.

Lease termination costs will be paid through 2009.

2004 and 2003 Restructurings

Activity and liability balances related to our 2004 and 2003 restructuring actions are as follows (in thousands):

	Lease Termination Costs
Balance, January 1, 2007	$ 12,248
Cash payments	(2,235)
Adjustment to liability	5,552
Effects of foreign currency exchange	99
Accretion	431
Balance, December 31, 2007	16,095
Cash payments	(687)
Adjustment to liability	(2,557)
Effects of foreign currency exchange	(10)

Accretion		151
Balance, March 31, 2008	$	12,992

Lease termination costs included vacating several leased facilities, net of estimated sublease income, costs associated with subleasing the vacated facilities, asset disposals and discontinued use of certain leasehold improvements and furniture and equipment primarily in our North America operating segment. Other costs include legal expenses incurred in international locations in conjunction with headcount reductions. Lease termination costs will be paid through 2013.

The adjustment in 2008 primarily relates to changes in previous estimates of base rent and sublease income for the Santa Clara lease.

7. Line of Credit

We have a 14.0 million Euro credit facility with a bank. The credit facility is available on an offering basis, meaning that transactions under the 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 credit facility is intended to be used for short-term credit requirements, with terms of one year or less. The credit facility can be cancelled at any time. No balances were outstanding as of March 31, 2008 and December 31, 2007.

8. 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 March 31,	
	2008	2007
Numerator Basic and diluted net income	$ 30,169	$ 43,350
Denominator Basic Basic weighted average common stock outstanding	160,992	159,799
Denominator Diluted Basic weighted average common stock outstanding	160,992	159,799
Effect of dilutive securities:		
Common stock options and restricted stock units and awards(1)	3,875	3,375
Diluted weighted average shares	164,867	163,174
Net income per share Basic	$ 0.19	$ 0.27
Net income per share Diluted	$ 0.18	$ 0.27

(1) In the three months ended March 31, 2008 and 2007, 4.6 million and 3.2 million RSUs and options to purchase common stock, respectively, were excluded from the calculation since the effect was anti-dilutive. In addition, we excluded 1.2 million PSUs for the three months ended March 31, 2008 because they are contingently issuable shares.

9. Income Taxes

Our consolidated provision for income taxes for the three months ended March 31, 2008 and 2007 was $38.6 million and $12.5 million, respectively, reflecting an effective tax rate of 56% and 22%, respectively. The effective tax rate for the three months ended March 31, 2008 differs from the U.S. federal statutory rate (statutory rate) primarily as a result of our acquisition integration activities, which resulted in an increase of 22 percentage points to our effective tax rate. We are currently in the process of seeking administrative relief with the U.S. Internal Revenue Service, which would reduce our tax expense related to these integration activities. If the administrative relief is granted, we will reverse the previously recorded tax expense in the period in which the relief is granted. The effective tax rate for the

three months ended March 31, 2007 differs from the statutory rate primarily due to the benefit of lower tax rates in certain foreign jurisdictions.

We account for uncertainty in income taxes in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). As a result, we apply a more-likely-than-not recognition threshold for all tax uncertainties. FIN 48 only allows the recognition of those tax benefits that have a greater than 50% likelihood of being sustained upon examination by the taxing authorities.

10. Business Segment Information

We have concluded that we have one business and operate in one industry. We develop, market, distribute and support computer and network security solutions for large enterprises, governments, 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 web sites, which provide 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.

Summarized financial information concerning our net revenue and income from operations by geographic region is as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Net revenue by region:		
North America	$ 189,750	$ 164,526
EMEA	122,248	101,690
Japan	27,019	25,212
Asia-Pacific, excluding Japan	18,036	13,292
Latin America	12,588	10,158
Net revenue	$ 369,641	$ 314,878
Operating income by region:		
North America	$ 56,084	$ 57,340
Europe	64,824	59,656
Japan	15,259	15,940
Asia-Pacific, excluding Japan	1,843	2,552
Latin America	7,653	6,903
Corporate	(92,416)	(100,971)
Income from operations	$ 53,247	$ 41,420

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.

The corporate expenses, which are not considered attributable to any specific geographic region, are as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**

General and administrative and other operating costs	$ 38,020	$ 44,143
Corporate marketing	20,478	14,407
Stock-based compensation	11,876	20,938
Amortization of purchased technology and other intangibles	18,900	11,051
SEC and compliance costs	1,376	5,052
Acquisition and retention bonuses	1,692	2,250
Restructuring charges	71	3,126
Loss on sale of assets and technology	3	4
Corporate expenses	$ 92,416	$ 100,971

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11. Litigation

Settled Cases

In February 2007, we reached a confidential settlement of a breach of contract, fraud and bad faith lawsuit filed in June 2002 in the United States District Court, District of Massachusetts. As part of the settlement, we acquired and recorded ownership of intangible assets valued at $9.3 million with all remaining claims settled for $6.2 million, of which $5.0 million was recognized as expense in the three months ended June 30, 2006 with the balance of $1.2 million being expensed in 2004 and prior periods. The case was dismissed in March 2007.

Open Cases

We have described below our material legal proceedings and investigations that are currently pending and are not in the ordinary course of business. If management believes that a loss arising from these matters is probable and can reasonably be estimated, we record the amount of the loss, or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As additional information becomes available, any potential liability related to these matters is assessed and the estimates are revised, if necessary. 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. The results of claims, lawsuits and investigations also 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.

Government Inquiries Relating to Historical Stock Option Practices

In May 2006, we announced that we had commenced an investigation of our historical stock option granting practices. As a result of that investigation, we concluded that certain stock options had been accounted for using incorrect measurement dates, which, in some instances, were chosen with the benefit of hindsight so as to intentionally give more favorable exercise prices. Consequently, certain of our historical financial statements needed to be restated to correct improper accounting for improperly priced stock options. In December 2007, we filed our Form 10-K for 2006, which included the effects of a restatement of our audited consolidated financial statements for 2004 and 2005, our selected financial data for 2002 through 2005, and our unaudited quarterly financial data for all quarters in 2005 and the first quarter of 2006.

On May 23, 2006, the SEC notified us that an investigation had begun regarding our historical stock option grants. On June 7, 2006, the SEC sent us a subpoena requesting certain documents related to stock option grants from January 1, 1995 through the date of the subpoena. At or around the same time, we received a notice of informal inquiry from the U.S. Department of Justice, the (DOJ), concerning our stock option granting practices. On August 15, 2006, we received a grand jury subpoena from the U.S. Attorney s Office for the Northern District of California relating to the termination of our former general counsel, his stock option related activities and the investigation. On November 6, 2006, we received a document request from the SEC for option grant data for McAfee.com, previously one of our consolidated subsidiaries that was a publicly traded company from December 1999 through September 2002.

On November 2, 2006, the investigative team created by the Special Committee of our board of directors met with the Enforcement Staff of the SEC in Washington D.C. and presented the initial findings of the investigation. Pursuant to discussions between the investigative team and the SEC during that meeting, the scope of the investigation was expanded to include a review of the historical McAfee.com option grants along with our historical exercise activity with a view toward determining potential exercise date manipulation and post-employment arrangements with former executives.

We have provided documents requested, and we are cooperating with the SEC and DOJ. The SEC investigation is still in its preliminary stages thus we are unable to determine the ultimate outcome at this time. As such, no provision has been recorded in the financial statements for this matter.

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Securities Cases

On May 31, 2006, a purported stockholder derivative lawsuit styled Dossett v. McAfee, Inc., No. 5:06CV3484 (JF) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Dossett). On June 7, 2006, another purported stockholder s derivative lawsuit styled Heavy & General Laborers Locals 472 & 172 Pension & Annuity Funds v. McAfee, Inc., No. 5:06CV03620 (JF) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Laborers). The Dossett and Laborers actions generally allege that we improperly backdated stock option grants between 1997 and the present, and that certain of our current and former officers or directors either participated in this backdating or allowed it to happen. The Dossett and Laborers actions assert claims purportedly on behalf of us for, inter alia, breach of fiduciary duty, abuse of control, constructive fraud, corporate waste, unjust enrichment, gross mismanagement, and violations of the federal securities laws. On July 13, 2006, the United States District Court for the Northern District of California entered an order consolidating the Dossett and Laborers actions as *In re McAfee, Inc. Derivative Litigation,* Master File No. 5:06CV03484 (JF) (the Consolidated Action). On January 22, 2007, we moved to dismiss the complaint in the Consolidated Action on the grounds that plaintiffs lack standing to sue on our behalf because, inter alia, they did not make a pre-suit demand on our board of directors. At the parties request, the Court continued on several occasions the due date for the plaintiffs opposition to our motion to dismiss and the date for the hearing of that motion. As a result of the settlement described below, there is no deadline by which plaintiffs must file an opposition to the motion to dismiss.

On August 7, 2007, a new stockholders derivative lawsuit styled Webb v. McAfee, Inc., No. C 07 4048 (PVT) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Webb). The new lawsuit generally alleges the same facts and causes of action that plaintiffs have asserted in the Consolidated Action. The plaintiff in Webb requested that his action be consolidated with the Consolidated Action. On September 21, 2007, the Court consolidated the Webb action with the Consolidated Action.

On June 2, 2006, three identical lawsuits styled Greenberg v. Samenuk, No. 106CV064854, Gordon v. Samenuk, No. 106CV064855, and Golden v. Samenuk, No. 106CV064856 were filed in the Superior Court of the State of California, County of Santa Clara against certain of our current and former directors and officers (the State Actions). Like the Consolidated Action, the State Actions generally allege that we improperly backdated stock option grants between 2000 and the present, and that certain of our current and former officers or directors either participated in this backdating or allowed it to happen. Like the Consolidated Action, the State Actions assert claims purportedly on behalf of us for, inter alia, breach of fiduciary duty, abuse of control, corporate waste, unjust enrichment, and gross mismanagement. On June 23, 2006, we moved to dismiss these actions in favor of the first-filed Consolidated Action. On September 18, 2006, the Court consolidated the State Actions and denied our motions to dismiss, but stayed the State Actions due to the first-filed action in federal court. The stay, which was continued by the Court on several occasions, expired in December 2007.

In December 2007, we reached a tentative settlement with the plaintiffs in the Consolidated Action and the State Actions. The tentative agreement must be submitted to and approved by the Court. We accrued $13.8 million in the condensed consolidated financial statements as of June 30, 2006 due to our ongoing stock option investigation and restatement related to expected payments pursuant to the tentative settlement and expect to complete the documentation and the required approvals in the second half of 2008. While we cannot predict the ultimate outcome of the lawsuits in the event that the tentative settlement is not approved by the Court, the provision recorded in the financial statements represents our best estimate at this time.

Certain investment bank underwriters, our company, and certain of our directors and officers have been named in a putative class action for violation of the federal securities laws in the United States District Court for the Southern

District of New York, captioned *In re McAfee.com Corp. Initial Public Offering Securities Litigation,* 01 Civ. 7034 (SAS). This is one of a number of cases challenging underwriting practices in the initial public offerings (IPOs) of more than 300 companies. These cases have been coordinated for pretrial proceedings as *In re Initial Public Offering Securities Litigation,* 21 MC 92 (SAS). Plaintiffs generally allege that certain underwriters engaged in undisclosed and improper underwriting activities, namely the receipt of excessive brokerage commissions and

customer agreements regarding post-offering purchases of stock in exchange for allocations of IPO shares. Plaintiffs also allege that various investment bank securities analysts issued false and misleading analyst reports. The complaint against us claims that the purported improper underwriting activities were not disclosed in the registration statements for McAfee.com s IPO and seeks unspecified damages on behalf of a purported class of persons who purchased our securities or sold put options during the time period from December 1, 1999 to December 6, 2000. On February 19, 2003 the Court issued an Opinion and Order dismissing certain of the claims against us with leave to amend. We accepted a settlement proposal on July 15, 2003.

