

NETWORKS ASSOCIATES INC/

Form 10-Q/A

June 28, 2002

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Form 10-Q/ A**

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

**For the quarterly period ended June 30, 2001  
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 0-20558**

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**Networks Associates, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State of incorporation)*

**77-0316593**  
*(IRS Employer Identification Number)*

**3965 Freedom Circle**

**Santa Clara, California 95054  
(408) 988-3832**

*(Address and telephone number of principal executive offices)*

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Indicate by check mark whether 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, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

137,374,939 shares of the registrant's common stock, \$0.01 par value, were outstanding as of June 30, 2001.

**EXPLANATORY NOTE:**

THIS 10-Q/A IS BEING FILED FOR THE PURPOSE OF AMENDING AND RESTATING ITEMS 1, 2 AND 3 OF PART I OF FORM 10-Q TO REFLECT THE RESTATEMENT OF OUR CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE PERIODS ENDED JUNE 30, 2001 AND 2000. WE HAVE MADE NO FURTHER CHANGES TO THE PREVIOUSLY FILED 10-Q. ALL INFORMATION IN THE FORM 10-Q/A IS AS OF JUNE 30, 2001 AND DOES NOT REFLECT ANY SUBSEQUENT INFORMATION OR EVENTS OTHER THAN THE RESTATEMENT.

**This document contains 54 pages.**

**The Exhibit Index is on page 51.**

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**NETWORKS ASSOCIATES, INC.**

**FORM 10-Q/ A,**

**June 30, 2001**

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## NETWORKS ASSOCIATES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2001	December 31, 2000
	(As restated see Note 2)	(As restated see Note 2)
	(In thousands, except share and per share data) (Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 358,387	\$ 275,539
Short-term marketable securities	73,281	85,721
Accounts receivable, net	86,523	122,315
Prepaid expenses, income taxes and other current assets	39,278	50,346
Deferred taxes	104,644	86,771
	<hr/>	<hr/>
Total current assets	662,113	620,692
Long-term marketable securities	218,904	332,893
Fixed assets, net	71,705	75,499
Deferred taxes	117,412	120,261
Intangibles and other assets	210,659	242,275
	<hr/>	<hr/>
Total assets	\$ 1,280,793	\$ 1,391,620
	<hr/>	<hr/>
<b>LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 21,360	\$ 46,816
Accrued liabilities	253,875	254,282
Deferred revenue	183,292	151,566
	<hr/>	<hr/>
Total current liabilities	458,527	452,664
Deferred taxes	6,500	7,971
Deferred revenue, less current portion	30,133	26,592
Convertible debt	405,391	396,336
Other long-term debt and liabilities	427	532
	<hr/>	<hr/>
Total liabilities	900,978	884,095
Contingencies (Note 9)		
Minority interest	10,656	11,067
Common stock, \$0.01 par value; Authorized: 300,000,000; Issued: 139,328,528 shares at June 30, 2001 and December 31, 2000; Outstanding: 137,374,939 shares at June 30, 2001 and 138,089,775 shares at December 31, 2000.	1,393	1,381
Treasury stock, at cost: 1,953,589 shares at June 30, 2001 and 1,238,753 shares at December 31, 2000.	(52,411)	(23,186)
Additional paid-in capital	689,694	685,423
Accumulated other comprehensive loss	(30,890)	(31,266)
Accumulated deficit	(238,627)	(135,894)
	<hr/>	<hr/>
Total stockholders equity	369,159	496,458
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Total liabilities, minority interest, and stockholders' equity	\$1,280,793	\$1,391,620
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The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****NETWORKS ASSOCIATES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND  
COMPREHENSIVE INCOME (LOSS)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(As reclassified see Note 2)	(As restated and reclassified see Note 2)	(As reclassified see Note 2)	(As restated and reclassified see Note 2)
	(In thousands, except per share data) (Unaudited)			
Net revenue:				
Product	\$ 132,368	\$ 164,321	\$ 224,869	\$ 303,992
Services and support	60,194	55,720	123,289	103,237
Total net revenue	192,562	220,041	348,158	407,229
Cost of net revenue:				
Product	25,421	29,265	48,881	52,003
Services and support	14,233	9,637	27,460	18,912
Total cost of net revenue	39,654	38,902	76,341	70,915
Operating costs and expenses:				
Research and development(1)	34,886	42,885	74,859	84,060
Marketing and sales(2)	102,427	95,700	203,244	189,015
General and administrative(3)	26,883	24,475	49,022	37,888
Amortization of intangibles	16,672	14,932	32,517	29,362
Total operating cost and expenses	180,868	177,992	359,642	340,325
Income (loss) from operations	(27,960)	3,147	(87,825)	(4,011)
Interest and other income and expense, net	3,168	6,317	9,530	13,569
Gain on investments, net				40,373
Write-down of strategic and other investments	(13,138)		(18,138)	
Income (loss) before provision for income tax and minority interest	(37,930)	9,464	(96,433)	49,931
Provision for (benefit from) income taxes	(732)	7,500	(11,172)	28,499
Net income (loss) before minority interest	(37,198)	1,964	(85,261)	21,432
Minority interest in losses of consolidated subsidiaries	19	1,213	721	2,336
Net income (loss)	\$ (37,179)	\$ 3,177	\$ (84,540)	\$ 23,768
Other comprehensive income (loss), net	\$ 8,705	\$ (7,550)	\$ 376	\$ (3,885)
Comprehensive income (loss)	\$ (28,474)	\$ (4,373)	\$ (84,164)	\$ 19,883
Net income (loss) per share basic	\$ (0.27)	\$ 0.02	\$ (0.62)	\$ 0.17
Shares used in per share calculation basic	136,879	138,072	137,010	138,475



