VMWARE, INC.
Form 10-Q
November 03, 2011
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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 September 30, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For transition period from to

Commission File Number 001-33622

VMWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3292913**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification Number)**
3401 Hillview Avenue	
Palo Alto, CA	**94304**
(Address of principal executive offices)	**(Zip Code)**

(650) 427-5000

(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 ¨

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 ¨ No x

As of October 21, 2011, the number of shares of common stock, par value $0.01 per share, of the registrant outstanding was 422,179,225, of which 122,179,225 shares were Class A common stock and 300,000,000 were Class B common stock.

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VMware, VMworld, VMware vSphere, VMware View, Cloud Foundry, Zimbra and SpringSource are registered trademarks or trademarks of VMware, Inc. in the United States and/or other jurisdictions. All other marks and names mentioned herein may be trademarks of their respective companies.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VMware, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010
Operating activities:				
Net income	$ 177,538	$ 84,600	$ 523,508	$ 237,559
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	73,985	71,117	229,643	183,461
Stock-based compensation, excluding amounts capitalized	88,379	73,657	254,394	205,190
Excess tax benefits from stock-based compensation	(46,428)	(78,703)	(197,692)	(167,204)
Gain on sale of Terremark investment			(56,000)	
Other	6,968	261	10,794	6,120
Changes in assets and liabilities, net of acquisitions:				
Accounts receivable	46,174	51,553	72,757	159,241
Other assets	(57,402)	(59,179)	(91,455)	(83,430)
Due to/from EMC, net	17,505	13,629	42,940	15,931
Accounts payable	(10,846)	(1,971)	(12,553)	4,589
Accrued expenses	(19,539)	1,631	14,672	28,527
Income taxes receivable from EMC	69,796		246,240	2,508
Income taxes payable	14,321	11,697	51,922	42,821
Deferred income taxes, net	10,231	(4,088)	9,273	(8,435)
Unearned revenue	152,829	32,495	365,781	140,896
Net cash provided by operating activities	523,511	196,699	1,464,224	767,774
Investing activities:				
Additions to property and equipment	(54,948)	(31,137)	(177,180)	(91,245)
Purchase of leasehold interest (see Note G)	22,043		(151,083)	
Capitalized software development costs	(21,139)	(7,023)	(73,998)	(48,194)
Purchases of available-for-sale securities	(955,686)	(964,655)	(2,083,491)	(1,624,706)
Sales of available-for-sale securities	231,705	124,218	608,293	124,218
Maturities of available-for-sale securities	231,738	30,894	724,707	30,894
Sale of strategic investments		2,648	78,513	2,648
Business acquisitions, net of cash acquired	(99,522)	(125,820)	(303,610)	(292,970)
Transfer of net assets under common control	(1,930)		(22,393)	(175,000)
Other investing	(3,230)		(30,372)	206
Net cash used in investing activities	(650,969)	(970,875)	(1,430,614)	(2,074,149)

Financing activities:				
Proceeds from issuance of common stock	84,572	139,939	285,286	355,846
Repurchase of common stock	(210,527)	(141,440)	(490,916)	(285,940)
Excess tax benefits from stock-based compensation	46,428	78,703	197,692	167,204
Shares repurchased for tax withholdings on vesting of restricted stock	(34,230)	(24,533)	(104,808)	(70,116)
Net cash provided by (used in) financing activities	(113,757)	52,669	(112,746)	166,994
Net decrease in cash and cash equivalents	(241,215)	(721,507)	(79,136)	(1,139,381)
Cash and cash equivalents at beginning of the period	1,791,044	2,068,587	1,628,965	2,486,461
Cash and cash equivalents at end of the period	$ 1,549,829	$ 1,347,080	$ 1,549,829	$ 1,347,080
Non-cash items:				
Changes in capital additions, accrued but not paid	$ 15,126	$ 3,252	$ 21,347	$ 5,087
Changes in tax withholdings on vesting of restricted stock, accrued but not paid	(2,125)		813	

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

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VMware, Inc.

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010
Revenues:				
License	$ 443,597	$ 343,239	$ 1,327,402	$ 979,081
Services	498,266	371,006	1,379,392	1,042,601
	941,863	714,245	2,706,794	2,021,682
Operating expenses (1):				
Cost of license revenues	46,063	46,333	151,009	126,723
Cost of services revenues	106,678	80,229	304,104	226,641
Research and development	199,655	175,429	558,059	475,297
Sales and marketing	331,626	251,745	949,110	700,236
General and administrative	77,120	66,497	223,397	195,406
Operating income	180,721	94,012	521,115	297,379
Investment income	4,351	2,349	11,472	4,029
Interest expense with EMC	(915)	(1,245)	(2,846)	(3,103)
Other income (expense), net	(998)	1,629	55,806	(6,977)
Income before income taxes	183,159	96,745	585,547	291,328
Income tax provision	5,621	12,145	62,039	53,769
Net income	$ 177,538	$ 84,600	$ 523,508	$ 237,559
Net income per weighted-average share, basic for Class A and Class B	$ 0.42	$ 0.21	$ 1.25	$ 0.58
Net income per weighted-average share, diluted for Class A and Class B	$ 0.41	$ 0.20	$ 1.21	$ 0.56
Weighted-average shares, basic for Class A and Class B	422,030	411,755	420,247	408,082
Weighted-average shares, diluted for Class A and Class B	431,881	426,581	431,846	421,949

(1) Includes stock-based compensation as follows:				
Cost of license revenues	$ 367	$ 395	$ 1,271	$ 1,170
Cost of services revenues	6,068	4,387	17,396	12,601
Research and development	46,663	43,124	134,621	117,292
Sales and marketing	24,763	18,102	70,550	49,601
General and administrative	10,518	7,649	30,556	24,526

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

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VMware, Inc.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,549,829	$ 1,628,965
Short-term investments	2,426,870	1,694,675
Accounts receivable, net of allowance for doubtful accounts of $2,768 and $4,519	548,027	614,726
Due from EMC, net	12,489	55,481
Deferred tax asset	127,740	100,689
Other current assets	147,901	203,119
Total current assets	4,812,856	4,297,655
Property and equipment, net	516,661	419,065
Capitalized software development costs, net and other	177,420	151,945
Deferred tax asset	126,631	149,126
Intangible assets, net	426,584	210,928
Goodwill	1,760,269	1,568,600
Total assets	$ 7,820,421	$ 6,797,319
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 57,812	$ 58,913
Accrued expenses and other	508,149	459,813
Unearned revenues	1,468,126	1,270,426
Total current liabilities	2,034,087	1,789,152
Note payable to EMC	450,000	450,000
Unearned revenues	765,992	589,668
Deferred tax liability	4,899	30,096
Other liabilities	111,546	129,960
Total liabilities	3,366,524	2,988,876
Commitments and contingencies (see Note K)		
Stockholders equity:		
Class A common stock, par value $.01; authorized 2,500,000 shares; issued and outstanding 122,076 and 116,701 shares	1,221	1,167
Class B convertible common stock, par value $.01; authorized 1,000,000 shares; issued and outstanding 300,000 shares	3,000	3,000
Additional paid-in capital	3,096,738	2,955,971
Accumulated other comprehensive income	760	19,635
Retained earnings	1,352,178	828,670
Total stockholders equity	4,453,897	3,808,443

Total liabilities and stockholders equity	$ 7,820,421	$ 6,797,319

The accompanying notes are an integral part of the consolidated financial statements

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

A. Overview and Basis of Presentation

Company and Background

VMware, Inc. (VMware or the Company) is the leading provider of virtualization and virtualization-based cloud infrastructure solutions. VMware s virtualization infrastructure software solutions run on industry-standard desktop computers and servers and support a wide range of operating system and application environments, as well as networking and storage infrastructures.

Accounting Principles

The financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America.

Unaudited Interim Financial Information

These accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. In the opinion of management, these unaudited consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, for a fair statement of VMware s consolidated cash flows, results of operations and financial condition for the periods presented. Results of operations are not necessarily indicative of the results that may be expected for the full year 2011. Certain information and footnote disclosures typically included in annual consolidated financial statements have been condensed or omitted. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in VMware s 2010 Annual Report on Form 10-K.

VMware was incorporated as a Delaware corporation in 1998 and continues to operate in large measure as a stand-alone company following the Company s acquisition by EMC Corporation (EMC) in 2004 and following VMware s initial public offering of VMware s Class A common stock in August 2007. As of September 30, 2011, EMC holds 79.8% of VMware s outstanding common stock, including 37.0 million shares of VMware s Class A common stock and all of VMware s Class B common stock. VMware is considered a controlled company under the rules of the New York Stock Exchange. VMware historically has received, and continues to receive, certain administrative services from EMC, and VMware and EMC engage in certain intercompany transactions. Costs incurred by EMC for the direct benefit of VMware, such as salaries and benefits, travel and rent, plus a mark-up intended to approximate third-party costs, are included in VMware s consolidated financial statements. In addition, beginning in the three months ended June 30, 2011, VMware incurs costs to operate the Mozy service on behalf of EMC. These costs, plus a mark-up intended to approximate third-party costs, are reimbursed to VMware by EMC and recorded as a reduction to the costs VMware incurred on the consolidated statements of income.

Management believes the assumptions underlying the consolidated financial statements are reasonable. However, the amounts recorded for VMware s intercompany transactions with EMC may not be considered arm s length with an unrelated third party by nature of EMC s majority ownership of VMware. Therefore, the financial statements included herein may not necessarily reflect the cash flows, results of operations and financial condition had VMware engaged in such transactions with an unrelated third party during all periods presented. Accordingly, VMware s historical financial information is not necessarily indicative of what the Company s cash flows, results of operations and financial condition will be in the future if and when VMware contracts at arm s length with unrelated third parties for services the Company receives from and provides to EMC.

Principles of Consolidation

The consolidated financial statements include the accounts of VMware and its subsidiaries. All intercompany transactions and balances between VMware and its subsidiaries have been eliminated. All intercompany transactions with EMC in the consolidated statements of cash flows will be settled in cash, and changes in the intercompany balances are presented as a component of cash flows from operating activities.

Use of Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses during the reporting periods, and the disclosure of contingent liabilities at the date of the financial statements. Estimates are used for, but not limited to, capitalized software development costs, trade receivable valuation, certain accrued liabilities, useful lives of fixed assets and intangible assets, valuation of acquired intangibles, revenue reserves, income taxes, stock-based compensation and contingencies. Actual results could differ from those estimates.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Comprehensive income will either have to be presented in one continuous statement of comprehensive income or two separate consecutive statements. ASU 2011-05 is effective for each reporting entity s first annual reporting period that begins after December 15, 2011. VMware plans to adopt ASU 2011-05 on January 1, 2012 and will present comprehensive income in accordance with the requirements of the standard.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards* (ASU 2011-04). ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. ASU 2011-04 is effective for each reporting entity s first interim and annual reporting period that begins after December 15, 2011 and should be applied prospectively. Early application is not permitted. VMware is currently evaluating the impact of adopting ASU 2011-04, but currently believes there will be no significant impact on its consolidated financial statements.

B. Research and Development and Capitalized Software Development Costs

Costs related to research and development (R&D) are generally charged to expense as incurred. Capitalization of development costs of software to be sold, leased, or otherwise marketed are subject to capitalization beginning when technological feasibility has been established and ending when the product is available for general release. Judgment is required in determining when technological feasibility is established. As the Company s business, products and go-to-market strategy evolve, VMware continues to evaluate when technological feasibility is established. Changes in judgment as to when technological feasibility is established would likely materially impact the amount of costs capitalized compared to historical periods. For example, if the length of time between technological feasibility and general availability declines in the future, the amount of costs capitalized would likely decrease with a corresponding increase in R&D expense. In addition, VMware s R&D expenses and amounts capitalized as software development costs may not be comparable to VMware s peer companies due to differences in judgment as to when technological feasibility has been reached or differences in judgment regarding when the product is available for general release. Generally accepted accounting principles require annual amortization expense of capitalized software development costs to be the greater of the amounts computed using the ratio of current gross revenue to a product s total current and anticipated revenues, or the straight-line method over the product s remaining estimated economic life. To date, VMware has amortized these costs using the straight-line method as it is the greater of the two amounts. The costs are amortized over periods ranging from 18 to 24 months, which represent the product s estimated economic life. The ongoing assessment of the recoverability of these costs requires considerable judgment by management with respect to certain external factors such as anticipated future revenue, estimated economic life, and changes in software and hardware technologies. Material differences in amortization amounts could occur as a result of changes in the periods over which VMware actually generates revenues or the amounts of revenues generated.

Unamortized software development costs were $127.0 million and $103.3 million as of September 30, 2011 and December 31, 2010, respectively, and are included in capitalized software development costs, net and other on the consolidated balance sheets.

In the three months ended September 30, 2011 and 2010, VMware capitalized $24.5 million (including $3.4 million of stock-based compensation) and $8.3 million (including $1.2 million of stock-based compensation), respectively, of costs incurred for the development of software products. In the nine months ended September 30, 2011 and 2010, VMware capitalized $86.4 million (including $12.4 million of stock-based compensation) and $54.6 million (including $8.1 million of stock-based compensation), respectively, of costs incurred for the development of software products. These amounts have been excluded from R&D expenses on the accompanying consolidated statements of income. Amortization expense from capitalized amounts was $14.4 million and $26.1 million for the three months ended September 30, 2011 and 2010, respectively. Amortization expense from capitalized amounts was $62.7 million and $71.1 million for the nine months ended September 30, 2011 and 2010, respectively. Amortization expense is included in cost of license revenues on the consolidated statements of income.

C. Earnings per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted-average number of common shares outstanding and potentially dilutive securities outstanding during the period, as calculated using the treasury stock method. Potentially dilutive securities include stock options, unvested restricted stock units, unvested restricted stock awards, other unvested restricted stock, and purchase options under VMware s employee stock purchase plan. Securities are excluded from the computations of diluted net income per share if their effect would be anti-dilutive. As of September 30, 2011, VMware had 122.1 million shares of Class A common stock and 300.0 million shares of Class B common stock outstanding that were included in the calculation of basic earnings per share. VMware uses the two-class method to calculate earnings per share as both classes share the same rights in dividends, therefore basic and diluted earnings per share are the same for both classes.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The following table sets forth the computations of basic and diluted net income per share for the three and nine months ended September 30, 2011 and 2010 (table in thousands, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	$ 177,538	$ 84,600	$ 523,508	$ 237,559
Weighted-average shares, basic for Class A and Class B	422,030	411,755	420,247	408,082
Effect of dilutive securities	9,851	14,826	11,599	13,867
Weighted-average shares, diluted for Class A and Class B	431,881	426,581	431,846	421,949
Net income per weighted-average share, basic for Class A and Class B	$ 0.42	$ 0.21	$ 1.25	$ 0.58
Net income per weighted-average share, diluted for Class A and Class B	$ 0.41	$ 0.20	$ 1.21	$ 0.56

For the three months ended September 30, 2011 and 2010, stock options to purchase 0.8 million and 1.6 million shares, respectively, of VMware Class A common stock were excluded from the diluted earnings per share calculations because their effect would have been anti-dilutive. For the nine months ended September 30, 2011 and 2010, stock options to purchase 0.9 million and 3.3 million shares, respectively, of VMware Class A common stock were excluded from the diluted earnings per share calculations because their effect would have been anti-dilutive. For all periods presented, the shares of restricted stock excluded from the diluted earnings per share calculations were not material.

D. Investments

Investments as of September 30, 2011 and December 31, 2010 consisted of the following (tables in thousands):

	September 30, 2011			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. government and agency obligations	$ 479,692	$ 2,344	$ (71)	$ 481,965
U.S. and foreign corporate debt securities	1,055,944	910	(2,374)	1,054,480
Foreign governments and multi-national agency obligations	70,104	54	(84)	70,074
Municipal obligations	730,500	1,333	(478)	731,355
Asset-backed securities	29,413	9	(10)	29,412
Mortgage-backed securities	59,944	37	(397)	59,584
Total investments	$ 2,425,597	$ 4,687	$ (3,414)	$ 2,426,870

	December 31, 2010			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value

U.S. government and agency obligations	$ 379,288	$ 326	$ (310)	$ 379,304
U.S. and foreign corporate debt securities	522,677	724	(286)	523,115
Foreign governments and multi-national agency obligations	63,101	72	(13)	63,160
Municipal obligations	660,138	111	(762)	659,487
Asset-backed securities	17,800	9		17,809
Total fixed income securities	1,643,004	1,242	(1,371)	1,642,875
Equity securities	20,000	31,800		51,800
Total investments	$ 1,663,004	$ 33,042	$ (1,371)	$ 1,694,675

During the nine months ended September 30, 2011, a realized gain of $56.0 million was recorded in other income (expense), net on the consolidated income statement for the sale of VMware s investment in Terremark Worldwide, Inc., which was acquired by Verizon in a cash transaction. All other realized gains and realized losses on investments were not material for the three and nine months ended September 30, 2011 and 2010.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

As of September 30, 2011 and December 31, 2010, VMware had no investments that were in a continuous material unrealized loss position for twelve months or greater. Unrealized losses on investments as of September 30, 2011, and December 31, 2010, which have been in a net loss position for less than twelve months, were classified by investment category as follows (table in thousands):

	September 30, 2011		December 31, 2010	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government and agency obligations	$ 108,221	$ (71)	$ 109,932	$ (310)
U.S. and foreign corporate debt securities	564,859	(2,374)	149,831	(286)
Foreign governments and multi-national agency obligations	26,375	(84)	26,415	(13)
Municipal obligations	312,633	(478)	412,882	(762)
Asset-backed securities	7,051	(10)		
Mortgage-backed securities	46,134	(397)		
Total	$ 1,065,273	$ (3,414)	$ 699,060	$ (1,371)

VMware evaluated its investments as of September 30, 2011 and determined that there were no unrealized losses that indicated an other-than-temporary impairment.

Contractual Maturities

The contractual maturities of investments held at September 30, 2011 consisted of the following (table in thousands):

	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$ 1,143,021	$ 1,143,097
Due after 1 year through 5 years	1,203,990	1,205,526
Due after 5 years	78,586	78,247
Total investments	$ 2,425,597	$ 2,426,870

E. Fair Value Measurements and Derivative Instruments

Fair Value Measurements

Generally accepted accounting principles provide that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, generally accepted accounting principles established a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) inputs are quoted prices in active markets for identical assets or liabilities; (Level 2) inputs other than the quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and (Level 3) unobservable inputs for the assets or liabilities in which there is little or no market data, which requires VMware to develop its own assumptions.