We, together with the other issuer defendants and plaintiffs, entered into a stipulation of settlement and release of claims against the issuer defendants that was submitted to the Court for approval in June 2004. On August 31, 2005, the Court preliminarily approved the settlement which, among other things, was conditioned upon class certification. In December 2006, the appellate court overturned the certification of classes making it unlikely that the proposed settlement would receive final Court approval. As a result, on June 25, 2007, the Court entered an order terminating the proposed settlement. Plaintiffs have indicated that they will seek to amend their allegations and file amended complaints. It is uncertain whether there will be any revised or future settlement. Thus, the ultimate outcome, and any ultimate effect on us, cannot be precisely determined at this time.

Other

In February 2008, a former executive notified us of his intent to seek arbitration of claims associated with his employment. He alleges that McAfee breached his employment contract and committed certain additional wrongful acts related to the expiration of his stock options. The arbitration demand was filed on April 11, 2008 and we anticipate that arbitration will begin in October of 2008. We believe these claims are without merit, and intend to contest them vigorously. No provision has been recorded in the financial statements related to this matter.

On January 7, 2007, a former executive filed an arbitration demand with the American Arbitration Association, Dallas Texas, (the Texas arbitration) seeking the arbitration of claims associated with his employment. The Texas arbitration is scheduled to begin in September 2008. On September 5, 2007, a Complaint for Damages and Other Relief was also filed by the same former executive, in the Superior Court of the State of California, County of Santa Clara, No. 107CV-093592 (the California litigation). The California litigation generally contained the same claims as were filed in the Texas arbitration. A Motion to Compel Arbitration of the California litigation with the Texas arbitration was granted in December 2007. We have filed counterclaims against the former executive, who was terminated. The board determined this termination was for cause. We believe the claims associated with the Texas arbitration and the California litigation are without merit. We intend to vigorously contest these claims, and no provision has been recorded in the financial statements for either the Texas arbitration or the California litigation.

On August 17, 2006, a patent infringement lawsuit captioned Deep Nines v. McAfee, Inc., No. 9:06CV174, (Deep Nines litigation) was filed in the United States District Court for the Eastern District of Texas. The lawsuit asserts that (i) several of our Enterprise products infringe a Deep Nines patent, and (ii) we falsely marked certain products with a McAfee patent that was abandoned after its issuance. The lawsuit seeks preliminary and permanent injunctions against the sale of certain products as well as damages. We have counter-asserted that Deep Nines has infringed various McAfee patents. The Deep Nines litigation is still in the discovery stage thus we are unable to determine the ultimate outcome at this time. However, we believe that we have meritorious defenses to this lawsuit and intend to vigorously defend against it. No provision has been recorded in the financial statements for this matter.

In addition, we are engaged in certain legal and administrative proceedings incidental to our normal business activities and believe that these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

12. Warranty Accrual and Guarantees

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 March 31, 2008 and December 31, 2007 follows (in thousands):

	Warranty Accrual
Balance, January 1, 2007	$ 662
Additional accruals	1,546
Costs incurred during the period	(1,719)
Balance, December 31, 2007	489
Additional accruals	840
Costs incurred during the period	(745)
Balance, March 31, 2008	$ 584

The following is a summary of certain guarantee and indemnification agreements as of March 31, 2008:

Under the terms of our software license agreements with our customers, 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 licensees against any loss, expense, or liability from any damages that may be awarded against our customer. We include this infringement indemnification in our software license agreements and selected managed service arrangements. In the event the customer cannot use the software or service due to infringement and we can not obtain the right to use, replace or modify the license or service in a commercially feasible manner so that it no longer infringes, then we may terminate the license and provide the customer a pro-rata refund of the fees paid by the customer for the infringing license or service. We have recorded no liability associated with this indemnification, as we are not aware of any pending or threatened infringement actions that are probable losses. We believe the estimated fair value of these intellectual property indemnification clauses is minimal.

Under the terms of certain vendor agreements, in particular, vendors used as part of our managed services, 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, expense, or liability from any damages that may be awarded against our vendor. No maximum liability is stipulated in these vendor agreements. We have recorded no liability associated with this indemnification, as we are not aware of any pending or threatened infringement actions or claims that are probable losses. We believe the estimated fair value of these indemnification clauses is minimal.

As permitted under Delaware law, we have agreements whereby 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. The maximum potential amount of future payments we could be required to make under these indemnification agreements is not limited; however, we have director and officer insurance coverage that reduces our exposure and may enable us to recover a portion or all of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

Under the terms of our agreement to sell Magic in January 2004, we agreed to indemnify the purchaser for any breach of representations or warranties in the agreement as well as for any liabilities related to the assets prior

to sale that were not included in the purchaser assumed liabilities (undiscovered liabilities). Subject to limited exceptions, the maximum potential loss related to the indemnification is $10.0 million. To date, we have paid no amounts under the representations and warranties indemnification. We have not recorded any accruals related to these agreements.

Under the terms of our agreement to sell Sniffer in July 2004, we agreed to indemnify the purchaser for any breach of representations or warranties in the agreement as well as for any liabilities related to the assets prior to sale that were not included in the purchaser assumed liabilities (undiscovered liabilities). Subject to limited exceptions, the maximum potential loss related to the indemnification is $200.0 million. To date, we have paid no amounts under the representations and warranties indemnification. We have not recorded any accruals related to these agreements.

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Under the terms of our agreement to sell McAfee Labs assets in December 2004, we agreed to indemnify the purchaser for any breach of representations or warranties in the agreement as well as for any liabilities related to the assets prior to sale that were not included in the purchaser assumed liabilities (undiscovered liabilities). Subject to limited exceptions, the maximum potential loss related to the indemnification is $1.5 million. We have not recorded any accruals related to these agreements.

If we believe a liability associated with any of the aforementioned 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.

13. Related Party Transaction

David G. DeWalt, our chief executive officer, is a director of Polycom, Inc., one of our customers. We did not recognize any revenue from the sales to Polycom, Inc. during the three months ended March 31, 2008. At March 31, 2008, our outstanding accounts receivable balance related to Polycom, Inc., was $0.1 million. Our deferred revenue balance related to Polycom, Inc. was $0.1 million at March 31, 2008.

14. Subsequent Events

In May 2008, we have repurchased approximately 1.5 million shares of our common stock in the open market for approximately $52.2 million through May 9, 2008.

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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 that involve risks and uncertainties. These statements include, without limitation, statements regarding our expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this Report on Form 10-Q are based on information available to us on the date hereof. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, expects, plans, anticipates, estimates, predicts, potential, targets, goals, projects, continue, or variations of such words, similar express negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Neither we nor any other person can assume responsibility for the accuracy and completeness of forward-looking statements. Important factors that may cause actual results to differ from expectations include, but are not limited to, those discussed in Risk Factors in Part II, Item 1A in this quarterly report and in Part I, Item 1A in our annual report on Form 10-K for the fiscal year ended December 31, 2007. We undertake no obligation to revise or update publicly any forward-looking statements for any reason. We encourage you to read these sections carefully.

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: McAfee, Network Associates, ePolicy Orchestrator, ePO, VirusScan, IntruShield, Entercept, Foundstone, McAfee SiteAdvisor, Avert, Preventsys, Hercules, Ci Enforcer, Total Protection, AntiSpyware, SecurityAlliance, McAfee Security, Onigma, SafeBoot, ScanAle HackerSafe.

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, and continuously track and improve their security. 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.

We also provide software to manage and enforce security policies for organizations of any size. Finally, we incorporate expert services and technical support to ensure a solution is actively meeting our customers needs. These integrated solutions help our customers solve problems, enhance security and reduce costs.

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 partners. We derive our revenue from three sources: (i) service and support revenue, which include support and maintenance, training, consulting and web security revenue; (ii) subscription

revenue, which consists of revenue from online subscription arrangements; and (iii) product revenue, which includes revenue from perpetual software licenses (those with a one-time license fee) and hardware sales and retail product sales. We continue to focus our efforts on building a full line of complementary network and system protection solutions. During the fourth quarter of 2007, we acquired SafeBoot for $347.3 million net of imputed interest. During the first quarter of 2008, we acquired ScanAlert for $54.9 million, of which $49.1 was paid in the three months ended March 31, 2008 and $4.5 million was paid in the last quarter of 2007. We have recorded a

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$1.3 million long-term liability on our consolidated balance sheet as of March 31, 2008 for a portion of the purchase price held-back for future indemnification claims. The amount will be paid out, net of any claims, in July 2009.

We evaluate our consolidated financial performance utilizing a variety of indicators. Two of the primary indicators that we utilize are total net revenue and net income. As discussed more fully below, our net revenue in the three months ended March 31, 2008 grew by $54.7 million to $369.6 million from $314.9 million in the three months ended March 31, 2007. We believe net revenue is a key indicator of the growth and health of our business. Our net revenue is directly impacted by corporate information technology, government and consumer spending levels. We believe net income is a key indicator of the profitability of our business. Our net income for the three months ended March 31, 2008 declined by $13.2 million to $30.2 million from $43.4 million for the three months ended March 31, 2007 primarily due to our increased investment in sales activities and an increase in our effective tax rate discussed in Provision for Income Taxes below.

Critical Accounting Policies and Estimates

We had no significant changes in our critical accounting policies and estimates during the three months ended March 31, 2008 as compared to the critical 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, 2007.

Fair Value Measurements

On January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements regarding fair value measurement. We hold financial assets, such as available for sale securities and foreign currency contracts, subject to valuation under SFAS 157. In February 2008, the Financial Accounting Standard Board (FASB) issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities that are not remeasured at fair value on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. Any amounts recognized upon adoption of this rule as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. FSP 157-2 is effective for us beginning January 1, 2009. We continue to assess the impact that FSP 157-2 may have on our consolidated financial position and results of operations. See Note 2 to the condensed consolidated financial statements for further discussion.

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 March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Net revenue:				
Service and support	$ 188,218	$ 167,605	$ 20,613	12%

Subscription	160,974	128,368	32,606	25
Product	20,449	18,905	1,544	8
Total net revenue	$ 369,641	$ 314,878	$ 54,763	17%
Percentage of total net revenue:				
Service and support	51%	53%		
Subscription	44	41		
Product	5	6		
Total net revenue	100%	100%		

The increase in net revenue in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 reflected (i) a $30.0 million, or 16%, increase in our corporate business and (ii) a $24.8 million, or 19%, increase in our consumer business. Transactions from our corporate business include the sale of product offerings intended for enterprise, mid-market and small business use. Transactions from our consumer business include the sale of product offerings primarily intended for consumer use, as well as any revenues or activities associated with providing an overall safe consumer experience on the internet or cellular networks. The latter category includes annotation, scanning and search revenue associated with ScanAlert and SiteAdvisor as the primary benefit of such offerings is to protect the consumer internet and mobile experience and a majority of the fees generated are based on underlying consumer activity. In the three months ended March 31, 2008, approximately 82% of our total net revenue came from prior-period deferred revenue.

Net revenue from our corporate business increased during the three months ended March 31, 2008 compared to the three months ended March 31, 2007 primarily due to a 21% increase in revenues from our network protection offerings, a 16% increase in revenues from our end point solutions, which includes revenue from data encryption products integrated from our SafeBoot acquisition, and an 8% increase in our vulnerability and risk management offerings. During the three months ended March 31, 2008 compared to the three months ended March 31, 2007, we generally increased price points for our end point solutions. We also experienced an increase in both the number and size of larger transactions sold to customers through a solution selling approach which bundles multiple products and services into suite offerings, which positively impacted deferred revenue and will impact our revenue in future periods.

Net revenue from our consumer market increased during the three months ended March 31, 2008 compared to the three months ended March 31, 2007 primarily due to (i) online subscriber growth due partly to an increase in our customer base and expansion to additional countries, (ii) increased online renewal subscriptions from both a larger customer base and higher renewal rates, and (iii) increased conversions from point products to suite offerings due to our previous launch of McAfee Consumer Suites. We continued to strengthen our relationships with strategic channel partners, such as Acer, Cox, Dell and Toshiba Europe.

