VERITAS SOFTWARE CORP /DE/
Form 10-Q
June 14, 2004

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

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2004

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: 000-26247

VERITAS Software Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**77-0507675**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

350 Ellis Street
Mountain View, California 94043
(650) 527-8000
(Address, including Zip Code, of Registrant s Principal Executive Offices and Registrant s Telephone Number, including Area Code)

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 x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No o

The number of shares of the registrant s common stock outstanding as of May 28, 2004 was 431,842,356 shares.

VERITAS SOFTWARE CORPORATION

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PART I: FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

VERITAS SOFTWARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2004	December 31, 2003
(in thousands)	**(Unaudited)**	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 628,394	$ 823,171
Short-term investments	2,055,564	1,679,844
Accounts receivable, net of allowance for doubtful accounts of $7,479 and $7,807, respectively	155,375	250,098
Other current assets	67,583	60,254
Deferred income taxes	18,841	30,302
Total current assets	2,925,757	2,843,669
Property and equipment, net	572,824	572,977
Other intangibles, net	85,691	81,344
Goodwill, net	1,809,309	1,755,591
Other non-current assets	23,883	25,385
Deferred income taxes	83,854	69,500
	$ 5,501,318	$ 5,348,466
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 29,056	$ 38,289
Accrued compensation and benefits	88,223	124,655
Accrued acquisition and restructuring costs	24,953	25,051
Other accrued liabilities	62,767	83,184
Current portion of long-term debt	186,373	
Income taxes payable	181,534	141,623
Deferred revenue	426,943	398,772
Total current liabilities	999,849	811,574
Convertible subordinated notes	520,000	520,000

Long-term debt	194,257	380,630
Accrued acquisition and restructuring costs	63,124	69,019
Other long-term liabilities	25,106	23,649
Total liabilities	1,802,336	1,804,872
Stockholders equity:		
Common stock	460	458
Additional paid-in capital	6,997,443	6,941,798
Accumulated deficit	(1,278,028)	(1,378,076)
Deferred stock-based compensation	(8,849)	(8,455)
Accumulated other comprehensive income	6,259	6,172
Treasury stock, at cost; 28,609 shares at March 31, 2004 and December 31, 2003	(2,018,303)	(2,018,303)
Total stockholders equity	3,698,982	3,543,594
	$ 5,501,318	$ 5,348,466

See accompanying notes to condensed consolidated financial statements.

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VERITAS SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2004	**2003**
(in thousands, except per share amounts)	**(Unaudited)**	
Net revenue:		
User license fees	$302,409	$247,455
Services	183,338	142,681
Total net revenue	485,747	390,136
Cost of revenue:		
User license fees	9,519	11,917
Services (1)	65,843	52,302
Amortization of developed technology	3,824	14,782
Total cost of revenue	79,186	79,001
Gross profit	406,561	311,135
Operating expenses:		
Selling and marketing (1)	143,038	115,298
Research and development (1)	79,924	70,588
General and administrative (1)	47,749	38,179
Amortization of other intangibles	2,394	18,191
In-process research and development	400	4,100
Total operating expenses	273,505	246,356
Income from operations	133,056	64,779
Interest and other income, net	11,326	11,012
Interest expense	(5,702)	(7,738)
Gain (loss) on strategic investments	7,496	(3,518)
Income before income taxes	146,176	64,535
Provision for income taxes	46,128	21,431

Net income	$100,048	$ 43,104
Net income per share basic	$ 0.23	$ 0.10
Number of shares used in computing per share amounts basic	430,714	412,916
Net income per share diluted	$ 0.22	$ 0.10
Number of shares used in computing per share amounts diluted	444,921	419,380

(1) Amortization of stock-based compensation consists of:

Services	$ 237	$
Selling and marketing	2,881	
Research and development	1,222	314
General and administrative	744	
Total amortization of stock-based compensation	$5,084	$314

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2004	**2003**
(in thousands)	**(Unaudited)**	
Cash flows from operating activities:		
Net income	$ 100,048	$ 43,104
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	30,075	31,350
Amortization of developed technology	3,824	14,782
Amortization of other intangibles	2,394	18,191
In-process research and development	400	4,100
Provision for allowance for doubtful accounts	518	708
Stock-based compensation	5,084	314
Tax benefits from stock plans	6,816	1,642
(Gain) loss on strategic investments	(7,496)	3,518
Write-off of property and equipment	1,083	59
Deferred income taxes	(8,320)	(13,079)
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	93,328	96,491
Other assets	(22,600)	6,756
Accounts payable	(9,252)	(1,243)
Accrued compensation and benefits	(36,641)	(31,469)
Accrued acquisition and restructuring costs	(7,479)	(4,204)
Other accrued liabilities	(14,696)	(12,710)
Income and other taxes payable	39,959	31,704
Deferred revenue	25,652	16,835
Net cash provided by operating activities	202,697	206,849
Cash flows from investing activities:		
Purchases of investments	(947,776)	(414,877)
Sales and maturities of investments	598,515	529,812
Purchases of property and equipment	(28,081)	(19,939)
Purchase of businesses and technology, net of cash acquired	(60,449)	(54,524)
Payments made for prior year business and technology acquisitions		(2,106)