VMware s Level 1 classification of the fair value hierarchy includes money market funds, available-for-sale equity securities and certain available-for-sale fixed income securities because these securities are valued using quoted prices in active markets for identical assets. VMware s Level 2 classification includes the remainder of the available-for-sale fixed income securities because these securities are priced using quoted market prices for similar instruments and non-binding market prices that are corroborated by observable market data. VMware does not have any material assets or liabilities that fall into Level 3 of the fair value hierarchy.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The following tables set forth the fair value hierarchy of VMware s money market funds and available-for-sale securities, including those securities classified within cash and cash equivalents on the consolidated balance sheet, that were required to be measured at fair value as of September 30, 2011 and December 31, 2010 (tables in thousands):

	September 30, 2011		
	Level 1	Level 2	Total
Money-market funds	$ 1,086,996	$	$ 1,086,996
U.S. government and agency obligations	186,330	300,635	486,965
U.S. and foreign corporate debt securities		1,133,962	1,133,962
Foreign governments and multi-national agency obligations		74,788	74,788
Municipal obligations		739,057	739,057
Asset-backed securities		29,412	29,412
Mortgage-backed securities		59,584	59,584
Total cash equivalents and investments	$ 1,273,326	$ 2,337,438	$ 3,610,764

	December 31, 2010		
	Level 1	Level 2	Total
Money-market funds	$ 1,436,319	$	$ 1,436,319
U.S. government and agency obligations	66,762	312,543	379,305
U.S. and foreign corporate debt securities		537,544	537,544
Foreign governments and multi-national agency obligations		63,161	63,161
Municipal obligations		659,487	659,487
Asset-backed securities		55,749	55,749
Equity securities	51,800		51,800
Total cash equivalents and investments	$ 1,554,881	$ 1,628,484	$ 3,183,365

VMware s valuation inputs for foreign currency forward contracts are based on quoted prices and quoted pricing intervals from public data sources. These contracts are typically classified within Level 2 of the fair value hierarchy and are discussed below in the derivative instruments section.

Derivative Instruments

In order to manage exposure to foreign currency fluctuations, VMware enters into foreign currency forward contracts to hedge a portion of its net outstanding monetary assets and liabilities against movements in certain foreign exchange rates. These forward contracts are not designated as hedging instruments under applicable accounting guidance, and therefore all changes in the fair value of the forward contracts are reported in other income (expense), net in the consolidated statements of income. The gains and losses on VMware s foreign currency forward contracts generally offset the majority of the gains and losses associated with the underlying foreign-currency denominated assets and liabilities that VMware hedges. VMware does not enter into speculative foreign exchange contracts for trading purposes.

VMware s foreign currency forward contracts are generally traded on a monthly basis with a typical contractual term of one month. As of September 30, 2011, VMware had outstanding forward contracts with a total notional value of $147.4 million. The fair value of these forward contracts was immaterial as of September 30, 2011 and therefore excluded from the table above. The fair value was measured under Level 2 sources as discussed above.

F. Business Combinations, Intangible Assets, Net and Goodwill

Business Combinations

The results of operations of the acquired businesses mentioned below have been included in VMware s consolidated financial statements from the date of purchase. Pro forma results of operations have not been presented as the results of the acquired businesses were not material to VMware s consolidated results of operations in the three and nine months ended September 30, 2011 and 2010.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

In the nine months ended September 30, 2011, VMware acquired six companies. The aggregate consideration for these acquisitions was $304.2 million, net of cash acquired, and includes cash of $303.6 million and the fair value of equity awards assumed attributed to pre-combination services of $0.6 million. The following table summarizes the allocation of the consideration to the fair value of the tangible and intangible assets acquired in the nine months ended September 30, 2011 (table in thousands):

Other current assets	$ 4,856
Intangible assets	104,500
Goodwill	188,395
Deferred tax assets	48,851
Other assets	100
Total tangible and intangible assets acquired	346,702
Unearned revenues	(8,243)
Deferred tax liabilities	(25,498)
Accrued liabilities and other	(8,717)
Total liabilities assumed	(42,458)
Fair value of tangible and intangible assets acquired and liabilities assumed	$ 304,244

Intangible Assets, Net

The following table summarizes the fair value of the intangible assets acquired by VMware through both business combinations and asset purchases in the nine months ended September 30, 2011 (table in thousands):

	Weighted-Average Useful Lives (in years)	Fair Value Amount
Purchased technology	5.9	$ 95,200
Customer relationships and customer lists	6.6	21,600
Total intangible assets, net, excluding goodwill		$ 116,800

Goodwill

Changes in the carrying amount of goodwill for the nine months ended September 30, 2011 consisted of the following (table in thousands):

Balance, January 1, 2011	$ 1,568,600
Increase in goodwill related to business combinations	188,395
Deferred tax adjustments to purchase price allocations on previous acquisitions	3,896

Other adjustments to purchase price allocations on previous acquisitions	(622)
Balance, September 30, 2011	$ 1,760,269

G. Property and Equipment, Net

Property and equipment, net, as of September 30, 2011 and December 31, 2010 consisted of the following (table in thousands):

	September 30, 2011	December 31, 2010
Equipment and software	$ 499,664	$ 438,384
Buildings and improvements	292,278	270,786
Furniture and fixtures	57,740	52,613
Construction in progress	104,026	3,082
Total property and equipment	953,708	764,865
Accumulated depreciation	(437,047)	(345,800)
Total property and equipment, net	$ 516,661	$ 419,065

VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

Depreciation expense was $31.7 million and $29.0 million in the three months ended September 30, 2011 and 2010, respectively, and $93.7 million and $82.7 million in the nine months ended September 30, 2011 and 2010, respectively.

In the three months ended June 30, 2011, VMware closed an agreement to purchase all of the right, title and interest in a ground lease covering the property and improvements located adjacent to VMware s Palo Alto, California campus for $225.0 million. VMware paid the seller $45.0 million in the three months ended March 31, 2011 as a good faith deposit and in the three months ended June 30, 2011, VMware paid the remaining $180.0 million. Based upon the respective fair values and preliminary assumptions, $51.9 million of the purchase price was recorded to property and equipment, net on the June 30, 2011 consolidated balance sheet representing the estimated fair value of the buildings and site improvements. The remaining $173.1 million of the purchase price was recorded to intangible assets, net on the June 30, 2011 consolidated balance sheet for the fair value of the ground lease and the right to develop additional square footage on the parcel.

In the three months ended September 30, 2011, the gross amount classified to property and equipment, net was increased by $22.0 million to $73.9 million to reflect the final assumptions regarding VMware s intended use of the existing structures. As a result of this adjustment, the gross amount of the value attributed to the leasehold interest was decreased by the same amount. The $22.0 million adjustment is reflected on the consolidated statement of cash flows for the three months ended September 30, 2011. For the nine months ended September 30, 2011, the final value of $73.9 million paid and attributed to the property is included within additions to property and equipment and the $151.1 million paid and attributed to the intangible assets is separately disclosed within cash used in investing activities on the consolidated statement of cash flows.

As of September 30, 2011, $62.9 million of the buildings and site improvements were classified in construction in progress as the buildings had not yet been placed into service.

Concurrent with the closing of the transaction, VMware entered into an amended and restated ground lease for the new property with the Board of Trustees of the Leland Stanford Junior University (Stanford), the lessor of both the new property and VMware s existing campus. VMware will possess the title to the interest and buildings during the duration of the lease. Upon termination of the lease, all title will revert to Stanford. The $73.9 million of buildings and site improvements will be depreciated from the date they are placed into service through the term of the amended and restated ground lease. The $151.1 million of intangible assets will amortize through 2046. At the closing, VMware also entered into an amendment to the ground lease for its existing campus so that the terms of both leases will be 34 years and 11 months from the closing of the purchase agreement.

Annual rent payments to Stanford for the new property will initially be approximately $6.8 million, and will increase by 3% annually. VMware is also responsible for paying all taxes, insurance and other expenses necessary to operate the parcel. Additional rent of approximately $1.1 million per year will become payable in connection with the effectiveness of a right to construct further improvements on the parcel, which is currently expected to begin no earlier than January 1, 2014. Such additional rent would subsequently increase by 2% annually.

H. Accrued Expenses and Other

Accrued expenses and other as of September 30, 2011 and December 31, 2010 consisted of the following (table in thousands):

	September 30, 2011	December 31, 2010
Salaries, commissions, bonuses, and benefits	$ 202,478	$ 242,180
Accrued partner liabilities	113,435	94,676
Other	192,236	122,957
Total	$ 508,149	$ 459,813

Accrued partner liabilities relate to rebates and marketing development fund accruals for channel partners, system vendors and systems integrators, as well as accrued royalties.

I. Note Payable to EMC

In April 2007, VMware declared an $800.0 million dividend to EMC paid in the form of a note payable, with interest payable quarterly in arrears and originally due April 2012, of which $450.0 million remained outstanding as of September 30, 2011. In June 2011, VMware and EMC amended and restated the note to extend the maturity date of the note to April 16, 2015 and to modify the principal amount of the note to reflect the outstanding balance of $450.0 million. The interest rate continues to reset quarterly and bears an interest rate of the 90-day LIBOR plus 55 basis points. For the three months ended September 30, 2011 and 2010, $0.9 million and $1.2 million, respectively, of interest expense were recorded related to the note payable. For the nine months ended September 30, 2011 and 2010, $2.8 million and $3.1 million, respectively, of interest expense was recorded related to the note payable. The note may be repaid prior to the maturity date without penalty. No repayments of principal were made during the three months ended September 30, 2011.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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J. Income Taxes

Although VMware files a consolidated federal tax return with EMC, VMware calculates its income tax provision on a stand-alone basis. The Company s effective tax rate in the periods presented is the result of the mix of income earned in various tax jurisdictions that apply a broad range of income tax rates. The rate at which the provision for income taxes is calculated differs from the U.S. federal statutory income tax rate primarily due to different tax rates in foreign jurisdictions where income is earned and considered to be indefinitely reinvested.

VMware s effective income tax rate was 3.1% and 12.6% for the three months ended September 30, 2011 and 2010, respectively. The effective income tax rate was 10.6% and 18.5% for the nine months ended September 30, 2011 and 2010, respectively. The lower effective rate for the three months ended September 30, 2011, compared with the three months ended September 30, 2010, was primarily attributable to the reenactment of the U.S. federal R&D tax credit which occurred during the three months ended December 31, 2010, a change in estimate in the U.S. federal research tax credit calculation, and a change in estimates in the allocation of expenses from U.S. to international jurisdictions. As a result of the changes in estimates, VMware recognized a favorable tax benefit in the three months ended September 30, 2011, of $16.7 million upon the finalization of the 2010 tax returns and a favorable tax benefit of $7.5 million related to the first half of 2011. These changes in estimates increased both basic and diluted earnings per share by $0.06 from what would otherwise have been reported in the third quarter of 2011. The impact was not material to the nine months ended September 30, 2011. The lower effective rate for the nine months ended September 30, 2011, compared with the nine months ended September 30, 2010, included the items discussed above, as well as a release in uncertain tax benefits due to closure of a tax audit during the three months ended June 30, 2011.

VMware s rate of taxation in foreign jurisdictions is lower than the U.S. tax rate. VMware s international income is primarily earned by VMware s subsidiaries in Ireland. Management does not believe that any recent or currently expected developments in non-U.S. tax jurisdictions are reasonably likely to have a material impact on VMware s effective tax rate. As of September 30, 2011, VMware s total cash, cash equivalents, and short-term investments were $4.0 billion, of which $1.9 billion were held outside the U.S. If these overseas funds are needed for its operations in the U.S., VMware would be required to accrue and pay U.S. taxes on related undistributed earnings to repatriate these funds. However, VMware s intent is to indefinitely reinvest its non-U.S. earnings in its foreign operations and VMware s current plans do not demonstrate a need to repatriate them to fund its U.S. operations. VMware will meet its U.S. liquidity needs through ongoing cash flows generated from its U.S. operations, external borrowings, or both. VMware utilizes a variety of tax planning and financing strategies in an effort to ensure that its worldwide cash is available in the locations in which it is needed. All income earned abroad, except for previously taxed income for U.S. tax purposes, is considered indefinitely reinvested in VMware s foreign operations and no provision for U.S. taxes has been provided with respect thereto.

As of September 30, 2011, VMware had $82.8 million of gross unrecognized tax benefits, which excludes $5.5 million of offsetting tax benefits not recognized on the consolidated balance sheets. VMware s net unrecognized tax benefits of $84.8 million as of September 30, 2011, if recognized, would benefit VMware s effective income tax rate. The $84.8 million of net unrecognized tax benefits was classified as a non-current liability on the consolidated balance sheet. It is reasonably possible that within the next 12 months various statutes of limitations will lapse and audits will be resolved, which could potentially reduce total unrecognized tax benefits by between approximately $4 million and $6 million. Audit outcomes and the timing of audit settlements are subject to significant uncertainty. During the three months ended June 30, 2011, due to the closure of a tax audit, approximately $20.8 million of uncertain tax benefits were released, partially offset by approximately $12.1 million in tax payments due to audit results.

VMware recognizes interest expense and penalties related to income tax matters in the income tax provision. VMware recognized approximately $0.3 million in interest and penalties for the three months ended September 30, 2011 and has accrued $5.7 million of interest and penalties as of September 30, 2011, associated with the net unrecognized tax benefits. These amounts are included as components of the $84.8 million of net unrecognized tax benefits as of September 30, 2011.

K. Commitments and Contingencies

Litigation

From time to time, VMware is subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to intellectual property, contracts, employment and other matters. VMware accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. These accruals are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, management believes that the amount of any such additional loss would be immaterial to VMware s consolidated financial position and results of operation.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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Operating Lease Commitments

VMware leases office facilities and equipment under various operating leases. Facility leases generally include renewal options. VMware s future lease commitments at September 30, 2011 were as follows (table in thousands):

2011	$ 12,442
2012	44,767
2013	39,353
2014	33,026
2015	26,076
Thereafter	569,971
Total minimum lease payments	$ 725,635

The amount of the future lease commitments after 2015 is primarily for the ground lease on VMware s Palo Alto, California headquarter facilities and the ground lease for the campus expansion, which both expire in 2046. As several of VMware s operating leases are payable in foreign currencies, the operating lease payments may fluctuate in response to changes in the exchange rate between the U.S. Dollar and the foreign currencies in which the commitments are payable.

L. Stockholders Equity

VMware Stock Repurchase Programs

In February 2011, a committee of VMware s Board of Directors authorized the repurchase of up to an additional $550.0 million of VMware s Class A common stock through the end of 2012. From time to time, stock repurchases may be made pursuant to the February 2011 authorization in open market transactions or privately negotiated transactions as permitted by securities laws and other legal requirements. Purchases under the March 2010 authorization were completed in March 2011.

In the three months ended September 30, 2011, VMware repurchased and retired 2.4 million shares of its Class A common stock at a weighted-average price of $88.81 per share for an aggregate purchase price of $210.5 million, including commissions. In the nine months ended September 30, 2011, VMware repurchased and retired 5.5 million shares of its Class A common stock at a weighted-average price of $88.63 per share for an aggregate purchase price of $490.9 million, including commissions. The amount of repurchased shares was classified as a reduction to additional paid-in capital. VMware is not obligated to purchase any shares under its stock repurchase programs. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including VMware s stock price, corporate and regulatory requirements and other market and economic conditions. Purchases can be discontinued at any time that VMware feels additional purchases are not warranted. As of September 30, 2011, the authorized amount remaining for repurchase was $120.6 million.

VMware Restricted Stock

VMware restricted stock primarily consists of restricted stock units granted to employees and also includes restricted stock awards and other restricted stock. The following table summarizes restricted stock activity since January 1, 2011 (shares in thousands):

	Number of Shares	Weighted-Average Grant Date Fair Value (per share)
Outstanding, January 1, 2011	9,752	$ 54.17
Granted	4,255	91.42
Vested	(3,416)	45.04
Forfeited	(661)	61.40
Outstanding, September 30, 2011	9,930	72.79

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The total fair value of VMware restricted stock-based awards that vested in the nine months ended September 30, 2011 was $153.9 million. As of September 30, 2011, restricted stock unit awards and other restricted stock representing 9.9 million shares of VMware were outstanding, with an aggregate intrinsic value of $798.2 million based on the closing price as of September 30, 2011. Shares underlying restricted stock unit awards are not issued until the restricted stock units vest. These shares are scheduled to vest through 2015.

VMware Employee Stock Purchase Plan

The following table summarizes Employee Stock Purchase Plan (the ESPP) activity in the three and nine months ended September 30, 2011 and 2010 (table in thousands, except per share amounts):

	Purchase Period Ended July 31,		Purchase Period Ended January 31,	
	2011	2010	2011	2010
Cash proceeds	$ 30,151	$ 22,335	$ 26,813	$ 22,832
Class A common shares purchased	409	576	407	934
Weighted-average price per share	$ 73.70	$ 38.74	$ 65.90	$ 24.45

As of September 30, 2011, $18.4 million of ESPP withholdings were recorded as a liability on the consolidated balance sheet for the next purchase in January 2012.

VMware Shares Repurchased for Tax Withholdings

In each of the three months ended September 30, 2011 and 2010, VMware repurchased or withheld and retired 0.3 million shares of Class A common stock, for $32.1 million and $27.0 million, respectively, to cover tax withholding obligations. In each of the nine months ended September 30, 2011 and 2010, VMware repurchased or withheld and retired 1.1 million shares of Class A common stock, for $105.6 million and $72.6 million, respectively. These amounts differ from the amounts of cash remitted for tax withholding obligations on the consolidated statement of cash flows, due to timing of payments. Pursuant to the respective award agreements, these shares were repurchased or withheld in conjunction with the net share settlement upon the vesting of restricted stock and restricted stock units during the period. The value of the repurchased or withheld shares, including restricted stock units, was classified as a reduction to additional paid-in capital as of September 30, 2011 and December 31, 2010, respectively.