Net Revenue by Geography

The following table sets forth, for the periods indicated, net revenue in each of the five geographic regions in which we operate:

	Three Months Ended March 31,		**2008 vs. 2007**	
	2008	**2007**	**$**	**%**
	(Dollars in thousands)			
Net revenue:				
North America	$ 189,750	$ 164,526	$ 25,224	15%
Europe, Middle East and Africa (EMEA)	122,248	101,690	20,558	20
Japan	27,019	25,212	1,807	7
Asia-Pacific, excluding Japan	18,036	13,292	4,744	36
Latin America	12,588	10,158	2,430	24
Total net revenue	$ 369,641	$ 314,878	$ 54,763	17%

Percentage of total net revenue:

North America	51%	52%
EMEA	33	33
Japan	7	8
Asia-Pacific, excluding Japan	5	4
Latin America	4	3
Total net revenue	100%	100%

Net revenue outside of North America accounted for approximately 49% and 48% of net revenue in the three months ended March 31, 2008 and 2007, respectively. Net revenue from North America and EMEA has historically comprised between 80% and 90% of our business.

The increase in total net revenue in North America during the three months ended March 31, 2008 was primarily related to (i) a $7.2 million increase in corporate revenue in North America due to increased revenue from our network protection offerings, our end point solutions and our vulnerability and risk management offerings and (ii) an $18.0 million increase in consumer revenue in North America due to an increase in our customer base and increased conversions from point products to suite offerings.

The increase in total net revenue in EMEA during the three months ended March 31, 2008 was attributable to (i) a $16.8 million increase in corporate revenue due to increased revenue from our network protection offerings and our end point solutions offset by a slight decline in our vulnerability and risk management offerings and (ii) a $3.8 million increase in consumer revenue due to an increase in our customer base, expansion to additional countries and increased conversions from point products to suite offerings. Net revenue from EMEA was also positively impacted by the strengthening Euro against the United States (U.S.) Dollar, which resulted in an approximate $14.1 million impact to EMEA net revenue in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 that is included in the corporate and consumer increases above.

Our Japan, Latin America and Asia-Pacific operations combined have historically comprised less than 20% of our total net revenue, and we expect this trend to continue.

Risks inherent in international revenue include the impact of longer payment cycles, greater difficulty in accounts receivable collection, unexpected changes in regulatory requirements, seasonality, political instability, tariffs and other trade barriers, currency fluctuations, a high incidence of software piracy in some countries, product localization, international labor laws and our relationship with our employees and regional work councils and difficulties staffing and managing foreign operations. These factors may have a material adverse effect on our future international revenue.

Service and Support Revenue

The following table sets forth, for the periods indicated, each category of our service and support revenue as a percent of total service and support revenue:

	Three Months Ended March 31,		2008 vs. 2007	
	2008	**2007**	**$**	**%**
	(Dollars in thousands)			
Net service and support revenue:				
Support and maintenance	$ 175,941	$ 160,230	$ 15,711	10%
Consulting, training and other services	12,277	7,375	4,902	66
Total service and support revenue	$ 188,218	$ 167,605	$ 20,613	12%
Percentage of service and support revenue:				
Support and maintenance	93%	96%		
Consulting, training and other services	7	4		

Total service and support revenue	100%	100%

Service and support revenue includes revenue from software support and maintenance contracts, training, consulting and other services. The increase in service and support revenue in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 was attributable to an increase in support and maintenance primarily due to amortization of previously deferred revenue from support arrangements and an increase in sales of support renewals. In addition, revenue from consulting increased due to both our Foundstone Consulting Services, which includes threat modeling, security assessments and education, and McAfee Consulting Services, which provide product design and deployment support. During the three months ended March 31, 2008,

we recognized for the first time web security revenue, which includes annotation, scanning and search revenue associated with ScanAlert and is included in consulting, training and other services above.

Although we expect our service and support revenue 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 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 following table sets forth, for the periods indicated, the change in subscription revenue from March 31, 2007 to March 31, 2008:

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Total subscription revenue	$ 160,974	$ 128,368	$ 32,606	25%

Subscription revenue includes revenue from online subscription arrangements. The increase in subscription revenue in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 was attributable to (i) an increase in our online subscription arrangements due to our continued relationships with strategic channel partners, such as Acer, Cox, Dell and Toshiba Europe. (ii) an increase in revenue from our McAfee Total Protection Service for small and mid-market businesses and (iii) an increase in royalties from sales by our strategic channel partners. Subscription revenue continues to be positively impacted by our launch of McAfee Consumer Suites, including McAfee VirusScan Plus, McAfee Internet Security, and McAfee Total Protection Solutions, as these suites utilize a subscription-based model.

Product Revenue

The following table sets forth, for the periods indicated, each major category of our product revenue as a percent of total product revenue:

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Net product revenue:				
Licenses	$ 9,634	$ 10,074	$ (440)	(4)%
Hardware	8,771	7,533	1,238	16
Retail and other	2,044	1,298	746	57
Total product revenue	$ 20,449	$ 18,905	$ 1,544	8%

Percentage of product revenue:

Licenses	47%	53%
Hardware	43	40
Retail and other	10	7
Total product revenue	100%	100%

Product revenue includes revenue from perpetual software licenses, hardware sales and retail product sales. The increase in product revenue for the three months ended March 31, 2008, compared to the three months ended March 31, 2007, was attributable to decreased incentive rebates and funds provided to our partners for marketing which are recorded as an offset to revenue and included in retail and other revenue in the table above, partially offset by a decrease in licenses revenue. Licenses revenue continues to decrease as a result of the launch of our McAfee Consumer Suites. All new consumer licenses are subscription-based and included in subscription revenue.

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Cost of Net Revenue

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

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Cost of net revenue:				
Service and support	$ 14,844	$ 12,393	$ 2,451	20%
Subscription	46,590	37,386	9,204	25
Product	14,942	11,905	3,037	26
Amortization of purchased technology and patents	13,560	8,369	5,191	62
Total cost of net revenue	$ 89,936	$ 70,053	$ 19,833	28%
Components of Gross margin:				
Service and support	$ 173,374	$ 155,212		
Subscription	114,384	90,982		
Product	5,507	7,000		
Amortization of purchased technology and patents	(13,560)	(8,369)		
Total gross margin	$ 279,705	$ 244,825		
Total gross margin percentage	76%	78%		

Cost of Service and Support Revenue

Cost of service and support revenue consists principally of salaries, benefits and stock-based compensation related to employees providing customer support, training and consulting and web security services. During the three months ended March 31, 2008, we recognized for the first time, costs related to delivering annotation, scanning and search services, associated with ScanAlert. The cost of service and support revenue increased for the three months ended March 31, 2008 compared to the three months ended March 31, 2007 due to increased outsourcing of professional services related to both Foundstone Consulting Services and McAfee Consulting Services. The cost of service and support revenue as a percentage of service and support net revenue for the three months ended March 31, 2008 remained consistent when compared to the same period in 2007.

We anticipate the cost of service and support revenue will fluctuate in absolute dollars in connection with service and support revenue growth.

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 channel partners, 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 months ended March 31, 2008 compared to

the three months ended March 31, 2007 was primarily attributed to an increase in the volume of online subscription arrangements and royalties paid to our online strategic channel partners.

We anticipate that the cost of subscription revenue will increase in absolute dollars due to increased demand for our subscription-based products with associated 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. The cost of product revenue for the three months

ended March 31, 2008 increased from the three months ended March 31, 2007 due to increased sales of hardware-based security products and increased costs of materials and overhead. Cost of product revenue for the three months ended March 31, 2008 also increased as a percentage of product revenue compared to the same period in 2007, due primarily to (i) increased costs on hardware product sales (ii) a shift in product mix from higher margin licensing revenue to lower margin hardware revenue, partially offset by (iii) decreased incentive rebates and marketing funds.

We anticipate that cost of product revenue will increase or decrease in absolute dollars depending on the mix and size of certain enterprise-related transactions.

Amortization of Purchased Technology and Patents

The increase in amortization of purchased technology and patents in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 is driven by the acquisitions of ScanAlert in February 2008 and SafeBoot in November 2007. Amortization for the purchased technology and patents related to these acquisitions was $6.6 million in the three months ended March 31, 2008.

Our purchased technology is being amortized over estimated useful lives of up to seven years. Amortization associated with purchased technology recorded as of March 31, 2008 is expected to be an aggregate of approximately $39.5 million for the remainder of 2008.

Stock-based Compensation Expense

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. Compensation expense is recognized over the required service or performance period of the awards. Our stock-based awards include stock options, restricted stock awards (RSAs), restricted stock units (RSUs), restricted stock units with performance-based vesting (PSUs) and our Employee Stock Purchase Plan (ESPP).

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

	Three Months Ended March 31,	
	2008	**2007**
Amortization of fair value of options	$ 5,577	$ 5,058
Extension of post-termination exercise period		10,738
(Benefit) expense related to cash settlement of options	(382)	231
Restricted stock awards and units	5,825	4,911
Restricted stock units with performance-based vesting	255	
Tender offer	601	
Total stock-based compensation expense	$ 11,876	$ 20,938

Amortization of fair value of options. We recognize the fair value of stock options issued to employees and outside directors as stock-based compensation expense over the vesting period of the awards. As we adopted SFAS 123(R) using the modified prospective method, these charges include compensation expense for stock options granted prior to

January 1, 2006 but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for stock options granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R).

Extension of post-termination exercise period. From July 2006, when we announced that we might have to restate our historical financial statements as a result of our ongoing stock option granting practices investigation, through December 21, 2007, the date we became current on our reporting obligations under the Securities Exchange Act of 1934, as amended, (blackout period), we imposed restrictions on our ability to issue any shares, including those pursuant to stock option exercises. In January 2007, we extended the post-termination exercise period for vested options held by 640 former employees and outside directors that would expire during the blackout period. As a result of this modification, we recognized $10.7 million of stock-based compensation expense in the three months

ended March 31, 2007, based on the fair value of the modified options. The expense was calculated in accordance with the guidance in SFAS 123(R). The options were deemed to have no value prior to the extension of the life beyond the blackout period.

Based on the guidance in SFAS 123(R) and related FASB Staff Positions, after the January 2007 modification, stock options held by former employees and outside directors that terminated prior to such modification became subject to the provisions of EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock*, (EITF 00-19). As a result, in January 2007, these options were reclassified as liability awards within current liabilities. Accordingly, at the end of each reporting period, we determined the fair value of these options utilizing the Black-Scholes valuation model and recognized any change in fair value of the options in our condensed consolidated statements of income and comprehensive income in the period of change.

In November 2007, due to a delay in our becoming current in our reporting obligations, we extended the post-termination exercise period for options held by 690 former employees and outside directors whose service to us terminated subsequent to the January 2007 modification and those previously modified in January 2007 as discussed above, until the earlier of (i) the ninetieth (90th) calendar day after December 21, 2007, the date we became current in our reporting obligations under the Securities Exchange Act of 1934, as amended, (ii) the expiration of the contractual terms of the options, or (iii) December 31, 2008. Based on the guidance in SFAS 123(R) and related FASB Staff Positions, after the November 2007 modification, stock options held by the former employees and outside directors that terminated subsequent to the January 2007 modification and prior to November 2007 became subject to the provisions of EITF 00-19. As a result, in November 2007, these options were reclassified as liability awards within current liabilities. Accordingly, at the end of each reporting period, we determined the fair value of these options utilizing the Black-Scholes valuation model and recognized any change in fair value of the options in our condensed consolidated statements of income and comprehensive income in the period of change.

As of March 31, 2008, the January 2007 and November 2007 modified options had been exercised or had expired. The fair values of the options that had been exercised during the three months ended March 31, 2008 were remeasured on the respective date of exercise and recorded as an increase to additional paid-in capital. The options that expired were remeasured to have no fair value. We recognized a total benefit of $5.5 million related to the change in fair value of these options in the three months ended March 31, 2008. We did not recognize any expense related to the change in fair value of these options in the three months ended March 31, 2007 as our stock price did not change significantly from the January 2007 modification through March 31, 2007. Such amounts are included in general and administrative expense in our condensed consolidated statements of income and comprehensive income, and are not reflected as stock-based compensation expense.

Cash settlement of options. Certain stock options held by terminated employees expired during the blackout period as they could not be exercised during the 90-day period subsequent to termination. In January 2007, we determined that we would settle these options in cash. In the three months ended March 31, 2007, we recorded a liability of approximately $0.2 million, based on the intrinsic value of options held by current employees that expired during the blackout period. As of December 31, 2007, we recorded a liability of $5.7 million based on the intrinsic value of these options using our December 31, 2007 closing stock price. We paid $5.2 million in January 2008 to settle these options based on the average closing price of our common stock subsequent to December 21, 2007, the date we became current on our reporting obligations under the Securities Exchange Act of 1934, as amended. We recognized a benefit for the difference between the December 31, 2007 liability and the amount paid in the three months ended March 31, 2008.