Net cash provided by (used for) investing activities	(437,791)	38,366
Cash flows from financing activities:		
Proceeds from issuance of common stock	43,353	19,950
Net cash provided by financing activities	43,353	19,950
Effect of exchange rate changes	(3,036)	2,177
Net increase (decrease) in cash and cash equivalents	(194,777)	267,342
Cash and cash equivalents at beginning of period	823,171	764,062
Cash and cash equivalents at end of period	$ 628,394	$ 1,031,404
Supplemental disclosures:		
Cash paid for interest	$ 4,822	$ 4,312
Cash paid for income taxes	$ 18,347	$ 1,469

See accompanying notes to condensed consolidated financial statements.

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VERITAS SOFTWARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results for the interim periods presented are not necessarily indicative of the results that may be expected for any future period. The following information should be read in conjunction with the consolidated financial statements and accompanying notes included in VERITAS Software Corporation s Annual Report on Form 10-K for the year ended December 31, 2003.

2. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

3. Accounting for Stock-Based Compensation

The Company accounts for employee stock-based compensation in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and the disclosure requirements of SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of FASB Statement No. 123*. Since the exercise price of options granted under the Company s stock option plans is equal to the market value on the date of grant, no compensation cost has been recognized for grants under such plans. In accordance with APB Opinion No. 25, the Company does not recognize compensation cost related to its employee stock purchase plan. The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had accounted for its stock option and stock purchase plans under the fair value method of accounting under SFAS No. 123, *Accounting for Stock-Based Compensation*:

	Three Months Ended March 31,	
(in thousands, except per share amounts)	**2004**	**2003**
Net income (loss):		
As reported	$100,048	$ 43,104
Add:		
Stock-based employee compensation expense included in net income, net of tax	3,457	210
Less:		

Total stock-based employee compensation expense determined under the fair value method for all awards, net of tax	(73,237)	(74,997)
Pro forma	$ 30,268	$ (31,683)
Basic income (loss) per share:		
As reported	$ 0.23	$ 0.10
Pro forma	$ 0.07	$ (0.08)
Diluted income (loss) per share:		
As reported	$ 0.22	$ 0.10
Pro forma	$ 0.07	$ (0.08)

For purposes of the pro forma disclosures, the expected volatility assumptions the Company used prior to the fourth quarter of fiscal 2003 were based solely on the historical volatility of the Company s common stock over the most recent period commensurate with the estimated expected life of the Company s stock options. Beginning with the fourth quarter of fiscal 2003, the Company modified its approach and expected volatility by considering other relevant factors in accordance with SFAS No. 123. The Company considered implied volatility in market-traded options on the Company s common stock as well as historical volatility. The Company will continue to monitor these and other relevant factors used to measure expected volatility for future option grants.

Also, beginning with the third quarter of fiscal 2003, the Company decreased its estimate of the expected life of new options granted to its employees from 5 years to 4 years. The Company bases its expected life assumption on historical experience as well as the terms and vesting periods of the options granted. The reduction in the estimated expected life was a result of an analysis of the Company s historical experience.

For the pro forma amounts determined under SFAS No. 123, as set forth above, the fair value of each stock option grant under the stock option plans is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants:

	Three Months Ended March 31,	
	2004	2003
Risk-free interest rate	2.58%	2.91%
Dividend yield	0%	0%
Weighted average expected life	4.0 years	5.0 years
Volatility of common stock	55%	90%

The fair value of the employees purchase rights under the employee stock purchase plan is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for these rights:

	Three Months Ended March 31,	
	2004	2003
Risk-free interest rate	1.00%-1.87%	1.20%-1.66%
Dividend yield	0%	0%
Weighted average expected life	6 to 24 months	6 to 24 months
Volatility of common stock	86%	90%

As a result of the delay in filing the Company s Form 10-K for the year ended December 31, 2003, the Company suspended option-holders ability to use the Company s registration statements for its stock option plans (the Plans). As a result, option-holders were unable to exercise options under the Plans until such time as the Company filed its Form 10-K for the year ended December 31, 2003 and lifted the suspension on the use of the registration statements. Pursuant to the terms of the Plans, options held by certain former employees of the Company were scheduled to expire during the suspension period. On March 15, 2004, the Company extended the expiration date of such options for a period of 15 days from the date of filing the Form 10-K, which was considered a modification of such options. For the three months ended March 31, 2004, $4.3 million was expensed in the statement of operations as a result of this modification.