M. Comprehensive Income

The following table sets forth the components of comprehensive income for the three and nine months ended September 30, 2011 and 2010, respectively (table in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	$ 177,538	$ 84,600	$ 523,508	$ 237,559
Other comprehensive income:				
Unrealized gains (losses) on available-for-sale securities, net of taxes of $(798), $4,195, $282 and $5,699	(1,198)	6,858	423	9,299

Reclassification of (gains) losses on available-for-sale securities recognized during the period, net of taxes of $(194), $3, $(12,866) and $3	(290)	8	(19,298)	8
Total other comprehensive income	(1,488)	6,866	(18,875)	9,307
Total comprehensive income, net of taxes	$ 176,050	$ 91,466	$ 504,633	$ 246,866

In each period presented on VMware s consolidated balance sheets, accumulated other comprehensive income consisted of unrealized gains and losses on available-for-sale securities, net of taxes.

In the nine months ended September 30, 2011, VMware realized a gross gain of $56.0 million from the sale of its investment in Terremark Worldwide, Inc., which was acquired by Verizon in a cash transaction. The gain was recorded to other income (expense), net on the consolidated statements of income.

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VMware, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

N. Related Party Transactions

In April 2011, VMware acquired certain assets relating to EMC s Mozy cloud-based data storage and data center services, including certain data center assets and a license to certain intellectual property, for approximately $8.0 million. VMware also entered into an operational support agreement with EMC pursuant to which VMware took over responsibility to operate the Mozy service on behalf of EMC. VMware hired more than 300 Mozy employees and, pursuant to the support agreement, costs incurred by VMware to support EMC s Mozy services, plus a mark-up intended to approximate third-party costs, are reimbursed to VMware by EMC. On the consolidated statements of income, such amounts were approximately $13.1 million and $25.3 million, respectively, in the three and nine months ended September 30, 2011 and were recorded as a reduction to the costs VMware incurred. EMC retained ownership of the Mozy business and its remaining assets. EMC continues to be responsible to Mozy customers for Mozy products and services, and continues to recognize revenue from such products and services. As such, the assets acquired from EMC did not constitute a business and were accounted for as an asset purchase between entities under common control pursuant to generally accepted accounting principles. Accordingly, VMware included the carrying value of the transferred assets as of the date of transfer in its consolidated financial statements.

In April 2010, VMware acquired certain software product technology and expertise from EMC s Ionix IT management business for cash consideration of $175.0 million. EMC retained the Ionix brand and will continue to offer customers the products acquired by VMware, pursuant to the ongoing reseller agreement between EMC and VMware. In the three and nine months ended September 30, 2011, $1.9 million and $14.4 million, respectively, of contingent amounts were paid to EMC in accordance with the asset purchase agreement. These payments were recorded as a reduction to the capital contribution from EMC. As of September 30, 2011, all contingent payments under the agreement had been made. See VMware s Annual Report on Form 10-K for the fiscal year ended December 31, 2010 for further information.

Pursuant to the ongoing reseller arrangement with EMC that commenced in 2009, EMC bundles VMware s products and services with EMC s hardware and sells them to end-users. In the three months ended September 30, 2011 and 2010, VMware recognized revenues of $16.7 million and $8.0 million, respectively, from products and services sold pursuant to VMware s reseller arrangement with EMC. In the nine months ended September 30, 2011 and 2010, VMware recognized revenues of $50.9 million and $25.0 million, respectively, from products sold pursuant to VMware s reseller arrangement with EMC. As of September 30, 2011, $58.6 million of revenues from products and services sold under the reseller arrangement were included in unearned revenues.

In the three months ended September 30, 2011 and 2010, VMware recognized professional services revenues of $13.2 million and $16.6 million, respectively, for services provided to EMC s customers pursuant to VMware s contractual agreements with EMC. In the nine months ended September 30, 2011 and 2010, VMware recognized professional services revenues of $44.0 million and $38.6 million, respectively, from such contractual arrangements with EMC. As of September 30, 2011, $4.8 million of revenues from professional services to EMC customers were included in unearned revenues.

In the three months ended September 30, 2011 and 2010, VMware recognized revenues of $1.0 million and $2.5 million, respectively, from server and desktop products and services purchased by EMC for internal use pursuant to VMware s contractual agreements with EMC. In the nine months ended September 30, 2011 and 2010, VMware recognized $2.0 million and $4.8 million, respectively, from such contractual arrangements with EMC. As of September 30, 2011, $18.0 million of revenues from server and desktop products and services purchased by EMC for internal use were included in unearned revenues.

VMware purchased storage systems and software, as well as consulting services, from EMC for $3.8 million and $6.7 million in the three months ended September 30, 2011 and 2010, respectively, and for $17.2 million and $13.2 million in the nine months ended September 30, 2011 and 2010, respectively.

In certain geographic regions where VMware does not have an established legal entity, VMware contracts with EMC subsidiaries for support services and EMC employees who are managed by VMware s personnel. The costs incurred by EMC on VMware s behalf related to these employees are passed on to VMware and VMware is charged a mark-up intended to approximate costs that would have been charged had VMware contracted for such services with an unrelated third party. These costs are included as expenses in VMware s consolidated statements of income and primarily include salaries and benefits, travel and rent. Additionally, from time to time, EMC incurs certain administrative costs on VMware s behalf in the U.S. The total cost of the services provided to VMware by EMC as described above was $21.1 million and $18.0 million in the three months ended September 30, 2011 and 2010, respectively, and $63.8 million and $49.8 million in the nine months ended September 30, 2011 and 2010, respectively.

As calculated under VMware s tax sharing agreement with EMC, EMC paid VMware $100.0 million and $276.4 million in the three and nine months ended September 30, 2011, respectively, resulting from VMware s stand-alone federal taxable loss estimated for both fiscal year 2010 and the six months ended June 30, 2011, as well as a refund of VMware s overpayment related to fiscal year 2009. Under the tax sharing agreement, EMC paid VMware $2.5 million for the nine months ended September 30, 2010, resulting from VMware s stand-alone federal and state taxable losses for 2008. No payments were made by EMC to VMware during the three months ended September 30, 2010. VMware paid $5.1 million to EMC in the nine months ended September 30, 2010 for VMware s portion of EMC s 2009 consolidated federal income taxes. No payments were made to EMC by VMware in the three and nine months ended September 30, 2011 and in the three months ended September 30, 2010. The amounts that VMware pays to and receives from EMC for its portion of federal income taxes on EMC s consolidated tax return differ from the amounts VMware would owe or receive on a stand-alone basis and the difference is presented as a component of stockholders equity. For all periods presented the difference was not material.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

In the three months ended September 30, 2011 and 2010, $0.9 million and $1.2 million, respectively, of interest expense was recorded related to the note payable to EMC and included in interest expense with EMC on VMware s consolidated statements of income. In the nine months ended September 30, 2011 and 2010, $2.8 million and $3.1 million, respectively, of interest expense were recorded related to the note payable. VMware s interest expense as a separate, stand-alone company may be higher or lower than the amounts reflected in the consolidated financial statements. In June 2011, VMware and EMC amended the note to extend its maturity date from April 16, 2012 to April 16, 2015.

As of September 30, 2011, VMware had $12.5 million net due from EMC, which consisted of $42.0 million due from EMC, partially offset by $29.5 million due to EMC. These amounts resulted from the related party transactions described above. In addition to the $12.5 million due from EMC as of September 30, 2011, VMware had $38.8 million of income taxes receivable due from EMC, which is included in other current assets and $12.1 million of income taxes payable, which was included in accrued expenses and other, on VMware s consolidated balance sheets. The income tax receivable is related to 2011 and 2010 federal income taxes and is expected to be received from EMC in the fourth quarter of 2011. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter-end. The timing of the tax payments due to and from EMC is governed by the tax sharing agreement with EMC.

O. Segment Information

VMware operates in one reportable segment. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assessing performance. Since VMware operates in one operating segment, all required financial segment information can be found in the consolidated financial statements.

Revenues by geographic area for the three and nine months ended September 30, 2011 and 2010 were as follows (table in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	$ 443,413	$ 362,350	$ 1,293,290	$ 1,013,265
International	498,450	351,895	1,413,504	1,008,417
Total	$ 941,863	$ 714,245	$ 2,706,794	$ 2,021,682

No country other than the United States had material revenues for the three and nine months ended September 30, 2011 or 2010.

Long-lived assets by geographic area, which primarily include property and equipment, net, as of September 30, 2011 and December 31, 2010 were as follows (table in thousands):

	September 30, 2011	December 31, 2010
United States	$ 409,644	$ 306,182
International	48,128	43,363
Total	$ 457,772	$ 349,545

No country other than the United States accounted for 10% or more of these assets at September 30, 2011 or December 31, 2010, respectively.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
All dollar amounts expressed as numbers in this MD&A (except share and per share amounts) are in millions.

Overview

Our primary source of revenues is the licensing of virtualization and cloud infrastructure solutions and related support and services for use by businesses and organizations of all sizes and across numerous industries in their information technology (IT) infrastructure. Our virtualization solutions reflect a pioneering approach to computing that separates application software from the underlying hardware to achieve significant improvements in efficiency, agility, availability, flexibility and manageability. Our broad and proven suite of virtualization solutions addresses a range of complex IT problems that include cost and operational inefficiencies, facilitating access to cloud computing capacity, business continuity, software lifecycle management and corporate end-user computing device management. Our solutions run on industry-standard servers and desktop computers and support a wide range of operating system and application environments, as well as networking and storage infrastructures. Our solutions enable organizations to aggregate multiple servers, storage infrastructure and networks together into shared pools of capacity that can be allocated dynamically, securely and reliably to applications as needed, increasing hardware utilization and reducing spending. The benefits to our customers include substantially lower IT costs, cost-effective high availability across a wide range of applications, and a more automated and resilient systems infrastructure capable of responding dynamically to variable business demands. With our platform, VMware vSphere, we are helping companies along the path of cloud computing by providing compatible IT infrastructures for both businesses and cloud service providers.

Although we believe we are currently the leading provider of virtualization infrastructure software solutions, we face competitive threats to our leadership position from a number of companies, some of which have significantly greater resources than we do, which could result in increased pressure to reduce prices on our offerings. As a result, we believe it is important to continue to invest in strategic initiatives related to product research and development, market expansion and associated support functions to expand our industry leadership. We believe that we will be able to continue to meet our product development objectives through continued investment in our existing infrastructure, supplemented with strategic hires and acquisitions, funded through the operating cash flows generated from the sale of our products and services. We believe this is the appropriate priority for the long-term health and growth of our business.

Our current financial focus is on long-term revenue growth to generate free cash flows[1] to fund our expansion of industry segment share and to evolve our virtualization-based products for data centers, desktop computers and cloud computing through a combination of internal development and acquisitions. We expect to grow our business by broadening our virtualization infrastructure software solutions technology and product portfolio, increasing product awareness, promoting the adoption of virtualization and building long-term relationships with our customers through the adoption of enterprise license agreements (ELAs). Since the introduction of VMware vSphere and VMware View 4 in 2009, we have introduced more products that build on the vSphere foundation, including in the third quarter of 2011, VMware vSphere 5 and a comprehensive suite of cloud infrastructure technologies, as well as VMware View 5. We plan to continue to introduce additional products in the future. Additionally, we have made, and expect to continue to make, acquisitions designed to strengthen our product offerings and/or extend our strategy to deliver solutions that can be hosted at customer data centers or at service providers.

In evaluating our results, we also focus on operating margin excluding certain expenses which are included in our total operating expenses calculated in accordance with GAAP. The expenses excluded are stock-based compensation, the net effect of the amortization and capitalization of software development costs and certain other expenses consisting of employer payroll taxes on employee stock transactions, amortization of intangible assets and acquisition-related items. We believe this measure reflects our ongoing business in a manner that allows meaningful period-to-period comparisons. We are not currently focused on short-term operating margin expansion, but rather on investing at appropriate rates to support our growth and future product offerings in what may be a substantially more competitive environment.

As a consequence of the timing differences in the recognition of license revenues and software maintenance revenues, variability in operating margin can result from differences in when we quote and contract for our services and when the cost is incurred. Variability in operating margin can also result when we recognize previously unearned foreign denominated software maintenance and license revenues in future periods. Due to our use of the U.S. Dollar as our functional currency, unearned revenue remains at its historical rate when recognized into revenue while our operating expenses in future periods are based upon the foreign exchange rates at that time.

[1] Free cash flows, a non-GAAP financial measure, is defined as net cash provided by operating activities plus the excess tax benefits from stock-based compensation, less capital expenditures and capitalized software development costs. Each adjusting item is separately presented on our consolidated statements of cash flows. See Non-GAAP Financial Measures for further information.

We have developed a multi-channel distribution model to expand our global presence and to reach various segments of the industry. In the third quarter and first nine months of 2011, we derived over 85% of our sales from our channel partners, which include distributors, resellers, system vendors and systems integrators. Sales to our channel partners often involve three tiers of distribution: a distributor, a reseller and an end-user customer. Our sales force works collaboratively with our channel partners to introduce them to customers and new sales opportunities. As we expand geographically, we expect to continue to add additional channel partners. The remainder of our sales is primarily derived from purchases made directly by end-user customers.

Our customers continue to adopt our product platform as a strategic investment that improves efficiency and flexibility for their business and enables substantial cost savings. While the overall macroeconomic environment had shown improvement since early 2010, growing uncertainty in global macroeconomic conditions may impact IT spending and demand for our products and services in 2012. We expect to continue to manage our resources prudently, while making key investments in support of our long-term growth objectives.

Income Statement Presentation

As we operate our business in one operating segment, our revenues and operating expenses are presented and discussed at the consolidated level.

Sources of Revenues

License revenues

Our license revenues consist of revenues earned from the licensing of our software products. These products are generally licensed on a perpetual basis. Pricing models have generally been based upon the physical infrastructure, such as the number of physical desktop computers or server processors, on which our software runs. License revenues are recognized when the elements of revenue recognition for the licensed software are complete, generally upon electronic shipment of the software. The revenues allocated to the software license included in multiple-element contracts represent the residual amount of the contract after the fair value of the other elements has been determined. Certain products are licensed on a subscription basis.

We have recently begun to base pricing for some of our products on virtual, rather than purely physical, entitlements, while continuing to license such products on a perpetual basis. We believe that this new pricing model better aligns with the shift to virtual and cloud-based IT environments by enabling customers to align cost with actual use and value derived, rather than purely with hardware configurations and capacity. Effective in September 2010, we began pricing certain of our management solutions on a per-virtual-machine basis. In the third quarter of 2011, we revised the pricing model for VMware vSphere 5 effective with its general availability. VMware vSphere 5 will continue to be licensed perpetually on a per processor basis. However, two physical constraints, core and physical RAM, will be eliminated and replaced with a single virtualization-based entitlement of virtual memory, or vRAM, which can be shared across a large pool of servers.

Software maintenance revenues

Software maintenance revenues are recognized ratably over the contract period. Our contract periods typically range from one to five years and include renewals of software maintenance sold after the initial software maintenance period expires. Vendor-specific objective evidence (VSOE) of fair value for software maintenance services is established by the rates charged in stand-alone sales of software maintenance contracts or the stated renewal rate for software maintenance included in the license agreement. Customers receive various types of technical support based on the level of support purchased. Customers who are party to software maintenance agreements with us are entitled to receive product updates and upgrades on a when-and-if-available basis.

Professional services revenues

Professional services include design, implementation and training. Professional services are not considered essential to the functionality of our products, as these services do not alter the product capabilities and may be performed by our customers or by other vendors. Professional services engagements performed for a fixed fee, for which we are able to make reasonably dependable estimates of progress toward completion, are recognized on a proportional performance basis based on hours incurred and estimated hours of completion. Professional services engagements that are on a time and materials basis are recognized based on hours incurred. Revenues on all other professional services engagements are recognized upon completion. Our professional services may be sold with software products or on a stand-alone basis. VSOE of fair value for professional services is based upon the standard rates we charge for such services when sold separately.

Operating Expenses

Cost of license revenues

Our cost of license revenues principally consists of the amortization of capitalized software development costs and of intangibles, as well as royalty costs in connection with technology licensed from third-party providers and the cost of fulfillment of our software. The cost of fulfillment of our software includes product packaging, personnel costs and related overhead associated with the physical and electronic delivery of our software products.

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Cost of services revenues

Our cost of services revenues includes the costs of personnel and related overhead to deliver technical support for our products and to provide our professional services.

Research and development expenses

Our research and development (R&D) expenses include the personnel and related overhead associated with the R&D of new product offerings and the enhancement of our existing software offerings, net of amounts capitalized.

Sales and marketing expenses

Our sales and marketing expenses include personnel costs, sales commissions and related overhead associated with the sale and marketing of our license and services offerings, as well as the cost of product launches and certain marketing initiatives, including our annual VMworld conferences in the U.S. and Europe. Sales commissions are generally earned and expensed when a firm order is received from the customer and may be expensed in a period different than the period in which the related revenue is recognized.

General and administrative expenses

Our general and administrative expenses include personnel and related overhead costs to support the overall business. These expenses include the costs associated with our facilities, finance, human resources, IT infrastructure and legal departments, as well as expenses related to corporate costs and initiatives.

Results of Operations

Revenues

Our revenues in the third quarter and first nine months of 2011 and 2010 were as follows:

	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	% Change	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010	% Change
Revenues:						
License	$ 443.6	$ 343.2	29 %	$ 1,327.4	$ 979.1	36 %
Services:						
Software maintenance	426.8	314.1	36	1,176.9	871.8	35
Professional services	71.5	56.9	26	202.5	170.8	19
Total services	498.3	371.0	34	1,379.4	1,042.6	32
	$ 941.9	$ 714.2	32	$ 2,706.8	$ 2,021.7	34
Revenues:						
United States	$ 443.4	$ 362.3	22 %	$ 1,293.3	$ 1,013.3	28 %
International	498.5	351.9	42	1,413.5	1,008.4	40
	$ 941.9	$ 714.2	32	$ 2,706.8	$ 2,021.7	34

Total revenues increased by $227.6 or 32% to $941.9 in the third quarter of 2011 from $714.2 in the third quarter of 2010. Total revenues increased by $685.1 or 34% to $2,706.8 in the first nine months of 2011 from $2,021.7 in the first nine months of 2010. The revenue mix in the third quarter and first nine months of 2011 reflected increases in both license revenues and services revenues as compared with the third quarter and first nine months of 2010.