Restricted stock awards and units. We recognize stock-based compensation expense for the fair value of RSAs and RSUs. Fair value is determined as the difference between the closing price of our common stock on the grant date and the purchase price of the RSAs and RSUs. The fair value of these awards is recognized to expense over the requisite

service period of the awards.

Restricted stock units with performance-based vesting. We recognize stock-based compensation for the fair value of PSUs. These awards vest as follows: 50% vest only if performance criteria are met (performance component) and 50% cliff vest four years from the date of grant, with accelerated vesting if performance criteria

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are met (service component). Certain executive grants have only the performance component. The performance component will vest one-third each year from the date of grant, provided that the performance criteria are met for each respective year. If the performance criteria is not met in any one year, then the options that would have vested in that year are forfeited. The performance component is being recognized as expense one-third each year provided we determine it is probable that the performance criteria will be met. For certain of the PSUs, we have not communicated the performance criteria to the employees. For these awards, the accounting grant date will 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 will be marked-to-market at the end of each reporting period through the accounting grant date, and recognized over the expected vesting period. For the awards for which the performance criteria have been communicated, stock-based compensation expense has been measured on the grant date, and is being recognized over the expected vesting period.

The service component will cliff vest four years from the grant date, with an acceleration provision based on the same performance criteria as the performance component. If the performance criteria are met for each respective year, the awards will vest one-third each year from the grant date. The accounting grant date is deemed to have occurred and stock-based compensation has been measured on the grant date, and will be recognized over the expected vesting period.

Tender offer. In January 2008, after we became current with our reporting obligations under the Securities Exchange Act of 1934, as amended, we filed a Tender Offer Statement on Schedule TO with the Securities and Exchange Commission (SEC). The tender offer extended an offer by us to holders of certain outstanding stock options to amend the exercise price on certain of their outstanding options. The purpose of the tender offer was to amend the exercise price on options to have the same price as the fair market value on the revised measurement dates that were identified during the investigation of our historical stock option grant practices. As part of this tender offer, we will pay a cash bonus of $1.7 million, of which $0.4 million was paid to Canadian employees in the three months ended March 31, 2008, and $1.3 million will be paid to U.S. employees in 2009, to reimburse optionees who elected to participate in the tender offer for any increase in the exercise price of their options resulting from the amendment. The impact of the cash bonus, as recorded during the three months ended March 31, 2008, resulted in stock-based compensation expense of $0.6 million and a decrease to additional paid-in capital of $1.1 million.

The following table summarizes pre-tax stock-based compensation expense recorded in our condensed consolidated statements of income and comprehensive income by line item in the three months ended March 31, 2008 and 2007 (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Cost of net revenue service and support	$ 202	$ 599
Cost of net revenue subscription	98	358
Cost of net revenue product	144	258
Stock-based compensation expense included in cost of net revenue	444	1,215
Research and development	3,621	4,972
Marketing and sales	3,748	8,513
General and administrative	4,063	6,238
Stock-based compensation expense included in operating costs	11,432	19,723

Total stock-based compensation expense	11,876	20,938
Deferred tax benefit	(3,207)	(6,785)
Total stock-based compensation expense, net of tax	$ 8,669	$ 14,153

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

For existing employees, we grant RSUs that vest over a specified period of time based on service or based on the achievement of performance criteria. For new employees, we continue to grant stock options. Going forward,

our management and compensation committee will consider utilizing all types of equity compensation to reward top-performing employees.

At March 31, 2008, the estimated fair value of all unvested stock options, RSUs, PSUs and RSAs that have not yet been recognized as compensation expense was $113.2 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 compensation expense relating to 0.8 million PSUs for which the performance criteria has not been set.

Internal Revenue Code Section 409A

Adverse tax consequences resulted from our revision of accounting measurement dates during our restatement due to our investigation into our stock option granting practices for stock options that vested subsequent to December 31, 2004 (409A affected options). These adverse tax consequences included a penalty tax payable by the option holder under Internal Revenue Code (IRC) Section 409A (and, as applicable, similar penalty taxes under state tax laws). As virtually all holders of options with revised measurement dates were not involved in or aware of their incorrect option exercise prices, we took certain actions to deal with the adverse tax consequences that were incurred by the holders of such options.

Section 16(a) Officers and Directors

In December 2006, our board of directors approved the amendment of 409A affected options for those who were Section 16(a) officers at the time they received 409A affected options to increase the exercise price to the fair market value of our common stock on the revised measurement date. These amended options are not subject to taxation under IRC Section 409A. Under the Internal Revenue Service (IRS) regulations, these option amendments had to be completed by December 31, 2006 for anyone subject to Section 16(a) requirements upon receipt of the 409A affected options. There were no costs associated with this action, as the modifications increased the exercise price, which resulted in no incremental expense.

In the three months ended March 31, 2008, for one executive officer, we amended the exercise price of his options to have the same price as the fair market value on the revised measurement dates that were identified during the investigation of our historical stock option grant practices. We will pay this executive officer a cash bonus of $0.1 million in 2009 to reimburse for the increase in the exercise price of his options resulting from the amendment.

IRS Announcement 2007-18 Compliance

In February 2007, our board of directors approved our participation in a voluntary program under IRS Announcement 2007-18 and a similar state of California Announcement, whereby we paid additional 409A taxes on behalf of certain former United States employees who had already exercised 409A affected options for the additional taxes they incur under IRC Section 409A (and, as applicable, similar state of California tax law). Current and former Section 16(a) officers and directors were specifically excluded from the program. Through March 31, 2007, we recorded $1.3 million of expense associated with this program for Section 409A affected options exercised during this period. We had no expense associated with this program in the three months ended March 31, 2008.

Certain Former Employees Future Exercises of 409A Affected Options

In May 2007, our board of directors approved cash payments as necessary to certain former employees who exercised 409A affected options during 2006 or that may exercise 409A affected options in the future.

In November 2007, our board of directors approved the unilateral amendment of 409A affected options held by certain former employees who did not exercise 409A affected options during 2006 to increase the exercise price to the fair market value of our common stock on the revised measurement date, and to make cash payments as compensation for the increase in the exercise prices of amended options. These amended options would not be subject to taxation under IRC 409A.

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In the three months ended March 31, 2008, we recorded no costs associated with former employees exercises of certain Section 409A affected options. The following table summarizes for the three months ended March 31, 2007 costs associated with actions taken by us with respect to IRC Section 409A (in thousands):

	Three Months Ended March 31, 2007
Cost of net revenue	$
Research and development	789
Marketing and sales	321
General and administrative	194
Costs associated with IRC Section 409A	$ 1,304

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 March 31		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Research and development(1)	$ 58,625	$ 54,613	$ 4,012	7%
Percentage of net revenue	16%	17%		

(1) Includes stock-based compensation charges of $3,621 and $4,972 in the three months ended March 31, 2008 and 2007, respectively.

Research and development expenses consist primarily of salary, benefits, and stock-based compensation for our development 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 March 31, 2008 was primarily attributable to (i) a $5.1 million increase in salary and benefit expense for individuals performing research and development activities due to an increase in average headcount and salary increases, (ii) a $1.3 million increase due to strengthening foreign currencies in EMEA and Japan against the U.S. Dollar in the three months ended March 31, 2008 compared to the same prior-year period, and (iii) increases in various other expenses related to research and development activities, partially offset by (i) a $1.6 million decrease attributable to acquisition-related bonuses, primarily related to the SiteAdvisor acquisition, and (ii) a $1.4 million decrease in stock-based compensation expense.

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 2008.

Marketing and Sales

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

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Marketing and sales(1)	$ 118,357	$ 93,081	$ 25,276	27%
Percentage of net revenue	32%	30%		

(1) Includes stock-based compensation charges of $3,748 and $8,513 in the three months ended March 31, 2008 and 2007.

Marketing and sales expenses consist primarily of salary, commissions, stock-based compensation and benefits for marketing and sales personnel and costs associated with travel for our marketing and sales personnel, advertising and promotions. The increase in marketing and sales expenses during the three months ended March 31, 2008 compared to the three months ended March 31, 2007 reflected (i) a $18.4 million increase in salary and benefit expense, including commissions, for individuals performing marketing and sales activities due to an increase in average headcount and salary increases, (ii) a $3.3 million increase due to strengthening foreign currencies in EMEA and Japan against the U.S. Dollar in the three months ended March 31, 2008 compared to the same prior-year period, (iii) a $3.3 million increase related to worldwide travel expense, (iv) a $2.7 million increase in contract labor, and (v) a $2.7 million increase due to increased investment in sales, marketing, promotion and advertising programs, including marketing spend for SiteAdvisor and corporate branding initiatives, partially offset by (i) a $4.8 million decrease in stock-based compensation expense, and (ii) decreases in various other expenses associated with marketing and sales activities.

We anticipate that marketing and sales expenses will increase in absolute dollars primarily due to our planned branding initiatives and our additional investment in sales capacity for 2008.

General and Administrative

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

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
General and administrative(1)	$ 42,689	$ 44,851	$ (2,162)	(5)%
Percentage of net revenue	12%	14%		

(1) Includes stock-based compensation charges of $4,063 and $6,238 in the three months ended March 31, 2008 and 2007, 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 decrease in general and administrative expenses during the three months ended March 31, 2008 compared to the three months ended March 31, 2007 reflected (i) $5.5 million benefit related to the change in fair value of certain stock options subject to the provisions of EITF 00-19, (ii) a $2.2 million decrease in legal expenses, and (iii) a $2.2 million decrease in stock-based compensation expense, partially offset by (i) a $3.6 million increase in salary and benefit expense for individuals performing general and administrative activities due to an increase in average headcount and salary increases, (ii) a $1.8 million increase in contract labor, (iii) a $1.2 million increase due to strengthening foreign currencies in EMEA and Japan against the U.S. Dollar in the three months ended March 31, 2008 compared to the same prior-year period, and (iv) increases in various other expenses related to general and administrative activities.

We anticipate that general and administrative expenses will increase in absolute dollars during the remainder of 2008.

SEC and Compliance Costs

The following table sets forth, for the periods indicated, a comparison of SEC and compliance costs:

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
SEC and compliance costs	$ 1,376	$ 5,052	$ (3,676)	(73)%

SEC and compliance costs consist principally of costs arising as a result of our historical investigation into our stock option granting practices. The decrease in SEC and compliance costs during the three months ended March 31,

2008 compared to the three months ended March 31, 2007 is attributable to a decrease in costs associated with the investigation. The costs in 2008 are all ongoing legal costs associated with the investigation.

Amortization of Intangibles

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

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Amortization of intangibles	$ 5,340	$ 2,682	$ 2,658	99%

Intangibles consist of identifiable intangible assets such as trademarks and customer lists. The increase in amortization of intangibles was attributable to our 2008 and 2007 acquisitions, in which we acquired approximately $60.1 million of intangible assets related to the SafeBoot and ScanAlert acquisitions.

Restructuring Charges

The following table sets forth, for the periods indicated, a comparison of our restructuring charges:

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Restructuring charges	$ 71	$ 3,126	$ (3,055)	(98)%

Restructuring charges in the three months ended March 31, 2008 totaled $0.1 million, of which $2.5 million was 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 $2.4 million benefit related primarily to previous estimates of base rent and sublease income for the Santa Clara lease which was restructured in 2003 and 2004. During the three months ended March 31, 2007, we permanently vacated several leased facilities and recorded a $0.3 million accrual for estimated lease related costs associated with the permanently vacated facilities and we recorded a restructuring charge of $2.6 million related to a reduction in headcount.

Interest and Other Income

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

Three Months Ended March 31,		2008 vs. 2007	
2008	2007	$	%
(Dollars in thousands)			

Interest and other income	$ 13,035	$ 14,315	$ (1,280)	(9)%

Interest and other income includes interest earned on investments, as well as net foreign currency transaction gains or losses. The decrease in interest and other income is partially due to a lower average rate of annualized return on our investments from approximately 5% in the three months ended March 31, 2007 to approximately 4% in the three months ended March 31, 2008.