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Net income (loss) per share	diluted	\$ (0.27)	\$ 0.02	\$ (0.62)	\$ 0.17
		<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>
Shares used in per share calculation	diluted	136,879	142,238	137,010	143,272
		<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>

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- (1) Includes stock-based compensation charge of \$107, \$394, \$198 and \$848 for the three months and six months ended June 30, 2001 and 2000, respectively.
- (2) Includes stock-based compensation charge of \$169, \$625, \$313 and \$1,345 for the three months and six months ended June 30, 2001 and 2000, respectively.
- (3) Includes stock-based compensation charge of \$931, \$340, \$2,352 and \$732 for the three months and six months ended June 30, 2001 and 2000, respectively.

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

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## NETWORKS ASSOCIATES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2001	2000
		(As restated see Note 2)
		(In thousands)
		(Unaudited)
Cash flows from operating activities:		
Net income (loss)	\$ (84,540)	\$ 23,768
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and bad debt expense	41,852	40,251
Interest on convertible notes	9,422	8,983
Realized gain on investments	(3,876)	141
Write-down of strategic investments	18,138	
Minority interest	(721)	(2,336)
Deferred taxes	(17,657)	(23,147)
Stock compensation charges	2,863	2,925
Gain on sale of Goto.com investment		(28,551)
Gain on sale of Network Associates Japan investment		(11,947)
Changes in assets and liabilities:		
Accounts receivable	42,368	(3,029)
Prepaid expenses, income taxes and other	7,938	(22,002)
Accounts payable and accrued liabilities	(23,120)	61,577
Deferred revenue	38,367	20,174
	<u>31,034</u>	<u>66,807</u>
Cash flows from investing activities:		
Purchase of marketable securities	(300,052)	(247,969)
Proceeds from sale of marketable securities	421,698	254,111
Purchase of investments		(17,650)
Proceeds from sale of Goto.com investment		36,750
Proceeds from sale of shares of Network Associates Japan		11,947
Purchase of shares of Network Associates Japan	(10,655)	
Acquisitions by subsidiary		(1,959)
Additions to fixed assets	(13,435)	(30,128)
	<u>97,556</u>	<u>5,102</u>
Cash flows from financing activities:		
Repayment of notes payable		(67)
Proceeds from issuance of common stock from option plan and stock purchase plans	8,842	14,768
Repurchase of common stock	(53,800)	(62,859)
Other	(779)	1,606
Proceeds from sale of put options		13,890
	<u>(45,737)</u>	<u>(32,662)</u>
Effect of exchange rate fluctuations	(5)	(31,868)

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Net increase in cash and cash equivalents	82,848	7,379
Cash and cash equivalents at beginning of period	275,539	316,784
Cash and cash equivalents at end of period	\$ 358,387	\$ 324,163

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

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**NETWORKS ASSOCIATES, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. Basis of Presentation**

The unaudited, condensed consolidated financial statements have been prepared by Networks Associates, Inc. (the Company) without audit in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X. The unaudited, condensed consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The Company has two reportable segments consisting of computer security and management software, and managed security and availability application services to business users on the Internet (Infrastructure) and consumer PC security and management software on the Internet (McAfee.com).