License Revenues

Software license revenues increased by $100.4 or 29% to $443.6 in the third quarter of 2011 from $343.2 in the third quarter of 2010. Software license revenues increased by $348.3 or 36% to $1,327.4 in the first nine months of 2011 from $979.1 in the first nine months of 2010. License revenues increased in the third quarter and first nine months of 2011 primarily due to strong global demand for vSphere.

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In the third quarter and first nine months of 2011, we observed an increase in the volume of our ELAs as compared with the respective periods in 2010 due to growing customer interest, as well as strong renewals from existing ELA customers. We have promoted the adoption of virtualization and built long-term relationships with our customers through the adoption of ELAs. ELAs continue to be an important component of our revenue growth and are offered both directly by us and through certain channel partners. ELAs are a core component of our strategy to build long-term relationships with customers as they commit to our virtualization infrastructure software solutions in their data centers. ELAs provide a base from which to sell additional products, such as our application platform products, our end-user computing products, and virtualization and cloud management products. Under a typical ELA, a portion of the revenues is attributed to the license and recognized immediately and the remainder is deferred and primarily recognized as software maintenance revenues in future periods. In addition, ELAs typically include an initial maintenance period that is longer than other types of license sales.

Services Revenues

Services revenues increased by $127.3 or 34% to $498.3 in the third quarter of September 30, 2011 from $371.0 in the third quarter of 2010. Services revenues increased by $336.8 or 32% to $1,379.4 in the first nine months of 2011 from $1,042.6 in the first nine months of 2010. The increase in services revenues during the third quarter and first nine months of 2011 was primarily attributable to growth in our software maintenance revenues.

Software maintenance revenues increased by $112.6 or 36% to $426.8 in the third quarter of 2011 from $314.1 in the third quarter of 2010. Software maintenance revenues increased by $305.1 or 35% to $1,176.9 in the first nine months of 2011 from $871.8 in the first nine months of 2010. In the third quarter and first nine months of 2011, software maintenance revenues benefited from strong renewals, multi-year software maintenance contracts sold in previous periods, and additional maintenance contracts sold in conjunction with new software license sales. In the third quarter and first nine months of 2011, customers continued to buy, on average, more than 24 months of support and maintenance with each new license purchased, which we believe illustrates our customers commitment to VMware as a core element of their data center architecture and hybrid cloud strategy.

Professional services revenues increased by $14.6 or 26% to $71.5 in the third quarter of 2011 from $56.9 in the third quarter of 2010. Professional services revenues increased by $31.7 or 19% to $202.5 in the first nine months of 2011 from $170.8 in the first nine months of 2010. Professional services revenues increased as growth in our license sales and installed-base led to additional demand for our professional services, including consulting and customer training. As we continue to invest in our partners and expand our eco-system of third-party professionals with expertise in our solutions to independently provide professional services to our customers, we do not expect our professional services revenues to constitute an increasing component of our revenue mix. As a result of this strategy, our professional services revenue can vary based on the delivery channels used in any given period as well as the timing of engagements.

Revenue Growth in Constant Currency

We have invoiced and collected in the Euro, the British Pound, the Japanese Yen, and the Australian Dollar in their respective regions since May 2009. As a result, our total revenues are affected by changes in the value of the U.S. Dollar against these currencies. In order to provide a comparable framework for assessing how our business performed excluding the effect of foreign currency fluctuations, management analyzes year-over-year revenue growth on a constant currency basis. Since all of our entities operate with the U.S. Dollar as their functional currency, unearned revenues for orders booked in currencies other than U.S. Dollars are converted into U.S. Dollars at the exchange rate in effect for the month in which each order is booked. We calculate constant currency on license revenues recognized during the current period that were originally booked in currencies other than U.S. Dollars by comparing the exchange rates at which the revenue was recognized against the exchange rate that was used in the comparable period. We do not calculate constant currency on services revenues, which include software maintenance revenues and professional services revenues.

In the third quarter of 2011, the year-over-year growth in license revenues measured on a constant currency basis was 25% compared with 29% as reported, and was 34% compared with 36% as reported year-over-year in the first nine months of 2011. The year-over-year growth in total revenues in the third quarter of 2011 measured on a constant currency basis was 30% compared with 32% as reported, and was 33% compared with 34% as reported year-over-year in the first nine months of 2011.

Unearned Revenues

Our unearned revenues as of September 30, 2011 and December 31, 2010 were as follows:

	September 30, 2011	December 31, 2010
Unearned license revenues	$ 269.6	$ 267.1
Unearned software maintenance revenues	1,804.6	1,461.3
Unearned professional services revenues	159.9	131.7
Total unearned revenues	$ 2,234.1	$ 1,860.1

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The complexity of our unearned revenues has increased over time as a result of acquisitions, an expanded product portfolio and a broader range of pricing and packaging alternatives. As of September 30, 2011, total unearned revenues increased by $374.0 or 20% to $2,234.1 from $1,860.1 at December 31, 2010. This increase was primarily due to growth in unearned software maintenance revenues, attributable to our growing base of maintenance contracts. Unearned software maintenance revenues are recognized ratably over terms from one to five years with a weighted-average remaining term at September 30, 2011 of approximately 1.8 years. Unearned license revenues are recognized either ratably or upon the delivery of existing products, future products or services. Future products include, in some cases, emerging products that are offered as part of product promotions where the purchaser of an existing product is entitled to receive a promotional product at no additional charge. We regularly offer product promotions, generally as a strategy to build awareness of our emerging products. To the extent promotional products have not been delivered and VSOE of fair value cannot be established, the revenue for the entire order is deferred until such time as all product delivery obligations have been fulfilled. Unearned professional services revenues result primarily from prepaid professional services, including training, and are recognized as the services are delivered. We believe our overall unearned revenue balance improves predictability of future revenues and that it is a key indicator of the health and growth of our business.

Operating Expenses

Information about our operating expenses in the third quarter and first nine months of 2011 and 2010 is as follows:

	For the Three Months Ended September 30, 2011				
	Core Operating Expenses (1)	Stock-Based Compen-sation	Capitalized Software Development Costs, net	Other Expenses	Total Operating Expenses
Cost of license revenues	$ 18.5	$ 0.4	$ 14.4	$ 12.8	$ 46.1
Cost of services revenues	99.0	6.1		1.6	106.7
Research and development	170.9	46.7	(21.1)	3.2	199.7
Sales and marketing	302.6	24.8		4.2	331.6
General and administrative	65.4	10.4		1.2	77.0
Total operating expenses	$ 656.4	$ 88.4	$ (6.7)	$ 23.0	$ 761.1
Operating income					$ 180.7
Operating margin					19.2%

	For the Three Months Ended September 30, 2010				
	Core Operating Expenses (1)	Stock-Based Compen-sation	Capitalized Software Development Costs, net	Other Expenses	Total Operating Expenses
Cost of license revenues	$ 13.1	$ 0.4	$ 26.1	$ 6.7	$ 46.3
Cost of services revenues	74.0	4.4		1.8	80.2
Research and development	135.6	43.1	(7.0)	3.7	175.4
Sales and marketing	230.5	18.1		3.1	251.7
General and administrative	57.0	7.7		1.9	66.6
Total operating expenses	$ 510.2	$ 73.7	$ 19.1	$ 17.2	$ 620.2
Operating income					$ 94.0
Operating margin					13.2%

	For the Nine Months Ended September 30, 2011				
	Core Operating Expenses (1)	Stock-Based Compen-sation	Capitalized Software Development Costs, net	Other Expenses	Total Operating Expenses
Cost of license revenues	$ 54.1	$ 1.2	$ 62.7	$ 33.0	$ 151.0
Cost of services revenues	281.8	17.4		4.9	304.1

Research and development	486.8	134.6	(74.0)	10.7	558.1
Sales and marketing	866.5	70.6		12.0	949.1
General and administrative	189.3	30.6		3.5	223.4
Total operating expenses	$ 1,878.5	$ 254.4	$ (11.3)	$ 64.1	$ 2,185.7
Operating income					$ 521.1
Operating margin					19.3%

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	For the Nine Months Ended September 30, 2010				
	Core Operating Expenses (1)	Stock-Based Compen-sation	Capitalized Software Development Costs, net	Other Expenses	Total Operating Expenses
Cost of license revenues	$ 39.0	$ 1.2	$ 71.1	$ 15.4	$ 126.7
Cost of services revenues	210.3	12.6		3.7	226.6
Research and development	395.3	117.3	(44.8)	7.5	475.3
Sales and marketing	645.4	49.6		5.2	700.2
General and administrative	166.2	24.5		4.8	195.5
Total operating expenses	$ 1,456.2	$ 205.2	$ 26.3	$ 36.6	$ 1,724.3
Operating income					$ 297.4
Operating margin					14.7%

(1) Core operating expenses is a non-GAAP financial measure that excludes stock-based compensation, the net effect of the amortization and capitalization of software development costs and certain other expenses from our total operating expenses calculated in accordance with GAAP. The other expenses excluded are employer payroll taxes on employee stock transactions, amortization of intangible assets and acquisition-related items. See Non-GAAP Financial Measures for further information.

Operating margins increased from 13.2% in the third quarter of 2010 to 19.2% in the third quarter of 2011. Operating margins increased from 14.7% in the first nine months of 2010 to 19.3% in the first nine months of 2011. The increase in our operating margin in the third quarter and first nine months of 2011 compared with the third quarter and first nine months of 2010 primarily relates to the increase in our revenues, which outpaced the increase in our expenses. In evaluating our results, we generally focus on core operating expenses. We believe that our core operating expenses reflect our business in a manner that allows meaningful period-to-period comparisons. Our core operating expenses are reconciled to the most comparable GAAP measure, total operating expenses, in the table above.

Core Operating Expenses

The following discussion of our core operating expenses and the components comprising our core operating expenses highlights the factors that we focus on when evaluating our operating margin and operating expenses. The increases or decreases in operating expenses discussed in this section do not include changes relating to stock-based compensation, the net effect of the amortization and capitalization of software development costs and certain other expenses, which consist of employer payroll taxes on employee stock transactions, amortization of intangible assets and acquisition-related items.

Core operating expenses increased by $146.3 or 29% in the third quarter of 2011 compared with the third quarter of 2010. Core operating expenses increased by $422.3 or 29% in the first nine months of 2011 compared with the first nine months of 2010. As quantified below, these increases were primarily due to increases in employee-related expenses, which include salaries and benefits, bonuses, commissions, and recruiting and training. The increase in employee-related expenses was largely a result of incremental headcount from strategic hiring, business growth and business acquisitions.

A portion of our core operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, marketing, and research and development, are denominated in foreign currencies, and are thus exposed to foreign exchange rate fluctuations. Core operating expenses were negatively impacted by $21.5 and $45.6, respectively, in the third quarter and first nine months of 2011 as compared with the third quarter and first nine months of 2010, due to the effect of fluctuations in the exchange rates between the U.S. Dollar and foreign currencies.

Cost of License Revenues

Core operating expenses in cost of license revenues increased by $5.4 or 41% in the third quarter of 2011 compared with the third quarter of 2010, and by $15.0 or 39% in the first nine months of 2011 as compared to the first nine months of 2010. The increases were primarily due to increases of $2.4 and $8.2 in the third quarter and first nine months of 2011, respectively, in royalty and licensing costs for technology licensed from third-party providers that is used in our products and also other costs incurred in connection with our license sales. Additionally, cost of license revenues increased by $1.8 and $3.9 in the third quarter and first nine months of 2011, respectively, due to IT development costs.

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Cost of Services Revenues

Core operating expenses in cost of services revenues increased by $25.1 or 34% in the third quarter of 2011 compared with the third quarter of 2010, and by $71.5 or 34% in the first nine months of 2011 compared with the first nine months of 2010. The increases were primarily due to growth in employee-related expenses of $11.7 and $34.9 in the third quarter and first nine months of 2011, respectively, which was largely driven by incremental growth in headcount, as well as an increase in expenses of $4.1 and $12.8 for IT development costs. Fluctuations in the exchange rate between the U.S. Dollar and foreign currencies also contributed $4.1 and $8.9, respectively, to the overall increase in costs of services revenues. Additionally, our third-party professional services costs increased by $3.9 and $10.3, respectively, to provide technical support and professional services primarily in connection with increased services revenues.

Research and Development Expenses

Core operating expenses for R&D increased by $35.3 or 26% in the third quarter of 2011 compared with the third quarter of 2010, and by $91.5 or 23% in the first nine months of 2011 compared with the first nine months of 2010. The increases were primarily due to growth in employee-related expenses of $25.0 and $66.3 in the third quarter and first nine months of 2011, respectively, which were primarily driven by incremental growth in headcount from strategic hiring and business acquisitions.

Sales and Marketing Expenses

Core operating expenses for sales and marketing increased by $72.2 or 31% in the third quarter of 2011 compared with the third quarter of 2010, and by $221.1 or 34% in the first nine months of 2011 compared with the first nine months of 2010. The increases were primarily due to growth in employee-related expenses of $43.1 and $128.0 in the third quarter and first nine months of 2011, respectively, driven by incremental growth in headcount. The negative impact of $13.0 and $28.0, respectively, from fluctuations in the exchange rate between the U.S. Dollar and foreign currencies further contributed to the increases. Additionally, the costs of marketing programs increased by $6.9 and $26.0, respectively, in support of our expanding markets and sales efforts.

General and Administrative Expenses

Core operating expenses for general and administrative increased by $8.4 or 15% in the third quarter of 2011 compared with the third quarter of 2010, and by $23.1 or 14% in the first nine months of 2011 compared with the first nine months of 2010. The increases were primarily due to increases of $7.5 and $20.0 in the third quarter and first nine months of 2011, respectively, related to employee-related expenses primarily due to incremental growth in headcount.

Stock-Based Compensation Expense

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Stock-based compensation, excluding amounts capitalized	$ 88.4	$ 73.7	$ 254.4	$ 205.2
Stock-based compensation capitalized	3.4	1.2	12.4	8.1
Stock-based compensation, including amounts capitalized	$ 91.8	$ 74.9	$ 266.8	$ 213.3

Stock-based compensation expense increased by $16.9 and $53.5 in the third quarter and first nine months of 2011 compared to the third quarter and first nine months of 2010 primarily due to increases of $28.2 and $62.9, respectively, from new awards issued to our existing employees both in the second half of 2010 and the second quarter of 2011, as well as $6.1 and $25.9, respectively, for awards made to new employees in the last twelve months. These increases were partially offset by decreases of $14.9 and $30.8 in the third quarter and first nine months of 2011, respectively, primarily related to fully vested grants and forfeitures.

Stock-based compensation is recorded to each operating expense category based upon the function of the employee to whom the stock-based compensation relates and fluctuates based upon the value and number of awards granted. Compensation philosophy varies by function, resulting in different weightings of cash incentives versus equity incentives. As a result, functions with larger cash-based components, such as commissions, will have comparatively lower stock-based compensation expense than other functions.

As of September 30, 2011, the total unamortized fair value of our outstanding equity-based awards held by our employees was approximately $687.9 and is expected to be recognized over a weighted-average period of approximately 2.7 years. Stock-based compensation expense reported in our accompanying consolidated statements of income is reduced by the amount of stock-based compensation that may be capitalized for the development of new software products and the amount of awards that are forfeited.

Capitalized Software Development Costs, Net

Development costs of software to be sold, leased, or otherwise marketed are subject to capitalization beginning when the products technological feasibility has been established and ending when the product is available for general release. Judgment is required in determining when technological feasibility is established. As our business, products and go-to-market strategy evolve, we continue to evaluate when technological feasibility is established. Changes in judgment as to when technological feasibility is established would likely materially impact the amount of costs capitalized compared to historical periods. For example, if the length of time between technological feasibility and general availability declines in the future, the amount of costs capitalized would likely decrease with a corresponding increase in R&D expense. The R&D expenses and amounts that we capitalize as software development costs may not be comparable to our peer companies due to differences in a variety of factors, including multiple areas of judgment inherent in the assessment of these costs.

In the third quarter of 2011, we capitalized $24.5 (including $3.4 of stock-based compensation) of costs incurred for the development of software products compared with $8.3 (including $1.2 of stock-based compensation) in the third quarter of 2010. In the first nine months of 2011, we capitalized $86.4 (including $12.4 of stock-based compensation) of costs incurred for the development of software products compared with $54.6 (including $8.1 of stock-based compensation) in the first nine months of 2010. These amounts have been excluded from R&D expense on our accompanying consolidated statements of income.

The increases in capitalized software development costs of $16.3 and $33.5 in the third quarter and first nine months of 2011, respectively, were primarily due to increases in capitalized software development costs of $13.1 and $36.6, respectively, for the development of VMware vSphere 5 over prior versions. Additionally, the third quarter and first nine months of 2011 had increases in capitalized software development costs of $11.4 and $14.9, respectively, related to the timing of when certain products reached technological feasibility. The increases in capitalized software costs were partially offset by reductions of $8.3 and $19.7 in third quarter and first nine months of 2011, respectively, as we ceased capitalization on other products due to their general release.

In the third quarter of 2011, amortization expense from capitalized software development costs decreased $11.7 to $14.4 from $26.1 in the third quarter of 2010. In the first nine months of 2011, amortization expense from capitalized software development costs decreased $8.4 to $62.7 from $71.1 in the first nine months of 2010. These amounts are included in cost of license revenues on our accompanying consolidated statements of income. The decrease in the amortization of software development costs during the third quarter and first nine months of 2011 compared with the third quarter and first nine months of 2010 was primarily due to a net decrease of $10.4 and $5.0, respectively, related to the timing of VMware vSphere 5 and prior vSphere releases.