During the three months ended March 31, 2008 and 2007, we recorded a net foreign currency transaction loss in our condensed consolidated statements of income of $0.9 million and $0.7 million, respectively.

We anticipate that interest and other income will decrease during 2008 as a result of a declining interest rate environment and lower cash balances due to our stock repurchase program.

Gain on Sale of Investment, Net

During the three months ended March 31, 2008 and 2007, we recognized a gain on the sales of marketable securities of $2.5 million and $0.1 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 more lucrative yields or for liquidity purposes, thus resulting in gains and losses on sale.

Provision for Income Taxes

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

	Three Months Ended March 31,		2008 vs. 2007	
	2008	2007	$	%
	(Dollars in thousands)			
Provision for income taxes	$ 38,575	$ 12,494	$ 26,081	**
Effective tax rate	56%	22%		

** Calculation not meaningful.

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 March 31, 2008 differs from the U.S. federal statutory rate (statutory rate) primarily due to an increase in our estimated annual effective tax rate resulting from acquisition integration activities. The increase in the effective tax rate for the three months ended March 31, 2008 as compared to the prior period is primarily a result of our acquisition integration activities, which resulted in an increase of 22 percentage points to our effective tax rate. We are currently in the process of seeking administrative relief with the U.S. Internal Revenue Service, which would reduce our tax expense related to these integration activities. If the administrative relief is granted, we will reverse the previously recorded tax expense in the period in which the relief is granted. The effective tax rate for the three months ended March 31, 2007 differs from the statutory rate primarily due to the benefit of lower tax rates in certain foreign jurisdictions offset by the impact of adjustments to tax reserves.

The earnings from our foreign operations in India are subject to a tax holiday from a grant effective through March 31, 2009. The tax holiday provides for zero percent taxation on certain classes of income and requires certain conditions to be met. We are in compliance with these conditions as of March 31, 2008.

Recent Accounting Pronouncements

See Note 2 to the condensed consolidated financial statements.

Acquisitions

ScanAlert

In January 2008, we acquired 100% of the outstanding shares of ScanAlert, a provider of a vulnerability assessment and certification services for e-commerce sites, for $54.9 million. Of this amount, we paid $4.5 million in the fourth

quarter of 2007 to a third party to settle prior alleged patent infringement claims against ScanAlert and for a fully paid future license for the use of the patent until its expiration and we paid $49.0 million, net of cash received, in the three months ended March 31, 2008. We have recorded a $1.3 million long-term liability on our consolidated balance sheet as of March 31, 2008 for a portion of the purchase price held-back for future indemnification claims.

We plan to incorporate ScanAlert s technology into our existing SiteAdvisor web rating system. The results of operations for ScanAlert have been included in our results of operations since the date of acquisition. See Note 4 to the condensed consolidated financial statements for further discussions.

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Liquidity and Capital Resources

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Net cash provided by operating activities	$ 71,374	$ 101,781
Net cash provided by (used in) investing activities	22,317	(18,277)
Net cash used in financing activities	(63,978)	(184)

Overview

At March 31, 2008, our cash, cash equivalents and marketable securities totaled $1,293.1 million and we did not have any debt. Our principal source of liquidity was our existing cash, cash equivalents and short-term marketable securities of $804.3 million. During the three months ended March 31, 2008, we had net income of $30.2 million and we received $53.7 million from proceeds from the issuance of common stock under our employee options plans. We paid $49.0 million, net of cash received, for the purchase of 100% of the outstanding shares of ScanAlert, Inc. and we paid $6.0 million for direct acquisition costs accrued at December 31, 2007 for our acquisition of SafeBoot. In addition, we used $127.2 million for repurchases of our common stock, including commissions, and $10.5 million for purchases of property and equipment, of the $127.2 million used for stock repurchases, $113.5 million was used for share repurchases in the open market and $13.7 million was used to repurchase shares of common stock in connection with our obligation to holders of restricted stock to withhold the number of shares required to satisfy the holders tax liabilities in connection with the vesting of such shares.

Our management plans to use our cash and cash equivalents for future operations, potential acquisitions and repurchases of 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 will be sufficient to satisfy our anticipated cash needs for working capital and capital expenditures for at least the foreseeable future.

Operating Activities

Net cash provided by operating activities in the three months ended March 31, 2008 and 2007 was primarily the result of our net income of $30.2 million and $43.4 million, respectively. Net income for the three months ended March 31, 2008 was adjusted for non-cash items such as depreciation and amortization of $28.5 million, non-cash stock-based compensation expense of $11.7 million, changes in deferred income taxes of $34.6 million, and changes in various assets and liabilities such as a decrease in accounts receivable of $45.3 million, a decrease in accrued taxes and other liabilities of $32.9 million, an increase in prepaid expenses, prepaid taxes and other assets of $10.8 million, a decrease in deferred revenue of $8.9 million and a decrease in accounts payable of $7.7 million.

Net income for the three months ended March 31, 2007 was adjusted for non-cash items such as depreciation and amortization of $20.3 million, non-cash stock compensation expense of $20.7 million, changes in deferred income taxes of $6.7 million, and changes in various assets and liabilities such as a decrease in accounts receivable of $24.9 million, a decrease in accrued taxes and other liabilities of $6.3 million, a decrease in deferred revenue of $5.2 million and an increase in prepaid expenses, prepaid taxes, and other assets of $3.2 million.

Historically, our primary source of operating cash flow was the collection of accounts receivable from our customers and the timing of payments to our vendors and service providers. One measure of the effectiveness of our collection

efforts is average accounts receivable days sales outstanding, or DSO . DSOs were 48 days and 42 days in the three months ended March 31, 2008 and 2007, respectively. We calculate accounts receivable DSO on a net basis by dividing the net accounts receivable balance at the end of the quarter by the amount of net revenue recognized for the quarter multiplied by 90 days. We expect DSOs to vary from period to period because of changes in quarterly revenue and the effectiveness of our collection efforts. In 2008 and 2007, we did not make any significant changes to our payment terms for our customers, which are generally net 30. In the three months ended March 31, 2008 compared to the three months ended March 31, 2007, DSOs increased due to the acquisition of SafeBoot in the fourth quarter of 2007 and the acquisition of ScanAlert in the first quarter of 2008. We expect our DSOs will continue to be impacted by the acquisitions of SafeBoot and ScanAlert.

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Our operating cash flows, including changes in accounts payable and accrued liabilities, are impacted by the timing of payments to our vendors for accounts payable and taxing authorities. We typically pay our vendors and service providers in accordance with invoice terms and conditions, and take advantage of invoice discounts when available. The timing of future cash payments in future periods will be impacted by the nature of accounts payable arrangements and strategic channel partner arrangements. In the three months ended March 31, 2008 and 2007, we did not make any significant changes to our payment timing to our vendors.

Our cash and marketable securities balances are held in numerous locations throughout the world, including substantial amounts held outside the United States. As of March 31, 2008, approximately $412.9 million was held outside the United States. We utilize a variety of tax planning and financing strategies to ensure that our worldwide cash is available in the locations in which it is needed.

We incurred material expenses in 2007 as a direct result of the investigation into our historical stock option granting practices and related accounting. These costs primarily related to professional services for the investigation, legal, historical accounting and taxing guidance. In addition, we incurred costs related to litigation, the investigation by the SEC, the grand jury subpoena from the U.S. Attorney s Office for the Northern District of California and the preparation and review of our restated consolidated financial statements. We expect that we may be subject to certain fines and/or penalties resulting from the findings of the investigation. We cannot reasonably estimate the range of fines and/or penalties, if any, that might be incurred as a result of the investigation. We expect to pay for these fines and/or penalties with available cash.

We expect to meet our obligations as they become due through available cash 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 11.

Investing Activities

Our investing activities for the three months ended March 31, 2008 and 2007 are as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Net proceeds from sales or maturities (purchases) of marketable securities	$ 87,863	$ (12,584)
Acquisitions, net of cash acquired	(55,041)	
(Increase) decrease in restricted cash	(12)	352
Purchase of property, equipment and leasehold improvements	(10,493)	(10,150)
Proceeds from the sale of assets and technology		4,105
Net cash provided by (used in) investing activities	$ 22,317	$ (18,277)

Investments

In the three months ended March 31, 2008, net proceeds from the sale and maturity of marketable securities were $87.9 million compared to net purchases of marketable securities of $12.6 million in the three months ended

March 31, 2007. We have classified 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, mortgage-backed and investment grade corporate fixed income securities to maturity; however, 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. Because we invest only in investment securities that are highly liquid with a ready market, we believe that the purchase, maturity or sale of our investments has no material impact on our overall liquidity. We expect to continue our investing activities, including investment securities of a short-term and long-term nature.

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Acquisitions

During the three months ended March 31, 2008, we paid $49.0 million, net of cash received, related to the acquisition of ScanAlert, Inc. and $6.0 million for direct acquisition costs accrued at December 31, 2007 for our acquisition of SafeBoot. Our available cash and equity securities may be used to acquire or invest in complementary companies, products and technologies in the future.

Restricted Cash

The restricted cash, which is included in other assets, of $0.6 million at both March 31, 2008 and December 31, 2007 consisted primarily of cash collateral related to leases in the United States and India, as well as workers compensation insurance coverage.

Property and Equipment

The $10.5 million of property and equipment purchased during the three months ended March 31, 2008 was primarily for purchases of computers, equipment and software for ongoing projects. The $10.2 million of property and equipment purchased during the three months ended March 31, 2007 was primarily for purchases of computers, equipment and software for ongoing projects and for leasehold improvements related to our expanded research and development facility in Beaverton, Oregon.

We anticipate that we will continue to purchase property and equipment necessary in the normal course of our business. The amount and timing of these purchases and the related cash outflows in future periods is difficult to predict and is dependent on a number of factors including our hiring of employees, the rate of change in computer hardware/software used in our business and our business outlook.

Proceeds from the sale of assets and technology

The $4.1 million of proceeds from the sale of assets during the three months ended March 31, 2007 was primarily related to the sale of our fractional interests in corporate aircraft.

Financing Activities

Our financing activities for the three months ended March 31, 2008 and 2007 are as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Proceeds from issuance of common stock from option plans	$ 53,677	$
Excess tax benefits from stock-based compensation	9,520	12
Repurchase of common stock	(127,175)	(196)
Net cash used in financing activities	$ (63,978)	$ (184)

Stock Option and Stock Purchase Plans

Historically, our recurring cash flows provided by financing activities have been from the receipt of cash from the issuance of common stock under stock option and ESPPs. Beginning in July 2006, we suspended purchases under our ESPP and prohibited our employees from exercising stock options due to the announced investigation into our historical stock option granting practices and our inability to become current on our reporting obligations under the Securities Exchange Act of 1934, as amended. Therefore, in the three months ended March 31, 2007, we received no proceeds from the issuance of common stock under stock option and stock purchase plans. On December 21, 2007, we became current on our reporting obligations and our employees were able to exercise stock options for the first time in over 18 months. We received cash proceeds from these plans in the amount of $53.7 million in the three months ended March 31, 2008. We do not expect proceeds from the exercise of stock options to be as significant in future quarterly periods.

While we expect to continue to receive these proceeds in future periods, the timing and amount of such proceeds are difficult to predict and are contingent on a number of factors including the price of our common stock, the number of employees participating in the plans and general market conditions. For existing employees, we grant RSUs that vest over a specified period of time based on service or based on the achievement of performance criteria. For new employees, we continue to grant stock options. Going forward, our management and compensation committee will consider utilizing all types of equity compensation to reward top-performing employees. If management and our compensation committee decide to grant only RSUs and PSUs, which provide no proceeds to us, going forward, our proceeds from issuance of common stock will be significantly less than proceeds that we received historically. We plan to reinstate our ESPP with a six-month offering period, a 15% discount and a six-month look back feature beginning in the three months ended June 30, 2008.