In the opinion of management, all adjustments, consisting only of normal recurring adjustments considered necessary for a fair presentation, have been included. The results of operations for the three month and six month periods ended June 30, 2001 are not necessarily indicative of the results to be expected for the full year or for any future periods. The accompanying unaudited, condensed consolidated financial statements should be read in conjunction with the restated audited consolidated financial statements contained in the Company's Annual Report on Form 10-K/a filed with the Securities and Exchange Commission on June 28, 2002. The balance sheet at December 31, 2000 has been derived from the audited financial statements as of and for the year ended December 31, 2000, but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements.

Certain reclassifications have been made to the 2000 consolidated condensed financial statements and related notes to conform to the 2001 presentation.

**2. Restatement and Adoption of New Accounting Pronouncements:**

On April 25, 2002 the Company announced that it had discovered accounting inaccuracies in certain prior period financial statements, requiring restatement of the financial statements for these periods. The Company conducted an internal investigation under the direction of the Audit Committee of its Board of Directors to determine the scope and magnitude of these inaccuracies. On May 17, 2002, the Company announced that the Audit Committee of its Board of Directors had completed its internal accounting investigation. As a result of the internal accounting investigation, the Company's statement of operations, cash flows and stockholders' equity for the years ended December 31, 2000, 1999 and 1998 and the balance sheets as of December 31, 2000, 1999 and 1998 are being restated. In addition, to give effect to accumulated prior period adjustments and their related tax impacts, the Company announced the restatement of its December 31, 2000 and March 31, 2001 balance sheets. As a result, the Company is also restating its condensed consolidated statements of operations and cash flows for the three and six months ended June 30, 2000 and condensed consolidated balance sheet as of June 30, 2001, which are included in this Form 10-Q/A. The statements of operations and cash flows for the periods ended June 30, 2001 were not impacted by this restatement.

The Audit Committee's investigation determined that inaccurate accounting entries were made in 2000, 1999 and 1998, which required restatement. In 2000, these entries (a) recorded payments to a distributor in a balance sheet tax liability account instead of reducing Net revenue, (b) reclassified amounts from a tax liability account to the general and administrative and marketing and sales liability accounts, understating general and administrative and marketing and sales expenses, (c) recorded additions to sales return reserves as tax expense rather than as a reduction of Net revenue, (d) increased a tax liability account by reducing Net revenue and (e) adjusted the foreign currency accounts resulting in an overstatement of Net revenue and an understatement of Interest and other income. Additional entries had the effect of overstating Net revenue, overstating Operating costs and expenses, and understating Interest and other income. In the aggregate for 2000, the adjustments for these entries and related tax effects increased previously reported net loss by \$21.2

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**NETWORKS ASSOCIATES, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

million from \$102.7 million to \$123.9 million, and increased previously reported basic and diluted net loss by \$0.16 per share.

Generally, the entries in 1999 reclassified amounts from the tax liability accounts to operating expense liability accounts and sales return reserves. In the aggregate for 1999, the adjustments for these entries and related tax effects reduced previously reported net loss by \$3.0 million from \$159.9 million to \$156.9 million, and reduced previously reported basic and diluted net loss by \$0.02 per share.

The entries made during 1998 reclassified amounts from the tax liability accounts to operating expense liability accounts. In the aggregate for 1998, the adjustments for these entries and related tax effects reduced previously reported net income by \$4.0 million from \$36.4 million to \$32.4 million, and reduced previously reported basic and diluted net income by \$0.03 per share.

The results of the Audit Committee's investigation and the required restatement are set forth and described in greater detail in Network Associates' audited consolidated financial statements contained in the 2001 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on June 28, 2002.