Other Operating Expenses

Other operating expenses consist of employer payroll tax on employee stock transactions and intangible amortization, which are recorded to each individual line of operating expense on our accompanying consolidated statements of income. Additionally, other operating expenses include acquisition-related items, which are recorded to general and administrative expense on our income statement. Other operating expenses increased by $5.8 to $23.0 in the third quarter of 2011 from $17.2 in the third quarter of 2010, and increased by $27.5 to $64.1 in the first nine months of 2011 from $36.6 in the first nine months of 2010. The increase in the third quarter of 2011 was primarily due to additional intangible amortization of $7.7, primarily resulting from new acquisitions, of which $6.1 was recorded to costs of license revenues on our income statement. The increase in the first nine months of 2011 was primarily due to additional intangible amortization of $23.9, primarily resulting from new acquisitions, of which $17.5 was recorded to costs of license revenues on our income statement. In addition, in the first nine months of 2011, there was an increase of $4.5 in employer payroll taxes on employee stock transactions, which was driven by the increase in the market value of our stock and the number of awards exercised, sold or vested, and is recorded to each operating expense category based upon the function of the employee to whom the payroll taxes relate.

Investment Income

Investment income was $4.4 in the third quarter of 2011 and $2.3 in the third quarter of 2010. Investment income was $11.5 in the first nine months of 2011 and $4.0 in the first nine months of 2010. Investment income primarily consists of interest earned on cash, cash equivalents and short-term investment balances partially offset by the amortization of premiums paid on fixed income securities. Investment income increased in the third quarter and first nine months of 2011 as compared with the third quarter and first nine months of 2010 primarily due to a shift from a cash and cash equivalents portfolio primarily invested in money market funds to a short-term investment portfolio of fixed income securities.

Interest Expense with EMC

Interest expense with EMC was $0.9 and $1.2 in the third quarter of 2011 and 2010, respectively. Interest expense with EMC was $2.8 and $3.1 in the first nine months of 2011 and 2010, respectively. Interest expense with EMC consists of interest expense incurred on the note issued to EMC in April 2007 and further amended in June 2011. The interest rate on the note payable resets quarterly and is determined using the 90-day LIBOR rate plus 55 basis points, two business days prior to the first day of each fiscal quarter. For the third quarter of 2011 and 2010, the weighted-average rate was 0.80% and 1.08%, respectively.

Other Income (Expense), Net

Other expense, net of $1.0 in the third quarter of 2011 changed by $2.6 from other income, net of $1.6 in the third quarter of 2010. Other income, net of $55.8 in the first nine months of 2011 changed by $62.8 from other expense, net of $7.0 in the first nine of 2010. The change in the first nine months of 2011 was primarily due to a $56.0 gain recognized on the sale in the second quarter of 2011 of our investment in Terremark Worldwide, Inc., which was acquired by Verizon in a cash transaction.

Income Tax Provision

Our effective income tax rate was 3.1% and 12.6% for the three months ended September 30, 2011 and 2010, respectively. The effective income tax rate was 10.6% and 18.5% for the nine months ended September 30, 2011 and 2010, respectively. The lower effective rate for the three months ended September 30, 2011, compared with the three months ended September 30, 2010, was primarily attributable to the reenactment of the U.S. federal R&D tax credit which occurred during the three months ended December 31, 2010, a change in estimate in the U.S. federal research tax credit calculation, and a change in estimates in the allocation of expenses from U.S. to international jurisdictions. As a result of the changes in estimates, we recognized a favorable tax benefit in the three months ended September 30, 2011, of $16.7 upon the finalization of the 2010 tax returns and a favorable tax benefit of $7.5 related to the first half of 2011. These changes in estimates increased both basic and diluted earnings per share by $0.06 from what would otherwise have been reported in the third quarter of 2011. The impact was not material to the nine months ended September 30, 2011. The lower effective rate for the nine months ended September 30, 2011, compared with the nine months ended September 30, 2010, included the items discussed above as well as a release in uncertain tax benefits due to closure of a tax audit during the second quarter of 2011.

Our rate of taxation in foreign jurisdictions is lower than the U.S. tax rate. Our international income is primarily earned by our subsidiaries in Ireland. We do not believe that any recent or currently expected developments in non-U.S. tax jurisdictions are reasonably likely to have a material impact on our effective tax rate. As of September 30, 2011, our total cash, cash equivalents, and short-term investments were $4.0 billion of which $1.9 billion were held outside the U.S. If these overseas funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes on related undistributed earnings to repatriate these funds. However, our intent is to indefinitely reinvest our non-U.S. earnings in our foreign operations and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. We will meet our U.S. liquidity needs through ongoing cash flows generated from our U.S. operations, external borrowings, or both. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed. All income earned abroad, except for previously taxed income for U.S. tax purposes, is considered indefinitely reinvested in our foreign operations and no provision for U.S. taxes has been provided with respect thereto.

Although we file a federal consolidated tax return with EMC, we calculate our income tax provision on a stand-alone basis. Our effective tax rate in the periods presented is the result of the mix of income earned in various tax jurisdictions that apply a broad range of income tax rates. The rate at which the provision for income taxes is calculated differs from the U.S. federal statutory income tax rate primarily due to different tax rates in foreign jurisdictions where income is earned and considered to be indefinitely reinvested.

We have been included in the EMC consolidated group for U.S. federal income tax purposes, and expect to continue to be included in such consolidated group for periods in which EMC owns at least 80% of the total voting power and value of our outstanding stock as calculated for U.S. federal income tax purposes. The percentage of voting power and value calculated for U.S. federal income tax purposes may differ from the percentage of outstanding shares beneficially owned by EMC due to the greater voting power of our Class B common stock as compared to our Class A common stock and other factors. Each member of a consolidated group during any part of a consolidated return year is jointly and severally liable for tax on the consolidated return of such year and for any subsequently determined deficiency thereon. Should EMC s ownership fall below 80% of the total voting power or value of our outstanding stock in any period, then we would no longer be included in the EMC consolidated group for U.S. federal income tax purposes, and thus no longer be liable in the event that any subsequent income tax liability was incurred, but not discharged, by any other member of the EMC consolidated group. Additionally, our U.S. federal income tax would be reported separately from that of the EMC consolidated group.

Our effective tax rate for the remainder of 2011 may be affected by such factors as changes in tax laws, regulations or rates, changing interpretation of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, changes in our international organization, shifts in the amount of income before tax earned in the U.S. as compared with other regions in the world, and changes in overall levels of income before tax.

Our Relationship with EMC

As of September 30, 2011, EMC owned 36,978,000 shares of Class A common stock and all 300,000,000 shares of Class B common stock, representing 79.8% of our total outstanding shares of common stock and 97.3% of the combined voting power of our outstanding common stock.

In April 2011, we acquired certain assets relating to EMC s Mozy cloud-based data storage and data center services, including certain data center assets and a license to certain intellectual property, for approximately $8.0. We also entered into an operational support agreement with EMC pursuant to which we took over responsibility to operate the Mozy service on behalf of EMC. We hired more than 300 Mozy employees and, pursuant to the support agreement, costs incurred by us to support EMC s Mozy services, plus a mark-up intended to approximate third-party costs, are reimbursed to us by EMC. On the consolidated statements of income, such amounts were approximately $13.1 and $25.3, respectively, in the three and nine months ended September 30, 2011 and were recorded as a reduction to the costs we incurred. EMC retained ownership of the Mozy business and its remaining assets. EMC continues to be responsible to Mozy customers for Mozy products and services, and continues to recognize revenue from such products and services. As such, the assets acquired from EMC did not constitute a business and were accounted for as an asset purchase between entities under common control pursuant to generally accepted accounting principles. Accordingly, we included the carrying value of the transferred assets as of the date of transfer in our consolidated financial statements.

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In April 2010, we acquired certain software product technology and expertise from EMC s Ionix IT management business for cash consideration of $175.0. EMC retained the Ionix brand and will continue to offer customers the products acquired by us, pursuant to the ongoing reseller agreement between EMC and us. In the three and nine months ended September 30, 2011, $1.9 and $14.4, respectively, of contingent amounts were paid to EMC in accordance with the asset purchase agreement. These payments were recorded as a reduction to the capital contribution from EMC. As of September 30, 2011, all contingent obligations under the asset purchase agreement had been met and no further payments related to these obligations will be due to EMC. See our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 for further information.

Pursuant to the ongoing reseller arrangement with EMC that commenced in 2009, EMC bundles our products and services with EMC s hardware and sells them to end-users. In the three months ended September 30, 2011 and 2010, we recognized revenues of $16.7 and $8.0, respectively, from products and services sold pursuant to our reseller arrangement with EMC. In the nine months ended September 30, 2011 and 2010, we recognized revenues of $50.9 and $25.0, respectively, from products sold pursuant to our reseller arrangement with EMC. As of September 30, 2011, $58.6 of revenues from products and services sold under the reseller arrangement were included in unearned revenues.

In the three months ended September 30, 2011 and 2010, we recognized professional services revenues of $13.2 and $16.6, respectively, for services provided to EMC s customers pursuant to our contractual agreements with EMC. In the nine months ended September 30, 2011 and 2010, we recognized professional services revenues of $44.0 and $38.6, respectively, from such contractual arrangements with EMC. As of September 30, 2011, $4.8 of revenues from professional services to EMC customers were included in unearned revenues.

In the three months ended September 30, 2011 and 2010, we recognized revenues of $1.0 and $2.5, respectively, from server and desktop products and services purchased by EMC for internal use pursuant to our contractual agreements with EMC. In the nine months ended September 30, 2011 and 2010, we recognized $2.0 and $4.8, respectively, from such contractual arrangements with EMC. As of September 30, 2011, $18.0 of revenues from server and desktop products and services purchased by EMC for internal use were included in unearned revenues.

We purchased storage systems and software, as well as consulting services, from EMC for $3.8 and $6.7 in the three months ended September 30, 2011 and 2010, respectively, and for $17.2 and $13.2 in the nine months ended September 30, 2011 and 2010, respectively.

In certain geographic regions where we do not have an established legal entity, we contract with EMC subsidiaries for support services and EMC employees who are managed by our personnel. The costs incurred by EMC on our behalf related to these employees are passed on to us and we are charged a mark-up intended to approximate costs that would have been charged had we contracted for such services with an unrelated third party. These costs are included as expenses in our consolidated statements of income and primarily include salaries and benefits, travel and rent. Additionally, from time to time, EMC incurs certain administrative costs on our behalf in the U.S. The total cost of the services provided to us by EMC as described above was $21.1 and $18.0 in the three months ended September 30, 2011 and 2010, respectively, and $63.8 and $49.8 in the nine months ended September 30, 2011 and 2010, respectively.

As calculated under our tax sharing agreement with EMC, EMC paid us $100.0 and $276.4 in the three and nine months ended September 30, 2011, respectively, resulting from our stand-alone federal taxable loss estimated for both fiscal year 2010 and the six months ended June 30, 2011, as well as a refund of our overpayment related to fiscal year 2009. Under the tax sharing agreement, EMC paid us $2.5 for the nine months ended September 30, 2010, resulting from our stand-alone federal and state taxable losses for 2008. No payments were made by EMC to us during the three months ended September 30, 2010. We paid $5.1 to EMC in the nine months ended September 30, 2010 for our portion of EMC s 2009 consolidated federal income taxes. No payments were made to EMC by us in the three and nine months ended September 30, 2011 and in the three months ended September 30, 2010. The amounts that we pay to or receive from EMC for its portion of federal income taxes on EMC s consolidated tax return differ from the amounts we would owe or receive on a stand-alone basis and the difference is presented as a component of stockholders equity. For all periods presented the difference was not material.

In the three months ended September 30, 2011 and 2010, $0.9 and $1.2, respectively, of interest expense was recorded related to the note payable to EMC and included in interest expense with EMC on our consolidated statements of income. In the nine months ended September 30, 2011 and 2010, $2.8 and $3.1, respectively, of interest expense was recorded related to the note payable. Our interest expense as a separate, stand-alone company may be higher or lower than the amounts reflected in the consolidated financial statements. In June 2011, we and EMC amended the note to extend its maturity date from April 16, 2012 to April 16, 2015.

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As of September 30, 2011, we had net $12.5 due from EMC, which consisted of $42.0 due from EMC, partially offset by $29.5 due to EMC. These amounts resulted from the related party transactions described above. In addition to the $12.5 due from EMC as of September 30, 2011, we had $38.8 of income taxes receivable due from EMC, which is included in other current assets and $12.1 of income taxes payable, which was included in accrued expenses and other, on our consolidated balance sheets. The income tax receivable is related to 2011 and 2010 federal income taxes and is expected to be received from EMC in the fourth quarter of 2011. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter-end. The timing of the tax payments due to and from EMC is governed by the tax sharing agreement with EMC.

By nature of EMC s majority ownership of us, the amounts we recorded for our intercompany transactions with EMC may not be considered arm s length with an unrelated third party. Therefore the financial statements included herein may not necessarily reflect our financial condition, results of operations and cash flows had we engaged in such transactions with an unrelated third party during all periods presented. Accordingly, our historical results should not be relied upon as an indicator of our future performance as a stand-alone company.

Liquidity and Capital Resources

During the second quarter of 2010, we began investing in fixed income securities, which drove a shift from cash and cash equivalents to short-term investments. Our fixed income investment portfolio is denominated in U.S. Dollars and consists of various holdings, types and maturities. Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk.

	September 30,	
	2011	2010
Cash and cash equivalents	$ 1,549.8	$ 1,347.1
Short-term investments	2,426.9	1,557.1
Total cash, cash equivalents and short-term investments	$ 3,976.7	$ 2,904.2

Our operating activities in the third quarter and first nine months of 2011 and 2010, respectively, generated sufficient cash to meet our operating needs. Our cash flows for the third quarter and first nine months of 2011 and 2010 were as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Net cash provided by (used in):				
Operating activities	$ 523.5	$ 196.7	$ 1,464.2	$ 767.8
Investing activities	(651.0)	(970.9)	(1,430.6)	(2,074.1)
Financing activities	(113.8)	52.7	(112.7)	167.0
Net decrease in cash and cash equivalents	$ (241.3)	$ (721.5)	$ (79.1)	$ (1,139.3)

In evaluating our liquidity internally, we focus on long-term, sustainable growth in free cash flows and in non-GAAP cash flows from operating activities (non-GAAP operating cash flows). We define non-GAAP operating cash flows as net cash provided by operating activities less capitalized software development costs plus the excess tax benefits from stock-based compensation. We define free cash flows, also a non-GAAP financial measure, as non-GAAP operating cash flows less capital expenditures. See Non-GAAP Financial Measures for additional information.

Our non-GAAP operating cash flows and free cash flows for the three months and trailing twelve months ended September 30, 2011 and 2010 were as follows:

	For the Three Months Ended September 30,		For the Trailing Twelve Months Ended September 30,	
	2011	2010	2011	2010
Net cash provided by operating activities	$ 523.5	$ 196.7	$ 1,870.8	$ 1,051.5
Capitalized software development costs	(21.1)	(7.0)	(90.0)	(63.3)
Excess tax benefits from stock-based compensation	46.4	78.7	254.0	180.6
Non-GAAP operating cash flows	548.8	268.4	2,034.8	1,168.8
Capital expenditures	(54.9)	(31.1)	(217.6)	(114.7)
Free cash flows	$ 493.9	$ 237.3	$ 1,817.2	$ 1,054.1

Free cash flows increased by $763.1 or 72% to $1,817.2 for the trailing twelve months ended September 30, 2011 from $1,054.1 for the trailing twelve months ended September 30, 2010. The increase was primarily due to increased sales and related cash collections.

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Historically, we have invested excess cash predominantly in money market securities that are liquid and of high quality investment grade. The fair value for money market securities is determined based on quoted market prices as of the valuation date. We limit the amount of our domestic and international investments with any single issuer and any single financial institution, and also monitor the diversity of the portfolio, thereby diversifying the credit risk. In the second quarter of 2010, we began investing in fixed income securities. As of September 30, 2011, we held a diversified portfolio of money market funds and fixed income securities, which primarily consisted of highly liquid debt instruments of the U.S. government and its agencies, U.S. municipal obligations, and U.S. and foreign corporate debt securities.

As of September 30, 2011, our total cash, cash equivalents, and short-term investments were $3,976.7 of which $1,896.5 was held outside the U.S. If these overseas funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes on related undistributed earnings to repatriate these funds. However, our intent is to indefinitely reinvest our non-U.S. earnings in our foreign operations and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

We expect to continue to generate positive cash flows from operations and to use cash generated by operations as our primary source of liquidity. We believe that existing cash and cash equivalents, together with any cash generated from operations will be sufficient to meet normal operating requirements including strategic acquisitions and capital expenditures for at least the next twelve months.

Operating Activities

Cash provided by operating activities is driven by our net income, adjusted for non-cash items and changes in assets and liabilities. Non-cash adjustments include depreciation, amortization of intangible assets, amortization of premiums paid upon purchase of investments in our fixed income portfolio, stock-based compensation expense, deferred income taxes, excess tax benefits from stock-based compensation and other adjustments. Net changes in assets and liabilities were impacted by increases in unearned revenues in the periods presented, and we expect this trend to continue in the future.

Cash provided by operating activities increased by $326.8 to $523.5 in the third quarter of 2011 from $196.7 in the third quarter of 2010. Cash provided by operating activities increased by $696.5 to $1,464.2 in the first nine months of 2011 from $767.8 in the first nine months of 2010. The increase in both periods was primarily the result of an increase in cash collections from customers driven by strong sales volume. In addition, in the third quarter and first nine months of 2011, we benefited from the collection of $100.0 and $276.4, respectively, on the income tax receivable from EMC. There were no significant amounts collected from EMC under the tax sharing agreement during the third quarter and first nine months of 2010. Under the tax sharing agreement, EMC is obligated to pay to us an amount equal to the tax benefit that EMC will realize from our loss on its consolidated tax return. The increase in cash collections and the benefit from the collection of the income tax receivable was partially offset by increases in our core operating expenses, primarily related to incremental headcount from strategic hiring and business acquisitions.

Investing Activities

Cash used in investing activities is primarily attributable to the purchase of fixed income securities, business acquisitions, capital expenditures and capitalized software development costs. Cash provided by investing activities is primarily attributable to the sales or maturities of fixed income securities and the sale of strategic investments.