Excess Tax Benefits from Stock-Based Compensation

The excess tax benefit reflected as a financing cash inflow in the three months ended March 31, 2008 and 2007 represents excess tax benefits realized relating to stock-based payments to our employees, in accordance with SFAS 123(R). There is a corresponding cash outflow included in cash flows from operating activities.

Repurchase of Common Stock

In January 2008, our board of directors authorized the repurchase of up to $750.0 million of our common stock from time to time in the open market or through privately negotiated transactions through July 2009, depending on market conditions, share price and other factors. During the three months ended March 31, 2008, we used $113.5 million to repurchase 3.4 million shares of our common stock in the open market, including commissions paid on these transactions.

During the three months ended March 31, 2008 and the three months ended March 31, 2007, we used $13.7 million and $0.2 million, respectively, to repurchase shares of common stock in connection with our obligation to holders of restricted stock 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.

In May 2006, we suspended repurchases of our common stock in the open market due to the announced investigation into our historical stock option granting practices until December 21, 2007, the date we became current on our filing obligations. Therefore, in the three months ended March 31, 2007, we had no repurchases of our common stock pursuant to a publicly announced plan or program.

Credit Facility

We have a 14.0 million Euro credit facility with a bank. The credit facility is available on an offering basis, meaning that transactions under the 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 credit facility is intended to be used for short-term credit requirements, with terms of one year or less. The credit facility can be cancelled at any time. No balances were outstanding as of March 31, 2008 and December 31, 2007.

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

Our market risks at March 31, 2008, are consistent with those discussed in Item 7A of our annual report on Form 10-K for the year ended December 31, 2007 filed with the SEC.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and our chief accounting officer, have 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 because of the material weaknesses in

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our internal controls over financial reporting discussed below, our disclosure controls and procedures were not effective as of March 31, 2008.

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 accounting 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.

Material Weaknesses in Internal Control over Financial Reporting

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Our management identified the following material weakness in our internal controls over financial reporting as of March 31, 2008.

Our management identified errors in the tax calculations for the quarterly and annual financial statements resulting from: (i) historical analyses not being prepared in sufficient detail, (ii) current period tax calculations not being accurately prepared, and (iii) reviews of tax calculations not being performed with sufficient precision. Due to the number and amount of the errors identified resulting from these internal control deficiencies and the absence of mitigating controls, management has concluded that these internal control deficiencies constitute a material weakness in internal control because there is a reasonable possibility that a material misstatement of the interim and annual financial statements would not have been prevented or detected on a timely basis.

As described below under the heading *Changes in Internal Controls Over Financial Reporting,* we have taken a number of steps designed to improve our accounting for income taxes.

Changes in Internal Controls Over Financial Reporting

Except as described below, there have been no changes in our internal control over financial reporting since December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We continue the process of remediating the material weakness in accounting for income taxes by hiring more tax accounting personnel, with an emphasis on hiring personnel having international tax expertise. We will continue to make personnel additions and changes, and as necessary, implement additional remedial steps as indicated below:

We have automated key elements of the calculation of the provision for income taxes and the account reconciliation processes by implementing a new tax accounting system.

We continue to enhance the training and education of our tax accounting personnel.

We continue to improve our interim and annual review processes for various calculations including the tax provision computation process.

We believe the above steps will provide us with the infrastructure and processes necessary to accurately calculate our tax provision on a quarterly basis. We will continue to implement these remedial steps to ensure operating effectiveness of the improved internal controls over financial reporting.

PART II: OTHER INFORMATION

Item 1. *Legal Proceedings*

Settled Cases

In February 2007, we reached a confidential settlement of a breach of contract, fraud and bad faith lawsuit filed in June 2002 in the United States District Court, District of Massachusetts. As part of the settlement, we acquired and recorded ownership of intangible assets valued at $9.3 million with all remaining claims settled for $6.2 million, of which $5.0 million was recognized as expense in the three months ended June 30, 2006 with the balance of $1.2 million being expensed in 2004 and prior periods. The case was dismissed in March 2007.

Open Cases

We have described below our material legal proceedings and investigations that are currently pending and are not in the ordinary course of business. If management believes that a loss arising from these matters is probable and can reasonably be estimated, we record the amount of the loss, or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As additional information becomes available, any potential liability related to these matters is assessed and the estimates are revised, if necessary. 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. The results of claims, lawsuits and investigations also 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.

Government Inquiries Relating to Historical Stock Option Practices

In May 2006, we announced that we had commenced an investigation of our historical stock option granting practices. As a result of that investigation, we concluded that certain stock options had been accounted for using incorrect measurement dates, which, in some instances, were chosen with the benefit of hindsight so as to intentionally give more favorable exercise prices. Consequently, certain of our historical financial statements needed to be restated to correct improper accounting for improperly priced stock options. In December 2007, we filed our Form 10-K for 2006, which included the effects of a restatement of our audited consolidated financial statements for 2004 and 2005, our selected financial data for 2002 through 2005, and our unaudited quarterly financial data for all quarters in 2005 and the first quarter of 2006.

On May 23, 2006, the Securities and Exchange Commission (SEC) notified us that an investigation had begun regarding our historical stock option grants. On June 7, 2006, the SEC sent us a subpoena requesting certain documents related to stock option grants from January 1, 1995 through the date of the subpoena. At or around the same time, we received a notice of informal inquiry from the Department of Justice (DOJ), concerning our stock option granting practices. On August 15, 2006, we received a grand jury subpoena from the United States (U.S.) Attorney s Office for the Northern District of California relating to the termination of our former general counsel, his stock option related activities and the investigation. On November 6, 2006, we received a document request from the SEC for option grant data for McAfee.com, previously one of our consolidated subsidiaries that was a publicly traded company from December 1999 through September 2002.

On November 2, 2006, the investigative team created by the Special Committee of our board of directors met with the Enforcement Staff of the SEC in Washington D.C. and presented the initial findings of the investigation. Pursuant to discussions between the investigative team and the SEC during that meeting, the scope of the investigation was expanded to include a review of the historical McAfee.com option grants along with our historical exercise activity

with a view toward determining potential exercise date manipulation and post-employment arrangements with former executives.

We have provided documents requested, and we are cooperating with the SEC and DOJ. The SEC investigation is still in its preliminary stages thus we are unable to determine the ultimate outcome at this time. As such, no provision has been recorded in the financial statements for this matter.

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Securities Cases

On May 31, 2006, a purported stockholder derivative lawsuit styled Dossett v. McAfee, Inc., No. 5:06CV3484 (JF) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Dossett). On June 7, 2006, another purported stockholder s derivative lawsuit styled Heavy & General Laborers Locals 472 & 172 Pension & Annuity Funds v. McAfee, Inc., No. 5:06CV03620 (JF) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Laborers). The Dossett and Laborers actions generally allege that we improperly backdated stock option grants between 1997 and the present, and that certain of our current and former officers or directors either participated in this backdating or allowed it to happen. The Dossett and Laborers actions assert claims purportedly on behalf of us for, inter alia, breach of fiduciary duty, abuse of control, constructive fraud, corporate waste, unjust enrichment, gross mismanagement, and violations of the federal securities laws. On July 13, 2006, the United States District Court for the Northern District of California entered an order consolidating the Dossett and Laborers actions as *In re McAfee, Inc. Derivative Litigation,* Master File No. 5:06CV03484 (JF) (the Consolidated Action). On January 22, 2007, we moved to dismiss the complaint in the Consolidated Action on the grounds that plaintiffs lack standing to sue on our behalf because, inter alia, they did not make a pre-suit demand on our board of directors. At the parties request, the Court continued on several occasions the due date for the plaintiffs opposition to our motion to dismiss and the date for the hearing of that motion. As a result of the settlement described below, there is no deadline by which plaintiffs must file an opposition to the motion to dismiss.

On August 7, 2007, a new stockholders derivative lawsuit styled Webb v. McAfee, Inc., No. C 07 4048 (PVT) was filed in the United States District Court for the Northern District of California against certain of our current and former directors and officers (Webb). The new lawsuit generally alleges the same facts and causes of action that plaintiffs have asserted in the Consolidated Action. The plaintiff in Webb requested that his action be consolidated with the Consolidated Action. On September 21, 2007, the Court consolidated the Webb action with the Consolidated Action.

On June 2, 2006, three identical lawsuits styled Greenberg v. Samenuk, No. 106CV064854, Gordon v. Samenuk, No. 106CV064855, and Golden v. Samenuk, No. 106CV064856 were filed in the Superior Court of the State of California, County of Santa Clara against certain of our current and former directors and officers (the State Actions). Like the Consolidated Action, the State Actions generally allege that we improperly backdated stock option grants between 2000 and the present, and that certain of our current and former officers or directors either participated in this backdating or allowed it to happen. Like the Consolidated Action, the State Actions assert claims purportedly on behalf of us for, inter alia, breach of fiduciary duty, abuse of control, corporate waste, unjust enrichment, and gross mismanagement. On June 23, 2006, we moved to dismiss these actions in favor of the first-filed Consolidated Action. On September 18, 2006, the Court consolidated the State Actions and denied our motions to dismiss, but stayed the State Actions due to the first-filed action in federal court. The stay, which was continued by the Court on several occasions, expired in December 2007.

In December 2007, we reached a tentative settlement with the plaintiffs in the Consolidated Action and the State Actions. The tentative agreement must be submitted to and approved by the Court. We accrued $13.8 million in the condensed consolidated financial statements as of June 30, 2006 due to our ongoing stock option investigation and restatement related to expected payments pursuant to the tentative settlement and expect to complete the documentation and the required approvals in the second half of 2008. While we cannot predict the ultimate outcome of the lawsuits in the event that the tentative settlement is not approved by the Court, the provision recorded in the financial statements represents our best estimate at this time.

Certain investment bank underwriters, our company, and certain of our directors and officers have been named in a putative class action for violation of the federal securities laws in the United States District Court for the Southern

District of New York, captioned *In re McAfee.com Corp. Initial Public Offering Securities Litigation,* 01 Civ. 7034 (SAS). This is one of a number of cases challenging underwriting practices in the initial public offerings (IPOs), of more than 300 companies. These cases have been coordinated for pretrial proceedings as *In re Initial Public Offering Securities Litigation,* 21 MC 92 (SAS). Plaintiffs generally allege that certain underwriters engaged in undisclosed and improper underwriting activities, namely the receipt of excessive brokerage commissions and

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customer agreements regarding post-offering purchases of stock in exchange for allocations of IPO shares. Plaintiffs also allege that various investment bank securities analysts issued false and misleading analyst reports. The complaint against us claims that the purported improper underwriting activities were not disclosed in the registration statements for McAfee.com s IPO and seeks unspecified damages on behalf of a purported class of persons who purchased our securities or sold put options during the time period from December 1, 1999 to December 6, 2000. On February 19, 2003 the Court issued an Opinion and Order dismissing certain of the claims against us with leave to amend. We accepted a settlement proposal on July 15, 2003.

We, together with the other issuer defendants and plaintiffs, entered into a stipulation of settlement and release of claims against the issuer defendants that was submitted to the Court for approval in June 2004. On August 31, 2005, the Court preliminarily approved the settlement which, among other things, was conditioned upon class certification. In December 2006, the appellate court overturned the certification of classes making it unlikely that the proposed settlement would receive final Court approval. As a result, on June 25, 2007, the Court entered an order terminating the proposed settlement. Plaintiffs have indicated that they will seek to amend their allegations and file amended complaints. It is uncertain whether there will be any revised or future settlement. Thus, the ultimate outcome, and any ultimate effect on us, cannot be precisely determined at this time.

Other

In February 2008, a former executive notified us of his intent to seek arbitration of claims associated with his employment. He alleges that McAfee breached his employment contract and committed certain additional wrongful acts related to the expiration of his stock options. The arbitration demand was filed on April 11, 2008 and we anticipate that arbitration will begin in October of 2008. We believe these claims are without merit, and intend to contest them vigorously. No provision has been recorded in the financial statements related to this matter.