4. Net Income per Share

The following table sets forth the computation of basic and diluted net income per share:

(in thousands, except per share amounts)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Numerator:		
Net income	$100,048	$ 43,104
Denominator:		
Denominator for basic net income per share weighted-average shares outstanding	430,714	412,916
Potential common shares	14,207	6,464
Denominator for diluted net income per share	444,921	419,380
Basic net income per share	$ 0.23	$ 0.10
Diluted net income per share	$ 0.22	$ 0.10

For the three months ended March 31, 2004 and 2003, potential common shares consist of employee stock options using the treasury stock method. The following table sets forth the potential common shares that were excluded from the net income per share computations as their effect would be antidilutive:

(in thousands)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Employee stock options outstanding(1)	27,901	40,953
5.25% convertible subordinated notes(2)		6,695
1.856% convertible subordinated notes(2)		12,981
0.25% convertible subordinated notes(3)	11,274	

(1) For the three months ended March 31, 2004 and 2003, 27,901 and 40,953 employee stock options, respectively, were excluded from the computation of diluted net income per share because the exercise price of these options was greater than the average market price of the Company s common stock during the period, and therefore the effect is antidilutive.

(2) For the three months ended March 31, 2003, 6,695 potential common shares issuable upon the conversion of the Company s 5.25% convertible subordinated notes and 12,981 potential common shares issuable upon the conversion of the Company s 1.856% convertible subordinated notes, respectively, were excluded from the computation of diluted net income per share because the impact of adding back after tax interest expense associated with the convertible subordinated notes, and including the potential common shares, would be antidilutive.

(3) For the three months ended March 31, 2004, 11,274 potential common shares related to the Company s 0.25% convertible subordinated notes were excluded from the computation of diluted net income per share because the specified circumstances under which the 0.25% notes are convertible prior to maturity have not been met (see Note 9).

The weighted average exercise prices of employee stock options with exercise prices exceeding the average fair value of the Company s common stock was $33.00 and $56.04 per share for the three months ended March 31, 2004 and 2003, respectively.

5. Business Combinations

Ejasent, Inc.

In January 2004, the Company acquired all of the outstanding capital stock of Ejasent, Inc. (Ejasent), a privately held provider of application virtualization technology for utility computing. The Company acquired Ejasent to add important application migration technology, which allows IT personnel to move an application from one server to another without disrupting or terminating the application, to the Company s growing utility computing portfolio. The Ejasent acquisition was accounted for using the purchase method of accounting for total purchase consideration of $61.4 million, which included $47.8 million in cash and $13.6 million of acquisition-related costs. The purchase price was allocated to goodwill of $53.7 million, developed technology of $10.2 million, other intangibles of $1.9 million, in-process research and development (IPR&D) of $0.4 million, net deferred tax liabilities of $4.6 million and net tangible liabilities of $0.2 million. The weighted average amortization period for all purchased intangible assets is 4.4 years. Acquisition-related costs consist of $11.5 million of change in control bonuses and direct transaction costs of $2.1 million for legal and other professional fees. Total cash outlays for acquisition-related costs were $12.9 million through March 31, 2004. The results of operations of Ejasent were included in the Company s consolidated financial statements from the date of acquisition. The pro forma impact of the acquisition on the Company s results of operations is not significant.

Precise Software Solutions Ltd.

On June 30, 2003, the Company acquired all of the outstanding common stock of Precise Software Solutions Ltd. (Precise), a provider of application performance management products. The Company acquired Precise in order to expand its product and service offerings across storage, databases and application management. The Precise acquisition was accounted for using the purchase method of accounting for total purchase consideration of $715.1 million, which included 7.3 million shares of common stock valued at $210.6 million, $397.8 million of cash, $94.0 million relating to the assumption of Precise s outstanding vested and unvested stock options for 4.4 million shares of the Company s common stock and $12.7 million of acquisition-related costs. The purchase price was allocated to goodwill of $509.7 million, developed technology of $27.6 million, other intangibles of $34.3 million, IPR&D of $15.3 million, net deferred tax liabilities of $21.4 million, deferred stock-based compensation of $7.3 million and net tangible assets of $142.3 million. The weighted average amortization period for all purchased intangible assets is 3.7 years. The acquired IPR&D of $15.3 million was written off and the related charge was expensed in the statement of operations in the second quarter of 2003. Acquisition-related costs of $12.7 million consist of $9.0 million associated with investment banking and other professional fees, $3.3 million for terminating and satisfying existing lease commitments and $0.4 million for severance-related costs. Total cash outlays for acquisition-related costs were approximately $8.7 million for investment banking and other professional fees, $0.4 million for severance-related costs and $0.3 million for leases through March 31, 2004.