In addition, in the second quarter of 2011, we closed an agreement to purchase all of the right, title and interest in a ground lease covering the property and improvements located adjacent to our Palo Alto, California campus for $225.0. We paid the seller $45.0 in the first quarter of 2011 as a good faith deposit and in the second quarter of 2011, we paid the remaining $180.0. Based upon the respective fair values and our preliminary assumptions, $51.9 of the purchase price was recorded to property and equipment, net and the remaining $173.1 was recorded to intangible assets, net on the June 30, 2011 consolidated balance sheet. In the third quarter of 2011, the gross amount classified to property and equipment, net was increased by $22.0 to $73.9 to reflect the final assumptions regarding our intended use of the existing structures. As a result of this adjustment, the gross amount of the value attributed to the leasehold interest was decreased by the same amount. Refer to Note G to the consolidated financial statements for further information. The $22.0 adjustment is reflected on the consolidated statement of cash flows for the third quarter of 2011. For the first nine months of 2011, the final value of $73.9 paid and attributed to the property is included within additions to property and equipment and the $151.1 paid and attributed to the intangible assets is separately disclosed within net cash used in investing activities on the consolidated statement of cash flows. Our renovation of the new property will be a multi-year project with capital investment extending into future periods.

We began investing in fixed income securities during the second quarter of 2010 to achieve our objective of an appropriate investment return consistent with the preservation of principal and management of risk. Total fixed income securities of $955.7 and $2,083.5, respectively, were purchased in the third quarter and first nine months of 2011. In the third quarter and first nine months of 2010, we purchased $964.7 and

$1,624.7, respectively, of fixed income securities. All purchases of fixed income securities are classified as cash outflows from investing activities. We classify these investments as short-term investments on our consolidated balance sheets based upon the nature of the security and their availability for use in current operations or for other purposes, such as business acquisitions and strategic investments. These cash outflows were partially offset by cash inflows of $463.4 and $1,333.0 in the third quarter and first nine months of 2011, respectively, as a result of the sales and maturities of fixed income securities. In both the third quarter and first nine months of 2010, the cash inflows were $155.1 from sales and maturities of fixed income securities.

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In the second quarter of 2011, we sold our investment in Terremark Worldwide, Inc., which was acquired by Verizon in a cash transaction, for $76.0.

In the third quarter and first nine months of 2011, we paid $99.5 and $303.6, respectively, for business acquisitions as compared with $125.8 and $293.0, respectively, paid for various business acquisitions in the third quarter and first nine months of 2010. Business acquisitions are an important element in our industry and we expect to continue to consider additional strategic business acquisitions in the future. Refer to Note F to the consolidated financial statements for further information.

In the second quarter of 2010, we paid $175.0 to EMC to acquire certain software product technology and expertise from their Ionix IT management business. The net assets and expertise acquired from EMC constituted a business and were accounted for as a business combination between entities under common control. In subsequent quarters, total payments of $25.0 were made to EMC to satisfy contingent obligations under the asset purchase agreement. As of September 30, 2011, all contingent payments under the agreement had been made. Refer to Note N to the consolidated financial statements for further information.

Financing Activities

Proceeds from the issuance of our Class A common stock from the exercise of stock options and the purchase of shares under the VMware Employee Stock Purchase Plan (ESPP) were $84.6 and $139.9 in the third quarter of 2011 and 2010, respectively. Proceeds from the issuance of our Class A common stock from the exercise of stock options and the purchase of shares under ESPP were $285.3 and $355.8 in the first nine months of 2011 and 2010, respectively.

In the third quarter and first nine months of 2011, the cash inflows were offset by cash outflows of $210.5 and $490.9 respectively, to repurchase shares of our Class A common stock as part of our stock repurchase programs. In February 2011, a committee of our Board of Directors authorized the repurchase of up to $550.0 of our Class A common stock through the end of 2012. From time-to-time, stock repurchases may be made pursuant to the February 2011 authorization in open market transactions or privately negotiated transactions as permitted by securities laws and other legal requirements. In the third quarter and first nine months of 2010, we paid $141.4 and $285.9, respectively, to repurchase shares of our Class A common stock under the stock repurchase program approved in March 2010. Purchases under the March 2010 authorization were completed in March 2011.

In the third quarter and first nine months of 2011, we repurchased and retired 2.4 million and 5.5 million shares, respectively, of our Class A common stock at a weighted-average price of $88.81 and $88.63 per share, respectively, for an aggregate purchase price of $210.5 and $490.9, respectively, including commissions. We are not obligated to purchase any shares under our stock repurchase programs. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including our stock price, corporate and regulatory requirements and other market and economic conditions. Purchases can be discontinued at any time that we feel that additional purchases are not warranted. As of September 30, 2011, the authorized amount remaining for repurchase was $120.6.

There were additional cash outflows of $34.2 and $24.5 in the third quarter of 2011 and 2010, respectively, and $104.8 and $70.1 in the first nine months of 2011 and 2010, respectively, to cover tax withholding obligations in conjunction with the net share settlement upon the vesting of restricted stock units and restricted stock. Additionally, the excess tax benefit from stock-based compensation was $46.4 and $78.7 in the third quarter of 2011 and 2010, respectively, and $197.7 and $167.2 in the first nine months of 2011 and 2010, respectively, and is shown as a reduction to cash flows from operating activities and an increase to cash flows from financing activities. The year-over-year changes in the repurchase of shares and the excess tax benefit from stock-based compensation in the third quarter and first nine months of 2011 were primarily due to the increases in the market value of our stock and the number of awards exercised, sold or vested.

Future cash proceeds from issuances of common stock and the excess tax benefit from stock-based compensation and future cash outflows to repurchase our shares to cover tax withholding obligations will depend upon, and could fluctuate significantly from period-to-period based on the market value of our stock, the number of awards exercised, sold or vested, the tax benefit realized and the tax-affected compensation recognized.

Note Payable to EMC

As of September 30, 2011, $450.0 remained outstanding on a note payable to EMC, with interest payable quarterly in arrears. In June 2011, we and EMC amended and restated the note to extend the maturity date of the note to April 16, 2015 and to modify the principal amount of the note to reflect the outstanding balance of $450.0. The interest rate continues to reset quarterly and bears an interest rate of the 90-day LIBOR plus 55 basis points.

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Non-GAAP Financial Measures

Regulation S-K Item 10(e), Use of Non-GAAP Financial Measures in Commission Filings, defines and prescribes the conditions for use of non-GAAP financial information. Our measures of core operating expenses, non-GAAP operating cash flows and free cash flows each meet the definition of a non-GAAP financial measure.

Core Operating Expenses

Management uses the non-GAAP measure of core operating expenses to understand and compare operating results across accounting periods, for internal budgeting and forecasting purposes, for short- and long-term operating plans, to calculate bonus payments and to evaluate our financial performance, the performance of its individual functional groups and the ability of operations to generate cash. Management believes that core operating expenses reflect our business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business, as they exclude certain expenses that are not reflective of our operating results.

We define core operating expenses as our total operating expenses excluding the following components, which we believe are not reflective of our operational expenses. In each case, for the reasons set forth below, management believes that excluding the component provides useful information to investors and others in understanding and evaluating our operating results and future prospects in the same manner as management, in comparing financial results across accounting periods and to those of peer companies and to better understand the long-term performance of our core business.

Stock-based compensation. Stock-based compensation expense is generally fixed at the time the stock-based instrument is granted and amortized over a period of several years. Although stock-based compensation is an important aspect of the compensation of our employees and executives, determining the fair value of the stock-based instruments can involve a high degree of judgment and estimation and the expense recorded may bear little resemblance to the actual value realized by the grantee. Furthermore, unlike cash compensation, the value of stock-based compensation is subject to varying valuation methodologies and subjective assumptions related to different award types and incorporates certain factors, such as market volatility, that are beyond our control.

Amortization and capitalization of software development costs. Amortization and capitalization of software development costs can vary significantly depending upon the timing of products reaching technological feasibility and being made generally available.

Other expenses. Other expenses excluded are employer payroll taxes on employee stock transactions, amortization of intangible assets and acquisition-related items. The amount of employer payroll taxes on stock-based compensation is dependent on our stock price and other factors that are beyond our control and do not correlate to the operation of the business. Regarding the amortization of intangible assets, a portion of the purchase price of our acquisitions is generally allocated to intangible assets, such as intellectual property, and is subject to amortization. Additionally, the amount of an acquisition s purchase price allocated to intangible assets and the term of its related amortization can vary significantly and are unique to each acquisition. Acquisition-related items include direct costs of acquisitions, such as transaction fees, which vary significantly and are unique to each acquisition. However, we do not acquire businesses on a predictable cycle.

Non-GAAP operating cash flows and free cash flows

We define non-GAAP operating cash flows as net cash provided by operating activities less capitalized software development costs plus the excess tax benefits from stock-based compensation. We define free cash flows as non-GAAP operating cash flows less capital expenditures. Management uses non-GAAP operating cash flows as another measure of cash flows from operations because this measure offers a perspective of our operating cash flows that aligns with how management internally views our overall and individual functional group operating results. When viewing operating results for evaluating our past performance and for planning purposes, management excludes certain items, including the effect of capitalizing and amortizing software development costs and items related to stock-based compensation, which are also excluded in the non-GAAP operating cash flows measure. Management uses free cash flows as a measure of financial progress in our business, as it balances operating results, cash management and capital efficiency. In addition to quarterly free cash flows, management also focuses on trailing twelve month free cash flows, as free cash flows can be volatile in the short-term.

We believe that our measures of non-GAAP operating cash flows and free cash flows provide useful information to investors and others, as they allow for meaningful period-to-period comparisons of our operating cash flows for analysis of trends in our business. Additionally, we believe that information regarding non-GAAP operating cash flows and free cash flows provides investors and others with an important perspective on cash that we may choose to make available for strategic acquisitions and investments, the repurchase of shares, operations and other capital expenditures.

We deduct capitalization of software development costs from both measures because these costs are considered to be a necessary component of our operations and the amount capitalized under GAAP can vary significantly from period-to-period depending upon the timing of products reaching technological feasibility and being made generally available. Consequently, software development costs paid out during a period that are capitalized under GAAP and do not impact GAAP operating cash flows for that period do result in a decrease to our measures of non-GAAP operating cash flows and non-GAAP free cash flows, thereby providing management with useful measures of cash flows generated from operations during the period. We add back the excess income tax benefits from stock-based compensation to our measures of non-GAAP operating cash flows and free cash flows as management internally views cash flows arising from income taxes as similar to operating cash flows rather than as financing cash flows as required under GAAP. Furthermore, we exclude capital expenditures on property and equipment from free cash flows because these expenditures are also considered to be a necessary component of our operations.

Limitations on the use of Non-GAAP financial measures

A limitation of our non-GAAP financial measures of core operating expenses, non-GAAP operating cash flows and free cash flows is that they do not have uniform definitions. Our definitions will likely differ from the definitions used by other companies, including peer companies, and therefore comparability may be limited. Thus, our non-GAAP measures of core operating expenses, non-GAAP operating cash flows and free cash flows should be considered in addition to, not as a substitute for, or in isolation from, measures prepared in accordance with GAAP. Additionally, in the case of stock-based compensation, if we did not pay out a portion of compensation in the form of stock-based compensation and related employer payroll taxes, the cash salary expense included in costs of revenues and operating expenses would be higher which would affect our cash position. Further, the non-GAAP measure of core operating expenses has certain limitations because it does not reflect all items of income and expense that affect our operations and are reflected in the GAAP measure of total operating expenses.

We compensate for these limitations by reconciling core operating expenses to the most comparable GAAP financial measure. Management encourages investors and others to review our financial information in its entirety, not to rely on any single financial measure and to view our non-GAAP financial measures in conjunction with the most comparable GAAP financial measures.

See Results of Operations Operating Expenses for a reconciliation of the non-GAAP financial measure of core operating expenses to the most comparable GAAP measure, total operating expenses, for the third quarter and first nine months of 2011 and 2010.

See Liquidity and Capital Resources for a reconciliation of non-GAAP operating cash flows and free cash flows to the most comparable GAAP measure, net cash provided by operating activities, for the third quarter and first nine months of 2011 and 2010.

Off-Balance Sheet Arrangements, Contractual Obligations, Contingent Liabilities and Commitments

There were no substantial changes to our guarantee and indemnification obligations or our contractual commitments in the third quarter of 2011.

Critical Accounting Policies

Our consolidated financial statements are based on the selection and application of accounting principles generally accepted in the United States of America that require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements. We believe that the critical accounting policies set forth within Item 7 of our 2010 Annual Report on Form 10-K may involve a higher degree of judgment and complexity in their application than our other significant accounting policies and represent the critical accounting policies used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements, including, without limitation, statements regarding: the potential role of our products in cloud computing and other shifts in computing infrastructures; expectations of, and our plans for, achieving future business growth; macroeconomic conditions; future product offerings; plans for future acquisitions; our view of the competitive landscape and our plans for maintaining our leadership position through continuing investments; our expectation that we will be able to fund strategic investments through operating cash flows generated by sales of our products and services; our plans for funding expansion of our industry segment share and developing long term relationships with our customers; our plans for geographic expansion; our relationship with EMC; our plans for meeting product development objectives and introducing new products; our revenue outlook and mix; customer demand for our products; trends in enterprise license agreement (ELA) size and renewals and information technology (IT) spending in general; macroeconomic trends; the delivery of professional services to our customers; the sufficiency of our liquidity and capital reserves to fund our operations and business strategy; continuation of our stock repurchase program; factors affecting our tax position; expected expenditures to improve the real estate parcel adjacent to our headquarters that we recently purchased; our plans regarding cash, cash equivalents and short-term investments held in non-U.S. accounts; our expectations with respect to costs associated with foreign currency fluctuation and internal development; and our belief that the resolution of pending claims, legal proceedings and investigations will not have a material adverse effect on us.

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These forward-looking statements involve risks and uncertainties and the cautionary statements set forth above and those contained in the section of this report and our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 entitled Risk Factors identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We assume no obligation to, and do not currently intend to, update these forward-looking statements.

New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 is effective for each reporting entity s first annual reporting period that begins after December 15, 2011. We plan to adopt ASU 2011-05 on January 1, 2012 and will present comprehensive income in accordance with the requirements of the standard.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards* (ASU 2011-04). ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. ASU 2011-04 is effective for each reporting entity s first interim and annual reporting period that begins after December 15, 2011 and should be applied prospectively. Early application is not permitted. We are currently evaluating the impact of adopting ASU 2011-04, but currently believe there will be no significant impact on our consolidated financial statements.

Available Information

Our website is located at www.vmware.com, and our investor relations website is located at http://ir.vmware.com. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, all of which is made available free of charge, including:

- our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission (SEC);

- announcements of investor conferences, speeches and events at which our executives talk about our product, service and competitive strategies. Archives of these events are also available for a limited time;

- additional information on financial metrics, including reconciliations of non-GAAP financial measures discussed in our presentations to the nearest comparable GAAP measure;

- press releases on quarterly earnings, product and service announcements, legal developments and international news;

- corporate governance information including our certificate of incorporation, bylaws, corporate governance guidelines, board committee charters, business conduct guidelines (which constitutes our code of business conduct and ethics) and other governance-related policies;

- other news, blogs and announcements that we may post from time to time that investors might find useful or interesting; and

- opportunities to sign up for email alerts and RSS feeds to have information pushed in real time.

The information found on our website is not part of, and is not incorporated by reference into, this or any other report we file with, or furnish to, the SEC.

Unless the context requires otherwise, we are referring to VMware, Inc. when we use the terms VMware, the Company, we, our or us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

We operate in foreign countries, which expose us to market risk associated with foreign currency exchange rate fluctuations between the U.S. Dollar and various foreign currencies, the most significant of which is the Euro.

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International revenues as a percentage of total revenues were 52.9% and 49.3% in the third quarters of 2011 and 2010, respectively, and 52.2% and 49.9% in the first nine months of 2011 and 2010, respectively. Historically, our revenue contracts were primarily denominated in U.S. Dollars. In May 2009, we began to invoice and collect in the Euro, the British Pound, the Japanese Yen and the Australian Dollar in their respective regions. Additionally, a portion of our operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, sales and sales support and research and development, are denominated in foreign currencies, primarily those foreign currencies in which we also invoice and collect. Revenues resulting from selling in local currencies and costs incurred in local currencies are exposed to foreign exchange rate fluctuations which can affect our operating income. As exchange rates vary, operating margins may differ materially from expectations.

Operating expenses were negatively impacted by $21.5 million and $45.6 million in the third quarter and nine months of 2011, respectively, due to fluctuations in the exchange rates between the U.S. Dollar and foreign currencies as compared with the same periods in the prior year.

To manage the risk associated with fluctuations in foreign currency exchange rates, we utilize derivative financial instruments, such as foreign currency forward contracts. We enter into foreign currency forward contracts to hedge a portion of our net outstanding monetary assets and liabilities against movements in certain foreign exchange rates. Our foreign currency forward contracts are generally traded on a monthly basis with a typical contractual term of one month. As of September 30, 2011, we had outstanding forward contracts with a total notional value of $147.4 million. The fair value of these forward contracts was immaterial as of September 30, 2011. There can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. A hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in a potential loss in fair value of our foreign currency forward contracts of $14.7 million as of September 30, 2011. This sensitivity analysis disregards any potentially offsetting gain that may be associated with the underlying foreign-currency denominated assets and liabilities that we hedge. This analysis also assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. Dollar; however, foreign currency exchange rates do not always move in such a manner and actual results may differ materially. We do not enter into speculative foreign exchange contracts for trading purposes. See Note E to the consolidated financial statements for further information.

Interest Rate Risk

Fixed Income Securities

During the second quarter of 2010, we began investing in fixed income securities. Our fixed income investment portfolio is denominated in U.S. Dollars and consists of various holdings, types and maturities.

Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in interest rates or credit spreads could have a material adverse impact on the fair value of our fixed income investment portfolio. Hypothetical changes in interest rates of 50 basis points and 100 basis points would have changed the fair value of our fixed income investment portfolio as of September 30, 2011 by $11.9 million and $23.9 million, respectively. This sensitivity analysis assumes a parallel shift of all interest rates, however, interest rates do not always move in such a manner and actual results may differ materially. We monitor our interest rate and credit risk, including our credit exposures to specific rating categories and to individual issuers. There were no impairment charges on our cash equivalents and fixed income securities during the third quarter of 2011. These instruments are not leveraged and we do not enter into speculative securities for trading purposes. See Notes D and E to the consolidated financial statements for further information.