On January 7, 2007, a former executive filed an arbitration demand with the American Arbitration Association, Dallas Texas, (the Texas arbitration) seeking the arbitration of claims associated with his employment. The Texas arbitration is scheduled to begin in September 2008. On September 5, 2007, a Complaint for Damages and Other Relief was also filed by the same former executive, in the Superior Court of the State of California, County of Santa Clara, No. 107CV-093592 (the California litigation). The California litigation generally contained the same claims as were filed in the Texas arbitration. A Motion to Compel Arbitration of the California litigation with the Texas arbitration was granted in December 2007. We have filed counterclaims against the former executive, who was terminated. The board determined this termination was for cause. We believe the claims associated with the Texas arbitration and the California litigation are without merit. We intend to vigorously contest these claims, and no provision has been recorded in the financial statements for either the Texas arbitration or the California litigation.

On August 17, 2006, a patent infringement lawsuit captioned Deep Nines v. McAfee, Inc., No. 9:06CV174, (Deep Nines litigation) was filed in the United States District Court for the Eastern District of Texas. The lawsuit asserts that (i) several of our Enterprise products infringe a Deep Nines patent, and (ii) we falsely marked certain products with a McAfee patent that was abandoned after its issuance. The lawsuit seeks preliminary and permanent injunctions against the sale of certain products as well as damages. We have counter-asserted that Deep Nines has infringed various McAfee patents. The Deep Nines litigation is still in the discovery stage thus we are unable to determine the ultimate outcome at this time. However, we believe that we have meritorious defenses to this lawsuit and intend to vigorously defend against it. No provision has been recorded in the financial statements for this matter.

In addition, we are engaged in certain legal and administrative proceedings incidental to our normal business activities and believe that these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

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.

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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 and geographic markets are described in *Business Competition* in our 2007 Form 10-K. Our competitors include some large enterprises such as Microsoft, Cisco Systems, Symantec, IBM, Google and Trend Micro. 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 and/or greater financial, technical and marketing resources than we do.

Increasingly, our competitors are large vendors of hardware or operating system software. These competitors are continuously incorporating system and network protection functionality into their products, and enhancing that functionality either through internal development or increasingly through acquisitions. For example, in 2006 Microsoft released its consumer security solution and continues to boost the security functionality of its Windows platform through its acquisition strategy. More details about competitors expanding their system and network protection offerings are described in *Business Competition* in our 2007 Form 10-K. These large vendors have significantly greater product development and acquisition budgets and resources than we do. This might enable them to provide greater functionality and to expand that functionality more quickly than we are able to do.

Consumer business competition

More than 40% 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 and Comcast, 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, Microsoft over time has sought to add security features to its operating systems that would provide functionality similar to what our products offer, while at the same time making it more difficult for us to integrate our products with its operating systems. 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 obsolete and unmarketable even if these incorporated products are inferior or more limited than our products. 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 and Vista; and we must continue to expand our business models beyond traditional software licensing and subscription models. Specifically, software-as-a-service (SaaS) is becoming an increasingly important method and business model for the delivery of applications. Because of the advantages that SaaS models offer to customers over traditional software sales and licensing, competitors using SaaS models to a greater extent than we do could enjoy growth in their businesses and, as a result, we could lose business to such competitors.

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. In addition, we may choose not to deliver a previously announced, partially-developed product, thereby increasing our development costs without a corresponding benefit. For example, if Microsoft incorporates a product that performs the same or similar function as one of our products under development into the Windows platform, we might discontinue development if we believe the Microsoft product will undermine the market for our product. This could happen even if Microsoft s product is inferior or more limited than our product, especially if the Microsoft product is lower-priced or made available at no additional cost to customers. The occurrence of these events could negatively impact our business.

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

Failure to protect against security breaches

Our products are used to protect and manage computer systems and networks that may be critically important to our customers. Customers rely on our products to protect against security risks, prevent the loss of sensitive data and manage compliance activities. Because of the complexity of our products, they could contain undetected errors when first introduced and when new versions or enhancements are released. We have from time to time found errors in versions of our products, and we may find such errors in the future. Furthermore, because of the complexity of the environments in which 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. Any such product problems could have a negative impact on us as well. For example, failure of our products to identify or block viruses 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.

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, may 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.

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 tax compliance, and the overall political climate and potential political instability. Net revenue in our operating regions outside of North America represented 49% of total net revenue in the three months ended March 31, 2008, increasing from 48% in the three months ended March 31, 2007. 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. One primary legal risk is that some of our computer security solutions, particularly those incorporating encryption technology, may be subject to export restrictions. As a result, some products cannot be exported to international customers without prior United States (U.S.) government approval. The list of products and end users for which export approval is required, and the related regulatory policies, are subject to revision by the U.S. government at any time. The cost of compliance with U.S. and

international export laws and changes in existing laws could 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 law and regulations, we may become subject to penalties and fines or restrictions that may adversely affect our business.

Another significant legal risk resulting from our international operations is compliance with the Foreign Corrupt Practices Act (FCPA). In many foreign countries, particularly in those with developing economies, it may be common for non-McAfee personnel to engage in business practices that are prohibited by the FCPA or other U.S. laws and regulations. For example, in some countries it is customary to make payments to government regulators in order to encourage prompt and desirable regulatory actions. Such payments by U.S. companies, employees or agents of U.S. companies are prohibited by the FCPA. 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 of our employees, and agents, as well as those companies to which we outsource certain of our business operations, will not take actions in violation of our policies. Any such violation, even if prohibited by our policies and training programs, could have a material adverse effect on 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; and unexpected changes in regulatory requirements. 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. Accordingly, our future operating results will continue to be subject to fluctuations in foreign currency rates. Fluctuations in currency exchange rates and 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 During the three months ended March 31, 2008 and 2007, we recorded a net foreign currency transaction loss of $0.9 million and $0.7 million respectively in our consolidated statements of income and comprehensive income. 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.

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.

Significant percentage of sales through distributors

We sell a significant amount 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. In particular, 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 may 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.

Our PC OEMs 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.

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, including those with Ingram Micro Inc. and Tech Data Corporation, our two largest 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 revenues could decline. We could also lose the benefit of our investment of time, money and resources in the distributor relationship.

A significant portion of our net revenue is attributable to a fairly small number of distributors. Our top ten distributors represented 37% of our net revenue in each period for the three months ended March 31, 2008 and 2007. 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.

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 revenues.

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 $5.9 million as of March 31, 2008. 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.

We face risks associated with past and future acquisitions.

We may buy or make investments in complementary 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 to the risks noted below.

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.

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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 preexisting supplier, 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.

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. This risk is amplified by the increased costs and efforts in connection with compliance with the Sarbanes-Oxley Act. Acquisitions of privately held and/or non-US companies are particularly challenging because their prior practices in these areas typically do not meet the requirements of the Sarbanes-Oxley Act.

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. 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 consequences

Acquisitions may result in substantial accounting charges for restructuring and other expenses, write-offs of in-process research and development, future impairment of goodwill, amortization of intangible assets and stock-based compensation expense, any of which could materially adversely affect our operating results.

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. 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.

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. In the recent past we have experienced significant turnover in our senior management team and in our worldwide sales and finance organizations and replacing this personnel remains difficult.

It could be difficult, time consuming and expensive to replace any key management member or other critical personnel. Integrating new management and other key personnel also may 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 unique skills and the departure of existing employees and/or customers. It may take significant time to locate, retain and integrate qualified management personnel.

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. To attract and retain critical personnel, we believe that we must maintain an open and collaborative work environment. We also believe we need to provide a competitive compensation package, including stock options, other stock awards and other incentives. Increases in shares available for issuance under our stock option plans require stockholder approval. Institutional stockholders, or our other stockholders, may not approve future requests for increases in shares available under our equity incentive plans. For example, at our 2003 annual meeting held in December 2003, our stockholders did not approve a proposed increase in shares available for grant under our employee stock option plans. We continue to evaluate our compensation programs and in particular our equity compensation philosophy. In the future, we may decide to issue fewer stock options, RSAs, RSUs or PSUs, possibly impairing our ability to attract and retain necessary personnel. Conversely, issuing a comparable number of stock options RSAs, RSUs or PSUs, could adversely impact our results of operations due to the accounting charges required in connection with equity compensation and the dilutive impact on earning per share.

Risks relating to new hires and senior management changes

We continue to hire in key areas and have added a number of new employees in connection with our acquisitions. We have also increased our hiring in Bangalore, India in connection with the relocation of a significant portion of our research and development operations to India.

During 2007, 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. In April 2007, David DeWalt was hired as our chief executive officer and president. Later in 2007 we also appointed other senior executives. In March 2008, our chief financial officer Eric Brown resigned and in April 2008, we announced we had hired Albert Rocky Pimentel as our new chief financial officer. We may continue to experience changes in senior management going forward.

For new employees, including senior management, there may be reduced levels of productivity as recent additions or hires are trained or otherwise assimilate and adapt to our organization and culture. The significant turnover in our

senior management team during 2007 and 2008 may make it difficult to attract new employees and retain existing employees. Further, this turnover may also make it difficult to execute on our business plan and achieve our planned financial results.

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

Impact of fluctuations

Over the years our revenues, gross margins and operating results have fluctuated significantly from quarter to quarter and from year to year, and we expect fluctuations in our operating results to continue in the future. Thus, our operating results for prior periods may not be effective predictors of our future performance. The fluctuations make it difficult for us to accurately estimate operating results. Furthermore, because our expenses are based in part on our expectations regarding future revenues, expenses in the short term 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 revenues, gross margins and other operating results to fluctuate significantly from period to period, include, but are not limited to the following:

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 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 our quarters. Some customers believe they can enhance their bargaining power by waiting until the end of our quarter to place their order. 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. 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 fiscal 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. A failure of our third-party manufacturers to provide us with timely and accurate product cost information may impact our costs of goods sold and negatively impact 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 distribute our products. Any changes in the performance of the relationships with our distribution partners can impact our operating results. We also rely on third parties to manufacture our products. Changes in our supply chain could result in product fulfillment delays that contribute to fluctuations in operating results from period to period. We typically fulfill delivery of our hardware-based products from centralized distribution centers. We have in the past and may in the future make changes in our product delivery network. Changes in our product delivery network 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 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, 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 mix can impact operating expenses as

well as the amount of revenue and the timing of revenue recognition, so our profitability can fluctuate significantly based on product mix.

Timing of new products and customers

The timing of the introduction and adoption of new products, product upgrades or updates by us or our competitors can have a significant impact on revenue from period to period. For example, revenues tend to be higher shortly after we introduce new products compared to periods without new products. Our revenues 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, ongoing business operations and our cash flow also contribute to variability in our operating results. These include, but are not limited to, expenses related to our acquisition and disposition activities, 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 and financial restatements, 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.

Conditions and changes in the national and global economic and political environments may adversely affect our business and financial results.

Adverse economic conditions in markets in which we operate can harm our business. Economic growth in the United States slowed in the fourth quarter of 2007 and remained slow for the first quarter of 2008. Many customers may delay or reduce technology purchases as a result of this slow down or if the United States economy remains slow or contracts or other countries economies slow. This could result in reductions in sales of our products, longer sales cycles, 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 revenues 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 and financial condition.

Recent turmoil in the political environment in many parts of the world, including terrorist activities and military actions, the continuing tension in and surrounding Iraq, and increases in energy costs due to instability in oil-producing regions may continue to put pressure on global economic conditions. If global economic and market conditions, or economic conditions in the United States or other key markets deteriorate, we may experience material impacts on our business, operating results, and financial condition.

We have experienced, and may continue to experience, material weaknesses and significant deficiencies in our internal control and financial reporting environment, which impacts 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. In our Form 10-K for the year ended December 31, 2007, our management identified a material weakness relating to our accounting for income taxes. We have implemented, and will continue to implement,

additional controls and procedures to address the material weakness related to accounting for income taxes. See Item 9A, *Controls and Procedures* in our 2007 Form 10-K and Item 4, *Controls and Procedures* in this Form 10-Q, for details of these material weakness remediation programs. These efforts have resulted, and could further result, in significant expenses and could divert management attention away from operating our business. Even though our management believes that our efforts to remediate internal control deficiencies have improved the

operation of our internal control over financial reporting, we cannot be certain that the measures we have taken or we are planning to take will sufficiently and satisfactorily remediate the identified material weaknesses. Ongoing material weaknesses in internal controls create a reasonable possibility that a material misstatement of our interim and annual financial statements would not be prevented or detected on a timely basis.