During the three months ended March 31, 2002, the Company adopted the Financial Accounting Standards Board's Emerging Issues Task Force Statement No. 01-09, entitled "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products (EITF 01-09)". EITF 01-09 requires that payments to customers or reductions in their accounts receivable for certain marketing related amounts previously classified as charges to marketing expense be recorded as reductions of revenue. Upon adoption of EITF 01-09, the Company is required to retroactively reclassify amounts recognized for such payments in previously issued financial statements to comply with the income statement display requirements of the consensus.

The condensed consolidated balance sheets as of June 30, 2001 and December 31, 2000 and the condensed consolidated statements of operations for the three and six months ended June 30, 2000 contained herein have been restated to incorporate the adjustments described herein and the related tax effects. In addition, the Company reclassified amounts of approximately \$3.4 million and \$5.6 million for the three months ended June 30, 2001 and 2000, respectively, and \$18.1 million and \$14.6 million for the six months ended June 30, 2001 and 2000, respectively, from marketing and sales expense to revenue upon the adoption of EITF 01-09.

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The following are reconciliations of the Company's financial position and results of operations from financial statements previously filed to the restated and reclassified financial statements (in thousands, except per share data):

**Balance Sheet as of June 30, 2001**

	As Previously Reported	Cumulative Effect of Prior Year Changes	As Restated
Cash and cash equivalents	\$ 358,387	\$	\$ 358,387
Short-term marketable securities	73,281		73,281
Accounts receivable, net	86,523		86,523
Prepaid expenses, income taxes and other current assets	39,278		39,278
Deferred taxes	104,644		104,644
	<hr/>	<hr/>	<hr/>
Total current assets	662,113		662,113
Long-term marketable securities	218,904		218,904
Fixed assets, net	71,705		71,705
Deferred taxes	110,640	6,772	117,412
Intangible assets and other assets	210,659		210,659
	<hr/>	<hr/>	<hr/>
Total assets	\$ 1,274,021	\$ 6,772	\$ 1,280,793
	<hr/>	<hr/>	<hr/>
Accounts payable	\$ 21,360	\$	\$ 21,360
Accrued liabilities	224,910	28,965	253,875
Deferred revenue	183,292		183,292
	<hr/>	<hr/>	<hr/>
Total current liabilities	429,562	28,965	458,527
Deferred taxes	6,500		6,500
Deferred revenue, less current portion	30,133		30,133
Convertible debt	405,391		405,391
Other long term debt and liabilities	427		427
	<hr/>	<hr/>	<hr/>
Total liabilities	872,013	28,965	900,978
	<hr/>	<hr/>	<hr/>
Minority interest	10,656		10,656
Common stock	1,393		1,393
Treasury stock	(52,411)		(52,411)
Additional paid-in capital	689,694		689,694
Accumulated other comprehensive loss	(30,890)		(30,890)
Accumulated deficit	(216,434)	(22,193)	(238,627)
	<hr/>	<hr/>	<hr/>
Total stockholders' equity	391,352	(22,193)	369,159
	<hr/>	<hr/>	<hr/>
Total liabilities, minority interest and stockholders' equity	\$ 1,274,021	\$ 6,772	\$ 1,280,793
	<hr/>	<hr/>	<hr/>



**Table of Contents****NETWORKS ASSOCIATES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Balance Sheet as of December 31, 2000**