Note Payable to EMC

As of September 30, 2011, $450.0 million was outstanding on our consolidated balance sheet in relation to the note payable to EMC. The interest rate on the note payable was 0.80% as of September 30, 2011 and 1.08% as of September 30, 2010. In the third quarter of 2011 and 2010, $0.9 million and $1.2 million, respectively, of interest expense was recorded in each period related to the note payable. In the first nine months of 2011 and 2010, $2.8 million and $3.1 million, respectively, of interest expense were recorded in each period related to the note payable.

The note may be repaid, without penalty, at any time. In June 2011, we and EMC amended and restated the note to extend the maturity date of the note to April 16, 2015 and to modify the principal amount of the note to reflect the outstanding balance of $450.0 million. The amended agreement continues to bear an interest rate of the 90-day LIBOR plus 55 basis points, with interest payable quarterly in arrears. The interest rate on the note resets quarterly and is determined on the two business days prior to the first day of each fiscal quarter. If the interest rate on the note payable were to change 100 basis points from the September 30, 2011 rate, and assuming no additional repayments on the principal were made, our annual interest expense would change by $4.5 million.

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Equity Price Risk

During the second quarter of 2011, we sold our investment in Terremark Worldwide, Inc., which was acquired by Verizon in a cash transaction. As a result, we no longer have investments in equity securities that expose us to market risk associated with publicly traded equity securities.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by the Exchange Act, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Controls Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended September 30, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Controls

Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

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PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note K to the consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of legal proceedings. See also the risk factor entitled We may become involved in litigation that may adversely affect us in Part II, Item 1A of this Quarterly Report on Form 10-Q for a discussion of potential risks to our results of operations and financial condition that may arise from legal proceedings.

ITEM 1A. RISK FACTORS

The risk factors that appear below could materially affect our business, financial condition and results of operations. The risks and uncertainties described below are not the only risks and uncertainties facing us. Our business is also subject to general risks and uncertainties that affect many other companies.

Risks Related to Our Business

The virtualization and cloud computing products and services we sell are now increasingly targeted at emerging applications and therefore the potential market for our products remains uncertain.

Our products and services are based on computer virtualization and related technologies that have primarily been used for virtualizing on-premises data centers. We are also designing our products and services for use in emerging applications as a platform for cloud computing and end-user computing. Cloud computing applications for our products and services include infrastructure-as-a-service, or IaaS, platform-as-a-service, or PaaS, and software-as-a-service, or SaaS . Our success depends on organizations and customers perceiving technological and operational benefits and cost savings associated with the increasing adoption of virtual infrastructure solutions for on-premises data centers as well as for cloud computing and end-user computing. Although the use of virtualization technologies on servers and in on-premises data centers has gained acceptance for enterprise-level applications, the extent to which adoption of virtualization for cloud computing and end-user computing remains uncertain. As the markets for our products mature and the scale of our business increases, the rate of growth in our product sales will likely be lower than those we have experienced in earlier periods. In addition, to the extent that virtualization infrastructure solutions are adopted more slowly or less comprehensively than we expect, our revenue growth rates may slow materially or our revenue may decline substantially.

We expect to face increasing competition that could result in a loss of customers, reduced revenues or decreased operating margins.

The virtualization, cloud computing, and end-user computing markets are inter-related and rapidly evolving, and we expect competition to significantly intensify in the future. For example, Microsoft continues to make incremental improvements to its virtual infrastructure and virtual management products. Microsoft also has cloud-based computing offerings. We also face competition from other companies that have announced a number of new product initiatives, alliances and consolidation efforts. For example, Citrix Systems continues to enhance its end-user and server virtualization offerings and now has a client hypervisor in the market. IBM, Google and Amazon have existing cloud computing offerings and announced new cloud computing initiatives. Red Hat has also released commercial versions of Linux that have virtualization capabilities as part of the Linux kernel (KVM) and has also announced plans for cloud computing products. Other companies have also indicated their intention to expand offerings of virtual management and cloud computing solutions.

We believe that the key competitive factors in the virtualization and cloud computing markets include:

- the level of reliability and new functionality of product offerings;

the ability to provide comprehensive solutions, including management capabilities;

the ability to provide end-users access to their applications and data from multiple devices and through multiple content delivery mechanisms;

the ability to offer products that support multiple hardware platforms and operating systems;

the proven track record of formulating and delivering a roadmap of virtualization and cloud computing capabilities;

competitive pricing of products, individually and in bundles;

the ability to attract and preserve a large installed base of customers;

the ability to attract and preserve a large number of application developers to develop to a given cloud ecosystem;

the ability to create and maintain partnering opportunities with hardware vendors, infrastructure software vendors and cloud service providers;

the ability to develop robust indirect sales channels; and

the ability to attract and retain cloud, virtualization and systems experts as key employees.

Existing and future competitors may introduce products in the same markets we serve or intend to serve, and competing products may have better performance, lower prices, better functionality and broader acceptance than our products. Our competitors may also add features to their virtualization, end-user and cloud computing products similar to features that presently differentiate our product offerings from theirs. Many of our current or potential competitors also have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we do. This competition could result in increased pricing pressure and sales and marketing expenses, thereby materially reducing our operating margins, and could harm our ability to increase, or cause us to lose, market share. Increased competition also may prevent us from entering into or renewing service contracts on terms similar to those that we currently offer and may cause the length of our sales cycle to increase. Some of our competitors and potential competitors supply a wide variety of products to, and have well-established relationships with, our current and prospective end-users. For example, small to medium sized businesses and companies in emerging markets that are evaluating the adoption of virtualization-based technologies and solutions may be inclined to consider Microsoft solutions because of their existing use of Windows and Office products. Some of these competitors have in the past and may in the future take advantage of their existing relationships to engage in business practices that make our products less attractive to our end-users. Other competitors have limited or denied support for their applications running in VMware virtualization environments. These distribution, licensing and support restrictions, as well as other business practices that may be adopted in the future by our competitors, could materially impact our prospects regardless of the merits of our products. In addition, competitors with existing relationships with our current or prospective end-users could in the future integrate competitive capabilities into their existing products and make them available without additional charge. For example, Oracle provides free server virtualization software intended to support Oracle and non-Oracle applications, and Microsoft offers its own server virtualization software packaged with its Windows Server product and may offer built-in virtualization for future releases of the client version of Windows. Competitors may also leverage open source technologies to offer zero or low cost products capable of putting pricing pressure on our own product offerings. By engaging in such business practices, our competitors can diminish competitive advantages we may possess by incentivizing end-users to choose products that lack some of the technical advantages of our own offerings.

We also face potential competition from our partners. For example, third parties currently selling our products could build and market their own competing products and services or market competing products and services of third parties. If we are unable to compete effectively, our growth and our ability to sell products at profitable margins could be materially and adversely affected.

Ongoing uncertainty regarding global economic conditions and the stability of regional financial markets may reduce information technology spending below current expectations and therefore adversely impact our revenues, impede end-user adoption of new products and product upgrades and adversely impact our competitive position.

Our business depends on the overall demand for information technology and on the economic health of our current and prospective customers. The purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Weak economic conditions or significant uncertainty regarding the stability of financial markets could adversely impact our business, financial condition and results of operations in a number of ways, including by lengthening sales cycles, affecting the size of enterprise license agreements (ELAs) that customers will commit to, lowering prices for our products and services, reducing unit sales, reducing the rate of adoption of our products by new customers and the willingness of current customers to purchase upgrades to our existing products.

Ongoing economic uncertainty has also resulted in general and ongoing tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy and significant volatility in the credit, equity and fixed income markets. As a result, current or potential customers may be unable to fund software purchases, which could cause them to delay, decrease or cancel purchases of our products and services. Even if customers are willing to purchase our products and services, if they do not meet our credit requirements, we may not be able to record accounts receivable or unearned revenue or recognize revenues from these customers until we receive payment, which could adversely affect the amount of revenues we are able to recognize in a particular period.

In addition, although we plan to continue making strategic investments in our business, many of our competitors have significantly greater financial, technical and other resources than we do, and if the economic recovery is anemic or not sustained, they may be better positioned to continue investment in competitive technologies.

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Industry alliances or consolidation may result in increased competition.

Some of our competitors have made acquisitions or entered into partnerships or other strategic relationships to offer more comprehensive virtualization and cloud computing solutions than they individually had offered. For example, in 2010, Red Hat acquired Makara, a developer of PaaS solutions, and Citrix acquired VMLogix, a developer of lab management solutions that can be applied to cloud computing. Citrix Systems continues to invest in desktop virtualization marketing by continuing its close collaboration with Microsoft, announcing a new strategic partnership with Cisco, and acquiring smaller players like Kaviza and Ringcube. Moreover, information technology companies are increasingly seeking to deliver top-to-bottom IT solutions to end-users that combine enterprise-level hardware and software solutions to provide an alternative to our virtualization platform. For example, in early 2010, Oracle completed its acquisition of Sun Microsystems, which was both a hardware vendor and a provider of virtualization technology, and Microsoft and Hewlett-Packard announced a collaboration based on Microsoft s cloud computing and virtualization platforms. Hewlett-Packard also joined the OpenStack effort, an effort to develop an open-source solution for cloud computing. In 2011, Citrix announced its acquisition of Cloud.com, which offers an IaaS cloud services solution, and Red Hat continued to invest in the Open Virtualization Alliance (OVA) to bolster KVM as a direct competitor to VMware vSphere. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in the evolving virtualization infrastructure and enterprise IT solutions industry. Many of the companies driving this trend have significantly greater financial, technical and other resources than we do and may be better positioned to acquire and offer complementary products and technologies. The companies and alliances resulting from these possible combinations may create more compelling product offerings and be able to offer greater pricing flexibility than we can or may engage in business practices that make it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs (such as providing greater incentives to our channel partners to sell a competitor s product), technology or product functionality. This competition could result in a substantial loss of customers or a reduction in our revenues.

Our operating results may fluctuate significantly, which makes our future results difficult to predict and may result in our operating results falling below expectations or our guidance, which could cause the price of our Class A common stock to decline.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. Our past results should not be relied upon as an indication of our future performance. In addition, a significant portion of our quarterly sales typically occurs during the last month of the quarter, which we believe generally reflects customer buying patterns for enterprise technology. As a result, our quarterly operating results are difficult to predict even in the near term. If our revenues or operating results fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, the price of our Class A common stock would likely decline substantially.

In addition, factors that may affect our operating results include, among others:

- general economic conditions in our domestic and international markets and the effect that these conditions have on our customers capital budgets and the availability of funding for software purchases;
- fluctuations in demand, adoption rates, sales cycles and pricing levels for our products and services;
- fluctuations in foreign currency exchange rates;
- changes in customers budgets for information technology purchases and in the timing of their purchasing decisions;
- the timing of recognizing revenues in any given quarter, which, as a result of software revenue recognition policies, can be affected by a number of factors, including product announcements, beta programs and product promotions that can cause revenue recognition of certain orders to be deferred until future products to which customers are entitled become available;
- the sale of our products in the time frames we anticipate, including the number and size of orders in each quarter;

our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer demand, certification requirements and technical requirements;

the introduction of new pricing and packaging models for our product offerings;

the timing of the announcement or release of upgrades or new products by us or by our competitors;

our ability to maintain scalable internal systems for reporting, order processing, license fulfillment, product delivery, purchasing, billing and general accounting, among other functions;

our ability to control costs, including our operating expenses;

changes to our effective tax rate;

the increasing scale of our business and its effect on our ability to maintain historical rates of growth;

our ability to attract and retain highly skilled employees, particularly those with relevant experience in software development and sales;

our ability to conform to emerging industry standards and to technological developments by our competitors and customers;

renewal rates for ELAs as original ELA terms expire;

the timing and amount of software development costs that are capitalized beginning when technological feasibility has been established and ending when the product is available for general release;

unplanned events that could affect market perception of the quality or cost-effectiveness of our products and solutions; and

the recoverability of benefits from goodwill and intangible assets and the potential impairment of these assets.

If operating system and hardware vendors do not cooperate with us or we are unable to obtain early access to their new products, or access to certain information about their new products to ensure that our solutions interoperate with those products, our product development efforts may be delayed or foreclosed.

Our products interoperate with Windows, Linux and other operating systems and the hardware devices of numerous manufacturers. Developing products that interoperate properly requires substantial partnering, capital investment and employee resources, as well as the cooperation of the vendors or developers of the operating systems and hardware. Operating system and hardware vendors may not provide us with early access to their technology and products, assist us in these development efforts or share with or sell to us any application programming interfaces, or APIs, formats, or protocols we may need. If they do not provide us with the necessary early access, assistance or proprietary technology on a timely basis, we may experience product development delays or be unable to expand our products into other areas. To the extent that software or hardware vendors develop products that compete with ours or those of our controlling stockholder, EMC, they may have an incentive to withhold their cooperation, decline to share access or sell to us their proprietary APIs, protocols or formats or engage in practices to actively limit the functionality, or compatibility, and certification of our products. To the extent that we enter into collaborations or joint development and marketing arrangements with certain hardware and software vendors, vendors who compete with our collaborative partners may similarly choose to limit their cooperation with us. In addition, hardware or operating system vendors may fail to certify or support or continue to certify or support our products for their systems. If any of the foregoing occurs, our product development efforts may be delayed or foreclosed and our business and results of operations may be adversely affected.

Our new product and technology initiatives subject us to additional business, legal and competitive risks.

Over the last several years, we have introduced new product and technology initiatives that aim to leverage our virtualization infrastructure software products into the emerging areas of cloud computing and end-user computing as alternatives to the provisioning of physical computing resources. In connection with our September 2009 acquisition of SpringSource, we announced our intention to use SpringSource solutions to extend VMware s strategy to deliver solutions in the emerging PaaS market and have since, also acquired GemFire and RabbitMQ as part of VMware s overall PaaS strategy. Additionally, SpringSource s current offerings and their underlying open source technology position us in the enterprise and web application development and management markets. Our February 2010 acquisition of Zimbra extended our footprint to cloud-based email and collaboration services a part of VMware s strategy to extend into the emerging SaaS market. In 2010, we also announced our vCenter family of products to more fully manage virtualized and cloud environments, which may cause us to compete with other virtualization management vendors. In April 2011, we announced CloudFoundry, a VMware-operated developer cloud service and a new open source PaaS project. In the second quarter of 2011, we acquired SocialCast and SlideRocket, which provide applications directed toward the collaborative development and sharing of user-generated content within the enterprise.

These initiatives may present new and difficult technology challenges, end-users may choose not to adopt our new product or service offerings, and we may be subject to claims if customers of these offerings experience service disruptions or failures, security breaches or other quality issues. Further, the success of these new offerings depends upon the cooperation of hardware, software and cloud hosting vendors to ensure interoperability with our products and offer compatible products and services to end-users. We will also need to develop and implement appropriate go-to-market strategies and train our sales force in order to effectively market offerings in product categories in which we may have less experience than our competitors.

The cloud computing and end-user computing markets are in early stages of development. Other companies seeking to enter and develop competing standards for the cloud computing market, such as Microsoft, IBM, Oracle, Google and Amazon, and the end-user computing market, such as Citrix and Microsoft, have introduced or are likely to introduce their own initiatives that may compete with or not be compatible with our cloud and end-user computing initiatives which could limit the degree to which other vendors develop products and services around our offerings and end-users adopt our platforms. Additionally, our operating margins in our newer initiatives may be lower than those we have achieved in the markets we currently serve, we will need to develop appropriate pricing strategies for our new product initiatives, and we may not be successful enough in these newer activities to recoup our investments in them. If any of this were to occur, it could damage our reputation, limit our growth and negatively affect our operating results.

We rely on distributors, resellers, system vendors and systems integrators to sell our products, and our failure to effectively develop, manage or prevent disruptions to our distribution channels and the processes and procedures that support them could cause a reduction in the number of end-users of our products.

Our future success is highly dependent upon maintaining and increasing the number of our relationships with distributors, resellers, system vendors and systems integrators. Because we rely on distributors, resellers, system vendors and systems integrators, we may have little or no contact with the ultimate users of our products, thereby making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our products, service ongoing customer requirements, estimate end-user demand and respond to evolving customer needs.

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Recruiting and retaining qualified channel partners and training them in the use of our technology and product offerings requires significant time and resources. In order to develop and expand our distribution channel, we must continue to expand and improve our processes and procedures that support our channel, including our investment in systems and training, and those processes and procedures may become increasingly complex and difficult to manage. The time and expense required for sales and marketing organizations of our channel partners to become familiar with our product offerings, including our new product developments, may make it more difficult to introduce those products to end-users and delay end-user adoption of our product offerings.

We generally do not have long-term contracts or minimum purchase commitments with our distributors, resellers, system vendors and systems integrators, and our contracts with these channel partners do not prohibit them from offering products or services that compete with ours. Our competitors may be effective in providing incentives to existing and potential channel partners to favor products of our competitors or to prevent or reduce sales of our products. Certain system vendors now offer competing virtualization products preinstalled on their server products. Additionally, our competitors could attempt to require key distributors to enter into exclusivity arrangements with them or otherwise apply their pricing or marketing leverage to discourage distributors from offering our products. Accordingly, our channel partners may choose not to offer our products exclusively or at all. Our failure to maintain and increase the number of relationships with channel partners would likely lead to a loss of end-users of our products which would result in us receiving lower revenues from our channel partners. Three of our distributors each accounted for more than 10% of revenues in the first nine months of 2011 and in fiscal year 2010, and we have experienced similar concentrations in prior periods. Our agreements with distributors are typically terminable by either party upon 90 days prior written notice to the other party, and neither party has any obligation to purchase or sell any products under the agreements. While we believe that we have in place, or would have in place by the date of any such termination, agreements with replacement distributors sufficient to maintain our revenues from distribution, if we were to lose the distribution services of a significant distributor, such loss could have a negative impact on our results of operations until such time as we arrange to replace these distribution services with the services of existing or new distributors.

The concentration of our product sales among a limited number of distributors and the weakness in credit markets increases our potential credit risk. Additionally, weakness in credit markets could affect the ability of our distributors, resellers and customers to comply with the terms of credit we provide in the ordinary course of business. Accordingly, if our distributors, resellers and customers find it difficult to obtain credit or comply with the terms of their credit obligations, it could cause significant fluctuations or declines in our product revenues.