If management identifies additional material weaknesses or significant deficiencies in the future, their correction could require additional remedial measures which could be costly and time-consuming. In addition, the presence of further material weaknesses could result in financial statement errors which in turn could require us to restate our operating results. If a material weakness is identified for a future period year-end or if our previously identified material weaknesses are not remediated, our independent auditors would be unable to express an opinion on the effectiveness of our internal controls. 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.

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 software. However, the steps we have taken to protect our proprietary software 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. 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. For example, as discussed in Item 1, *Legal Proceedings*, we are currently defending a patent infringement case that seeks to prevent us from selling certain of our products.

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 of patents or other intellectual property rights that may be held invalid or infringed upon by our products (licenses may not be available on reasonable commercial terms or at all), and subject us to significant liabilities, including monetary 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 any software we acquire. 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.

Potential risks of using of open source software

Like many other software companies, we use and distribute open source software in order to add functionality to our products quickly and inexpensively. We face certain risks relating to our use of open source code. Open source license terms may be ambiguous and may result in unanticipated or uncertain obligations regarding our products. For example, the scope and requirements of the most common open source software license,

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the GNU General Public License (GPL) have not been interpreted in court. Our use of GPL or other open source software could subject certain portions of our proprietary software to the GPL requirements or other similar requirements. That may have an adverse impact on our sale of the products incorporating the open source software. Other forms of open source software licensing present license compliance risks for us. If we fail to comply with the license obligations, we could be sued and/or lose the right to use the open source code.

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.

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.

Strategic alliances

Uncertainty of realizing anticipated benefits. We have entered into strategic alliances with numerous third parties to support our future growth plans. 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. Strategic alliances require significant coordination between the parties involved, particularly if an alliance requires that we integrate the other company s 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. Our agreements relating to our strategic alliances 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.

Third-party manufacturing relationships

Less control of the manufacturing process and outcome. 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. These risks include, but are not limited to, 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.

Inadequate capacity. 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.

Hardware obsolescence. 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.

Our tax strategy may expose us to 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 thereof of the jurisdictions in which we operate. 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 audit in many jurisdictions, including notably the United States, California and The Netherlands. An adverse outcome in one or more of these ongoing audits, or in any future audits that may occur, could have a significant negative impact on our cash position and net income. Although we have established reserves for these audit 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, regulations and accounting principles (including accounting for uncertain tax positions), or interpretations of those changes. Significant judgment is required to determine the recognition and measurement attribute prescribed in FIN 48. In addition, FIN 48 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 goodwill.

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 revenues, 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.

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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.

As part of our efforts to continue improving our internal control over financial reporting, we upgraded our existing SAP information technology system during 2007 in order to automate certain controls that were previously performed manually. We may experience difficulties in transitioning to new or upgraded 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 safety precautions 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.

We face the risk of a decrease in our cash balances and losses in our investment portfolio.

Investment income is an important 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 rely on third-party money managers to manage the majority of our investment portfolio in a risk-controlled framework. Our cash throughout the world is invested in high-quality fixed-income securities and is affected by changes in interest rates. Interest

rates are highly sensitive to many factors, including governmental monetary policies and domestic and international economic and political conditions. Most amounts held outside the United States could be repatriated to the United States, but, under current law, would be subject to U.S. federal income tax, less applicable foreign tax credits.

The outlook for our investment income is dependent on the future direction of interest rates, the amount of any share repurchases or acquisitions that we effect and the amount of cash flows from operations that are available for investment. Any significant decline in our investment income or the value of our investments as a result of falling interest rates, deterioration in the credit of the securities in which we have invested, or general market conditions, could have an adverse effect on our net income.

Our investment strategy attempts to manage interest rate risk and limit credit risk. By policy, we only invest in what we view as very high quality debt securities and our largest holdings are short-term U.S. Government securities and high-quality, well-collateralized asset-backed securities. We do not hold any sub-prime mortgages, auction rate securities or structured investment vehicles. We do not invest in below investment-grade securities.

Our historical stock option granting practices have resulted in, and could continue to result in, continued or new litigation, regulatory proceedings, government enforcement actions and remedial actions, all of which have had, and will continue to have, a negative impact on our business and financial results.

In May 2006, we announced that we had commenced an investigation of our historical stock option granting practices. As a result of that investigation, we concluded that certain stock options had been accounted for using incorrect measurement dates, which, in some instances, were chosen with the benefit of hindsight so as to intentionally give more favorable exercise prices. Consequently, certain of our historical financial statements needed to be restated to correct improper accounting for improperly priced stock options. In December 2007, we filed our Form 10-K for 2006, which included the effects of a restatement of our audited consolidated financial statements for 2004 and 2005, our selected financial data for 2002 through 2005, and our unaudited quarterly financial data for all quarters in 2005 and the first quarter of 2006.

Shortly after we announced an internal investigation of our historical stock option granting practices, both the SEC and the DOJ, commenced investigations of our stock option practices. The filing of our restated consolidated financial statements did not resolve the pending SEC or DOJ inquiries. We are engaged in ongoing discussions with, and continue to provide information to, the SEC regarding certain of our prior period consolidated financial statements. The resolution of the SEC inquiry into our historical stock option granting practices could require us to file additional restatements of our prior consolidated financial statements or require that we take other actions not presently contemplated.

As part of the remedial actions we have taken in connection with the investigation and restatement, we terminated the employment of certain employees, including former executive officers. We are involved in litigation and other legal proceedings in connection with such terminations, as well as other stockholder lawsuits related to our historical stock option granting practices. We expect that there may be additional legal proceedings in the future which will require additional management time and additional expense. Any resolution of the legal proceedings may require us to make severance, settlement or other related payments in the future. See Note 11 to the consolidated financial statements included elsewhere in the report for more details about ongoing legal proceedings.

We cannot predict the outcome of the pending government inquiries or stockholder or other lawsuits, and we may face additional government inquiries, stockholder lawsuits and other legal proceedings. We cannot predict what, if any, enforcement action the SEC or DOJ will take with respect to our failure to be current in our periodic reports or our historical stock option granting practices.

As a result of our investigation and our conclusion that certain options had been mispriced, some of our employees and former employees were potentially exposed to significantly increased income tax liabilities and penalties and/or were unable to realize the benefits of their stock options. We have taken a number of steps to remedy this situation for employees, which has contributed to increased operating expenses. We believe we have taken, or are in the process of taking all corrective actions to compensate for the economic effects of mispriced stock

options for many of our current and former employees and directors, but it is possible that there will be other actions required.

All of the events described above have required us to devote significant management time and to incur significant accounting, legal, and other expenses. These consequences have diverted management attention from business operations and have affected our financial condition and results of operations. We anticipate that these impacts will continue to varying degrees in future periods.

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. 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. In this regard, we and a number of our current and former officers and directors are involved in or the subject of various legal actions. Managing, defending and indemnity obligations related to these actions have caused significant diversion of management s and the board of director s time and resulted in material expense to us. See Note 11 to the consolidated financial statements for additional information with respect to currently pending legal matters.

We face risks related to our 2006 settlement agreement with the SEC.

On February 9, 2006, the United States District Court for the Northern District of California entered a final judgment permanently enjoining us and our officers and agents from future violations of the securities laws. This final judgment resolved the charges filed against us in connection with the SEC s investigation of our accounting practices that commenced in March 2002. As a result of the judgment, we will forfeit for three years the ability to invoke the safe harbor for the forward-looking statements provision of the Private Securities Litigation Reform Act (Reform Act). This safe harbor provided us enhanced protection from liability related to forward-looking statements if the forward-looking statements were either accompanied by meaningful cautionary statements or were made without actual knowledge that they were false or misleading. While we may still rely on the bespeaks caution doctrine that existed prior to the Reform Act for defenses against securities lawsuits, without the statutory safe harbor, it may be more difficult for us to defend against any such claims. In addition, due to the permanent restraint and injunction against violating applicable securities laws, any future violation of the securities laws would be a violation of a federal court order and potentially subject us to a contempt order. For instance, if, at some point in the future, we were to discover a fact that caused us to restate our financial statements similar to the restatements that were the subject of the SEC action, we could be found to have violated the final judgment. We cannot predict whether the SEC might assert that our failure to remain current in our periodic reporting obligations or our historical stock option practices violated the final judgment or what, if any, enforcement action the SEC might take upon such a determination. Further, any collateral criminal or civil investigation, proceeding or litigation related to any future violation of the judgment, such as the compliance actions mandated by the judgment, could result in the distraction of management from our day-to-day business and may materially and adversely affect our reputation and results of operations.

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

During 2007 and up to the date of this filing, our stock price was highly volatile, ranging from a high of $41.35 to a low of $28.00. On April 30, 2008, our stock s closing price was $33.25. Announcements, business developments, such

as a 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 Microsoft

Corporation related to its 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.

In addition to the volatility that is related to our business activities and those of others in our industry, our stock price may also experience volatility that is completely unrelated to our performance or that of the security industry. During 2007 through April 2008, the major US and international stock markets have been extremely volatile. Fluctuations in these broad market indices can impact McAfee s stock price regardless of McAfee s performance.

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

Our charter documents and Delaware law

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.

Our classified board and other provisions of Delaware law and 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 2008 annual meeting must meet the qualifications and follow the procedures specified under both the Securities Exchange Act of 1934 and our bylaws.

Our rights plan

Our board of directors has adopted a stockholders rights plan. The rights would become exercisable on the tenth day after a person or group announces the acquisition of 15% or more of our common stock or announces the commencement of a tender or exchange offer the consummation of which would result in ownership by the person or group of 15% or more of our common stock. If the rights become exercisable, the holders of the rights (other than the person acquiring 15% or more of our common stock) will be entitled to acquire in exchange for the rights exercise price, shares of our common stock or shares of any company in which we are merged with a value equal to twice the rights exercise price. The rights plan makes it more difficult for a third party to acquire a majority of our outstanding voting stock and discourages a change of control of the company not approved by our board of directors.

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

Stock Repurchases

In January 2008, our board of directors authorized the repurchase of up to $750.0 million of our common stock in the open market or through privately negotiated transactions through July 2009, depending upon market conditions, share price and other factors. For the three months ended on March 31, 2008, we repurchased approximately 3.4 million shares of our common stock in the open market for approximately $113.4 million, excluding commission paid.

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The table below sets forth all repurchases by us of our common stock during the quarter ended March 31, 2008:

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)					
February 1, 2008 through February 29, 2008	1,507	$	33.50	1,507	$	699,518
March 1, 2008 through March 31, 2008	1,890		33.29	1,890		636,593
Total	3,397	$	33.38	3,397		

During the three months ended March 31, 2008, we also used $13.7 million to repurchase shares of common stock in connection with our obligation to holders of restricted stock units 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.

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

None.

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

None.

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/ Keith S. Krzeminski
Keith S. Krzeminski
Chief Accounting Officer and
Senior Vice President of Finance

May 12, 2008

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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	Second Restated Certificate of Incorporation of the Registrant, as amended on December 1, 1997	S-4	333-48593	3.1	March 25, 1998	
3.2	Certificate of Ownership and Merger between Registrant and McAfee, Inc.	10-Q	001-31216	3.2	November 8, 2004	
3.3	Second Amended and Restated Bylaws of the Registrant.	10-Q	001-31216	3.3	November 8, 2004	
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 August 16, 2007, between Registrant and Mark Cochran					X
10.2*	Letter agreement, dated September 14, 2007, between Registrant and Michael DeCesare					X
10.3*	Amendment of Stock Options, dated February 11, 2008, between Registrant and Christopher Bolin					X
10.4*	1997 Stock Incentive Plan, as amended					X
10.5*	1993 Stock Option Plan for Outside Directors, as amended					X
10.6*	Foundstone Inc. 2000 Stock Plan, as amended					X
10.7*	2002 Employee Stock Purchase Plan, as amended					X
10.8*	Form of Performance Stock Unit Issuance Agreement					X
31.1	Certification of Chief Executive Officer and Chief Accounting Officer pursuant to Section 302					X

	of the Sarbanes-Oxley Act of 2002	
32.1	Certification of Chief Executive Officer and Chief Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X

* Management contracts or compensatory plans or arrangements covering executive officers or directors of McAfee, Inc.