	<u>As Previously Reported</u>	<u>Cumulative Effect of Prior Year Changes</u>	<u>Inaccuracies</u>	<u>As Restated</u>
Cash and cash equivalents	\$ 275,539	\$	\$	\$ 275,539
Short-term marketable securities	85,721			85,721
Accounts receivable, net	122,315			122,315
Prepaid expenses, income taxes and other current assets	50,346			50,346
Deferred taxes	86,771			86,771
	<u>620,692</u>			<u>620,692</u>
Total current assets	620,692			620,692
Long-term marketable securities	332,893			332,893
Fixed assets, net	75,499			75,499
Deferred taxes	113,489	10,403	(3,631)	120,261
Intangible assets and other assets	242,275			242,275
	<u>1,384,848</u>	<u>10,403</u>	<u>(3,631)</u>	<u>1,391,620</u>
Total assets	\$ 1,384,848	\$ 10,403	\$ (3,631)	\$ 1,391,620
Accounts payable	\$ 46,816	\$	\$	\$ 46,816
Accrued liabilities	225,317	11,391	17,574	254,282
Deferred revenue	151,566			151,566
	<u>423,699</u>	<u>11,391</u>	<u>17,574</u>	<u>452,664</u>
Total current liabilities	423,699	11,391	17,574	452,664
Deferred taxes	7,971			7,971
Deferred revenue, less current portion	26,592			26,592
Convertible debt	396,336			396,336
Other long term debt and liabilities	532			532
	<u>855,130</u>	<u>11,391</u>	<u>17,574</u>	<u>884,095</u>
Total liabilities	855,130	11,391	17,574	884,095
Minority interest	11,067			11,067
Common stock	1,381			1,381
Treasury stock	(23,186)			(23,186)
Additional paid-in capital	685,423			685,423
Accumulated other comprehensive loss	(31,266)			(31,266)
Accumulated deficit	(113,701)	(988)	(21,205)	(135,894)
	<u>518,651</u>	<u>(988)</u>	<u>(21,205)</u>	<u>496,458</u>
Total stockholders equity	518,651	(988)	(21,205)	496,458
	<u>1,384,848</u>	<u>10,403</u>	<u>(3,631)</u>	<u>1,391,620</u>
Total liabilities, minority interest and stockholders equity	\$ 1,384,848	\$ 10,403	\$ (3,631)	\$ 1,391,620



**Table of Contents****NETWORKS ASSOCIATES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Statement of Operations for the Three Months Ended June 30, 2000**

	<u>As Previously Reported</u>	<u>Inaccuracies</u>	<u>EITF No. 01-09 Reclassifications</u>	<u>As Restated and Reclassified</u>
<b>Net revenue:</b>				
Product	\$ 177,952	\$ (8,000)	\$ (5,631)	\$ 164,321
Services and support	55,720			55,720
	<u>233,672</u>	<u>(8,000)</u>	<u>(5,631)</u>	<u>220,041</u>
<b>Cost of net revenue:</b>				
Product	29,265			29,265
Services and support	9,637			9,637
	<u>38,902</u>	<u></u>	<u></u>	<u>38,902</u>
<b>Operating costs and expenses:</b>				
Research and development	42,885			42,885
Marketing and sales	98,831	2,500	(5,631)	95,700
General and administrative	21,975	2,500		24,475
Amortization of intangibles	14,932			14,932
	<u>178,623</u>	<u>5,000</u>	<u>(5,631)</u>	<u>177,992</u>
Income from operations	16,147	(13,000)		3,147
Interest and other income and expense, net	5,967	350		6,317
	<u>22,114</u>	<u>(12,650)</u>	<u></u>	<u>9,464</u>
Provision for income taxes	11,928	(4,428)		7,500
	<u>10,186</u>	<u>(8,222)</u>	<u></u>	<u>1,964</u>
Net income before minority interest	10,186	(8,222)		1,964
Minority interest in losses of consolidated subsidiaries	1,213			1,213
	<u>\$ 11,399</u>	<u>\$ (8,222)</u>	<u>\$</u>	<u>\$ 3,177</u>
<b>Basic and diluted net income per share:</b>				
Net income per share basic	\$ 0.08			\$ 0.02
Net income per share diluted	\$ 0.08			\$ 0.02
Basic shares	138,072			138,072
Diluted shares	142,238			142,238

**Table of Contents****NETWORKS ASSOCIATES, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Statement of Operations for the Six Months Ended June 30, 2000**

	<u>As Previously Reported</u>	<u>Inaccuracies</u>	<u>EITF No. 01-09 Reclassifications</u>	<u>As Restated and Reclassified</u>
Net revenue:				
Product	\$ 344,891	\$(26,288)	\$(14,611)	\$ 303,992
Services and support	103,237			103,237
	<u>448,128</u>	<u>(26,288)</u>	<u>(14,611)</u>	<u>407,229</u>
Cost of net revenue:				
Product	53,003	(1,000)		52,003
Services and support	18,912			18,912
	<u>71,915</u>			