The results of operations of Precise are included in the Company s consolidated financial statements from July 1, 2003. The following table presents pro forma results of operations and gives effect to the acquisition of Precise as if the acquisition was consummated at the beginning of fiscal year 2003. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the acquisition been made as of the beginning of the period or of the results that may occur in the future. Net income excludes the write-off of acquired IPR&D of $15.3 million and includes amortization of intangible assets related to the acquisition of $4.7 million per quarter and amortization of deferred compensation of $0.5 million per quarter. The unaudited pro forma information is as follows:

(in thousands, except per share amounts)	Three Months Ended March 31, 2003
Total net revenue	$ 412,291
Net income	39,191
Net income per share basic	0.09
Net income per share diluted	0.09

Jareva Technologies, Inc.

On January 27, 2003, the Company acquired all of the outstanding capital stock of Jareva Technologies, Inc. (Jareva), a privately held provider of automated server provisioning products that enable businesses to automatically deploy additional servers without manual intervention. The Company acquired Jareva to integrate Jareva s technology into the Company s software products to enable the Company s customers to optimize their investments in server hardware by deploying new server resources on demand. The Jareva acquisition was accounted for using the purchase method of accounting for total purchase consideration of $68.7 million, which included $58.7 million of cash, $6.8 million relating to the assumption of options exercisable for 426,766 shares of the Company s common stock and $3.2 million of acquisition-related costs. The purchase price was allocated to goodwill of $51.3 million, developed technology of $9.1 million, other intangibles of $1.9 million, IPR&D of $4.1 million, net deferred tax liabilities of $6.1 million, deferred stock-based compensation of $4.6 million and net tangible assets of $3.8 million. The weighted average amortization period for all purchased intangible assets is 3.3 years. The acquired IPR&D of $4.1 million was written off and the related charge was expensed in the statement of operations in the first quarter of 2003. Acquisition-related costs of $3.2 million consist of $2.7 million associated with terminating and satisfying remaining lease commitments, partially offset by sublease income net of related sublease costs, and direct transaction costs of $0.5 million for legal and other professional fees. Total cash outlays for acquisition-related costs were $1.6 million through March 31, 2004. The results of operations of Jareva are included in the Company s consolidated financial statements from the date of acquisition. The pro forma impact on the Company s results of operations is not significant.

6. Goodwill and Other Intangible Assets

On January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. As a result, the Company no longer amortizes goodwill but will test it for impairment annually or whenever events or changes in circumstances suggest that the carrying amount may not be recoverable.

The following table sets forth the carrying amount of goodwill. Goodwill also includes amounts originally allocated to assembled workforce:

(in thousands)	March 31, 2004	December 31, 2003
Goodwill:		
Gross carrying amount	$ 3,895,936	$ 3,842,218
	(2,086,627)	(2,086,627)

Less accumulated amortization		
Net carrying amount of goodwill	$ 1,809,309	$ 1,755,591

During the first quarter of 2004, the Company acquired Ejasent (see Note 5), which increased goodwill by $53.7 million.

The following tables set forth the carrying amount of other intangible assets that will continue to be amortized:

	March 31, 2004		
(in thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
Developed technology	$299,749	$241,244	$58,505
Distribution channels	234,800	234,800	
Trademarks	26,650	25,213	1,437
Other intangible assets	52,074	35,983	16,091
Intangibles related to acquisitions	613,273	537,240	76,033
Convertible subordinated notes issuance costs	12,401	2,743	9,658
Total other intangibles	$625,674	$539,983	$85,691

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	December 31, 2003		
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$287,949	$237,043	$50,906
Distribution channels	234,800	234,800	
Trademarks	26,650	24,925	1,725
Other intangible assets	51,734	33,714	18,020
Intangibles related to business acquisitions	601,133	530,482	70,651
Convertible subordinated notes issuance costs	12,401	1,708	10,693
Total other intangibles	$613,534	$532,190	$81,344

Total amortization expense of intangible assets related to acquisitions is set forth in the table below:

	Three Months Ended March 31,	
(in thousands)	2004	2003
Developed technology	$ 4,201	$ 15,098
Distribution channels		14,675
Trademarks	288	1,522
Other intangible assets	2,269	2,056
Total amortization expense	$ 6,758	$ 33,351

For the three months ended March 31, 2004 and 2003, total amortization expense for intangible assets includes approximately $0.5 million and $0.4 million, respectively, that is included in cost of user license fees.

The total expected future annual amortization of intangible assets related to acquisitions is set forth in the table below:

Future

(in thousands)	Amortization
2004	$18,966
2005	23,167
2006	21,144
2007	10,699
2008	1,912
2009	145
Total	$76,033