Three of our distributors each accounted for more than 10% of revenues in the first nine months of 2011 and in fiscal year 2010, and we have experienced similar concentrations in prior periods. We anticipate that sales of our products to a limited number of distributors will continue to account for a significant portion of our total product revenues for the foreseeable future. The concentration of product sales among certain distributors increases our potential credit risks. For example, approximately 42% of our total accounts receivable as of September 30, 2011 was from three distributors. Some of our distributors may experience financial difficulties, which could adversely impact our collection of accounts receivable. One or more of these distributors could delay payments or default on credit extended to them. Our exposure to credit risks of our distributors may increase if our distributors and their customers are adversely affected by global or regional economic conditions. Additionally, we provide credit to distributors, resellers, and certain end-user customers in the normal course of business. Credit is generally extended to new customers based upon a credit evaluation. Credit is extended to existing customers based on ongoing credit evaluations, prior payment history, and demonstrated financial stability. Any significant delay or default in the collection of significant accounts receivable could result in an increased need for us to obtain working capital from other sources, possibly on worse terms than we could have negotiated if we had established such working capital resources prior to such delays or defaults. Any significant default could result in a negative impact on our results of operations.

The large majority of our revenues have come from our data center virtualization products including our flagship VMware vSphere product line. Decreases in demand for our data center virtualization products could adversely affect our results of operations and financial condition.

In fiscal year 2010, approximately 80% of our license revenues were from our data center virtualization and infrastructure solutions with the balance from our other solutions. Although we are continuing to develop other applications for our virtualization technology such as our cloud computing and end-user computing products, we expect that our data center virtualization products and related enhancements and upgrades will constitute a majority of our revenue for the foreseeable future. Declines and variability in demand for our data center virtualization products could occur as a result of:

- improved products or product versions being offered by competitors in our markets;
- competitive pricing pressures;

failure to release new or enhanced versions of our data center virtualization products on a timely basis, or at all;

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technological change that we are unable to address with our data center virtualization products or that changes the way enterprises utilize our products; or

general economic conditions.

Also, as more and more businesses achieve the virtualization of their data centers and other IT functions, the market for our VMware vSphere product line may become saturated. If we fail to introduce compelling new features in future upgrades to our VMware vSphere product line or develop new applications for our virtualization technology, demand for VMware vSphere may decline.

Additionally, in connection with the announcement in July 2011 of our latest update to VMware vSphere, we announced a change to its pricing structure. We expect that the new pricing model, which we began to implement with the general availability of VMware vSphere 5 in the third quarter of 2011, will better align with a cloud computing approach, whereby customers can align cost with actual use and value derived, rather than purely with hardware configurations and capacity. VMware vSphere 5 will continue to be licensed perpetually on a per processor basis. However, two physical constraints, core and physical RAM, will be eliminated and replaced with a single virtualization-based entitlement of virtual memory, or vRAM, which can be shared across a large pool of servers. Although we believe that our new pricing structure is better suited to changing trends in enterprise utilization of IT resources as the industry shifts to a cloud computing model, if our customers react adversely to this pricing structure change, they may consider adopting the products of our competitors or we may need to further adjust our pricing model, resulting in reduced demand for or revenue from our data center virtualization products. Moreover, if our modeling of the impact of this change in pricing structure on payment streams from our customers proves to be inaccurate, our revenue and operating margins could be negatively affected.

Due to our product concentration, our business, results of operations, financial condition, and cash flows would therefore be adversely affected by a decline in demand for our data center virtualization products.

Our revenues, collection of accounts receivable and financial results may be adversely impacted by fluctuation of foreign currency exchange rates. Although foreign currency hedges can offset some of the risk related to foreign currency fluctuations, we will continue to experience foreign currency gains and losses in certain instances where it is not possible or cost effective to hedge our foreign currency exposures.

Our revenues and our collection of accounts receivable may be adversely impacted as a result of fluctuations in the exchange rates between the U.S. Dollar and foreign currencies. For example, we have distributors in foreign countries that may incur higher costs in periods when the value of the U.S. Dollar strengthens against foreign currencies. One or more of these distributors could delay payments or default on credit extended to them as a result. Any significant delay or default in the collection of significant accounts receivable could result in an increased need for us to obtain working capital from other sources. If we determine that the amount of accounts receivable to be uncollectible is greater than our estimates, we would recognize an increase in bad debt expense, which would have a negative impact on our results of operations. In addition, in periods when the value of the U.S. Dollar strengthens, we may need to offer additional discounts, reduce prices or offer other incentives to mitigate the negative effect on demand.

Since the second quarter of 2009, we have invoiced and collected in certain non-U.S. Dollar denominated currencies, thereby conducting a portion of our revenue transactions in currencies other than the U.S. Dollar. Although this program may alleviate credit risk from our distributors during periods when the U.S. Dollar strengthens, it shifts the risk of currency fluctuations to us and may negatively impact our revenues, anticipated cash flows and financial results due to fluctuations in foreign currency exchange rates, particularly the Euro, the British Pound, the Japanese Yen and the Australian Dollar relative to the U.S. Dollar. While variability in operating margin may be reduced due to invoicing in certain of the local currencies in which we also recognize expenses, increased exposure to foreign currency fluctuations will introduce additional risk for variability in revenue-related components of our consolidated financial statements.

Since July 2009, we have entered into foreign currency forward contracts to hedge a portion of our net outstanding monetary assets and liabilities against movements in certain foreign exchange rates. Although we expect the gains and losses on our foreign currency forward contracts to generally offset the majority of the gains and losses associated with the underlying foreign-currency denominated assets and liabilities that we hedge, our hedging transactions may not yield the results we expect. Additionally, we expect to continue to experience foreign currency gains and losses in certain instances where it is not possible or cost effective to hedge our foreign currency exposures.

We are dependent on our management and our key development personnel, and the loss of key personnel may prevent us from implementing our business plan in a timely manner.

Our success depends largely upon the continued services of our existing management. We are also substantially dependent on the continued service of our key development personnel for product innovation. We generally do not have employment or non-compete agreements with our existing management or development personnel and, therefore, they could terminate their employment with us at any time without penalty and could pursue employment opportunities with any of our competitors. Changes to management and key employees can also lead to additional unplanned losses of key employees. The loss of key employees could seriously harm our ability to release new products on a timely basis and could significantly help our competitors.

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Because competition for our target employees is intense, we may not be able to attract and retain the highly skilled employees we need to support our planned growth, and our compensation expenses may increase.

To execute on our strategy, we must continue to attract and retain highly qualified personnel. Competition for these personnel is intense, especially for senior sales executives and engineers with high levels of experience in designing and developing software. We may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, in making employment decisions, particularly in the high-technology industry, job candidates often consider the value of the stock options, restricted stock grants or other stock-based compensation they are to receive in connection with their employment. Declines in the value of our stock could adversely affect our ability to attract or retain key employees and result in increased employee compensation expenses. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

We may become involved in litigation that may materially adversely affect us.

From time to time, we are involved in various legal, administrative and regulatory proceedings, claims, demands and investigations relating to our business, which may include claims with respect to patent, commercial, product liability, employment, class action, whistleblower and other matters. Such matters can be time-consuming, divert management s attention and resources and cause us to incur significant expenses. Furthermore, because litigation is inherently unpredictable, it is possible that our business, results of operations or financial condition could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims, demands or investigations.

If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur significant expenses to enforce our rights.

We depend on our ability to protect our proprietary technology. We rely on trade secret, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. As such, despite our efforts, the steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police such misappropriation or infringement is uncertain, particularly in countries outside of the United States. Further, with respect to patent rights, we do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims. To the extent that additional patents are issued from our patent applications, which are not certain, they may be contested, circumvented or invalidated in the future. Moreover, the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future. In addition, we rely on confidentiality or license agreements with third parties in connection with their use of our products and technology. There is no guarantee that such parties will abide by the terms of such agreements or that we will be able to adequately enforce our rights, in part because we rely on click-wrap and shrink-wrap licenses in some instances.

Detecting and protecting against the unauthorized use of our products, technology and proprietary rights is expensive, difficult and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of management resources, either of which could harm our business, financial condition and results of operations, and there is no guarantee that we would be successful. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to protecting their technology or intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property, which could result in a substantial loss of our market share.

We provide access to our hypervisor and other selected source code to partners, which creates additional risk that our competitors could develop products that are similar or better than ours.

Our success and ability to compete depend substantially upon our internally developed technology, which is incorporated in the source code for our products. We seek to protect the source code, design code, documentation and other information relating to our software, under trade secret and copyright laws. However, we have chosen to provide access to our hypervisor and other selected source code to more than 50 of our partners for co-development, as well as for open APIs, formats and protocols. Though we generally control access to our source code and other intellectual property, and enter into confidentiality or license agreements with such partners, as well as with our employees and consultants, our safeguards may be insufficient to protect our trade secrets and other rights to our technology. Our protective measures may be inadequate, especially because we may not be able to prevent our partners, employees or consultants from violating any agreements or licenses we may have in place or abusing their access granted to our source code. Improper disclosure or use of our source code could help competitors develop products similar to or better than ours.

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We are, and may in the future be, subject to claims by others that we infringe their proprietary technology which could force us to pay damages or prevent us from using certain technology in our products.

Companies in the software and technology industries own large numbers of patents, copyrights, trademarks, and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. This risk may increase as the number of products and competitors in our market increases and overlaps occur. In addition, as a well known information technology company, we face a higher risk of being the subject of intellectual property infringement claims. Any claim of infringement by a third party, even one without merit, could cause us to incur substantial costs defending against the claim, and could distract our management from our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our products. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which could require significant effort and expense and may ultimately not be successful. Any of these events could seriously harm our business, operating results and financial condition. Third parties may also assert infringement claims against our customers and channel partners. Any of these claims could require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because we generally indemnify our customers and channel partners from claims of infringement of proprietary rights of third parties in connection with the use of our products. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or channel partners, which could negatively affect our results of operations.

Our use of open source software could negatively affect our ability to sell our products and subject us to possible litigation.

A significant portion of the products, technologies or services acquired, licensed, developed or offered by us may incorporate so-called open source software, and we may incorporate open source software into other products in the future. Additionally, open source technology underlies the offerings of SpringSource and Zimbra, businesses we have acquired since 2009, as well as our Cloud Foundry offerings that we launched in 2011. Such open source software is generally licensed by its authors or other third parties under open source licenses, including, for example, the GNU General Public License, the GNU Lesser General Public License, Apache-style licenses, BSD-style licenses and other open source licenses. We monitor our use of open source software in an effort to avoid subjecting our products to conditions we do not intend. Although we believe that we have complied with our obligations under the various applicable licenses for open source software that we use, there is little or no legal precedent governing the interpretation of many of the terms of certain of these licenses, and therefore the potential impact of these terms on our business is somewhat unknown and may result in unanticipated obligations regarding our products and technologies. For example, we may be subjected to certain conditions, including requirements that we offer our products that use the open source software for no cost, that we make available source code for modifications or derivative works we create based upon incorporating, using or distributing the open source software and/or that we license such modifications or derivative works under the terms of the particular open source license. Any of these obligations could have an adverse impact on our intellectual property rights and our ability to derive revenue from products incorporating the open source software.

If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations. If our defenses were not successful, we could be subject to significant damages, enjoined from the distribution of our products that contained the open source software and required to comply with the foregoing conditions, which could disrupt the distribution and sale of some of our products. In addition, if we combine our proprietary software with open source software in a certain manner, under some open source licenses we could be required to release the source code of our proprietary software, which could substantially help our competitors develop products that are similar to or better than ours.

In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or assurance of title or controls on origin of the software. In addition, many of the risks associated with usage of open source such as the lack of warranties or assurances of title, cannot be eliminated, and could, if not properly addressed, negatively affect our business. We have established processes to help alleviate these risks, including a review process for screening requests from our development organizations for the use of open source and conducting appropriate due diligence of the use of open source in the products developed by companies we acquire, but we cannot be sure that all open source software is submitted for approval prior to use in our products or is discovered during due diligence.

Our SpringSource, Zimbra and Cloud Foundry product offerings rely upon and incorporate open source software technologies that subject us to additional risks and challenges, which could result in increased development expenses, delays or disruptions to the release or distribution of those software solutions, and increased competition.

In September 2009, we completed our acquisition of SpringSource and, in February 2010, we completed our acquisition of Zimbra. In April 2011, we launched our Cloud Foundry PaaS offering. Each provides product offerings that broadly use open source software solutions. Software solutions that are substantially or mostly based on open source software subject us to a number of risks and challenges:

- If open source software programmers, most of whom we do not employ, do not continue to develop and enhance open source technologies, our development expenses could be increased and our product release and upgrade schedules could be delayed.

- One of the characteristics of open source software is that anyone can modify the existing software or develop new software that competes with existing open source software. As a result, competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is also possible for new competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our solutions.

- It is possible that a court could hold that the licenses under which our open source products and services are developed and licensed are not enforceable or that someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable, or that open source components of our product or services offerings may not be liberally copied, modified or distributed, may have the effect of preventing us from distributing or developing all or a portion of our products or services. In addition, licensors of open source software employed in our offerings may, from time to time, modify the terms of their license agreements in such a manner that those license terms may no longer be compatible with other open source licenses in our offerings or our end-user license agreement or terms of service, and thus could, among other consequences, prevent us from continuing to distribute the software code subject to the modified license or terms of service.

- Actions to protect and maintain ownership and control over our intellectual property could adversely affect our standing in the open source community, which in turn could limit our ability to continue to rely on this community, upon which we are dependent, as a resource to help develop and improve our open source products and services.

If we are unable to successfully address the challenges of integrating offerings based upon open source technology into our business, our ability to realize revenues from such offerings will be negatively affected and our development costs may increase.

Our sales cycles can be long and unpredictable, our sales efforts require considerable time and expense and timing of sales is subject to changing purchasing behaviors of our customers. As a result, our sales are difficult to predict and may vary substantially from quarter to quarter, which may cause our operating results to fluctuate significantly.

The timing of our revenues is difficult to predict. Our sales efforts involve educating our customers about the use and benefit of our products, including their technical capabilities, potential cost savings to an organization and advantages compared to lower-cost products offered by our competitors. Customers typically undertake a significant evaluation process that has in the past resulted in a lengthy sales cycle which typically lasts several months, and may last a year or longer. We spend substantial time, effort and money on our sales efforts without any assurance that our efforts will produce any sales. In addition, product purchases are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. Moreover, the greater number of competitive alternatives, as well as announcements by our competitors that they intend to introduce competitive alternatives at some point in the future, can lengthen customer procurement cycles, cause us to spend additional time and resources to educate end-users on the advantages of our product offerings and delay product sales. These factors can have a particular impact on the timing and length of our ELA sales cycles.

Additionally, our quarterly sales have historically reflected an uneven pattern in which a disproportionate percentage of a quarter s total sales occur in the last month, weeks and days of each quarter. Similarly, our yearly sales have historically reflected a disproportionate percentage of the year s sales in the fourth fiscal quarter. These patterns make prediction of revenues, earnings and working capital for each financial period especially difficult and uncertain and increase the risk of unanticipated variations in financial condition and results of operations. We believe this uneven sales pattern is a result of many factors including the following:

- the tendency of customers to wait until late in a quarter to commit to a purchase in the hope of obtaining more favorable pricing;
- the fourth quarter influence of customers spending their remaining capital budget authorization prior to new budget constraints in the first nine months of the following year; and
- seasonal influences, such as holiday or vacation periods.

If sales expected from a specific customer for a particular quarter are not realized in that quarter or at all, our results could fall short of public expectations and our business, financial condition and results of operations could be materially adversely affected.

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Our current research and development efforts may not produce significant revenues for several years, if at all.

Developing our products is expensive. Our investment in research and development may not result in marketable products or may result in products that take longer to generate revenues, or generate less revenues, than we anticipate. Our research and development expenses were over 20% of our total revenues, in the first nine months of 2011 and in the fiscal year 2010. Our future plans include significant investments in software research and development and related product opportunities. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we may not receive significant revenues from these investments for several years, if at all.

We may not be able to respond to rapid technological changes with new solutions and services offerings, which could have a material adverse effect on our sales and profitability.

The markets for our software solutions are characterized by rapid technological changes, changing customer needs, frequent new software product introductions and evolving industry standards. The introduction of third-party solutions embodying new technologies and the emergence of new industry standards could make our existing and future software solutions obsolete and unmarketable. We may not be able to develop updated products that keep pace with technological developments and emerging industry standards and that address the increasingly sophisticated needs of our customers or that interoperate with new or updated operating systems and hardware devices or certify our products to work with these systems and devices. As a result, we may not be able to accurately predict the lifecycle of our software solutions, and they may become obsolete before we receive the amount of revenues that we anticipate from them. There is no assurance that any of our new offerings would be accepted in the marketplace. Significant reductions in server-related costs or the rise of more efficient infrastructure management software could also affect demand for our software solutions. As hardware and processors become more powerful, we will have to adapt our product and service offerings to take advantage of the increased capabilities. For example, while the introduction of more powerful servers presents an opportunity for us to provide better products for our customers, the migration of servers to quad-core and greater multi-core microprocessor technology also allows an end-user with a given number of licensed copies of our software to more than double the number of virtualization machines run per server socket without having to purchase additional licenses from us. If any of the foregoing events were to occur, our ability to retain or increase market share and revenues in the virtualization software market could be materially adversely affected.

Our success depends upon our ability to develop new products and services, integrate acquired products and services and enhance our existing products and services and develop appropriate business and pricing models.

If we are unable to develop new products and services, integrate acquired products and services, enhance and improve our products and support services in a timely manner or position and/or price our products and services to meet market demand, customers may not buy new software licenses from us or renew software license updates and product support. In addition, information technology standards from both consortia and formal standards-setting forums as well as de facto marketplace standards are rapidly evolving. We cannot provide any assurance that the standards on which we choose to develop new products will allow us to compete effectively for business opportunities in emerging areas such as cloud computing.

New product development and introduction involves a significant commitment of time and resources and is subject to a number of risks and challenges including:

- managing the length of the development cycle for new products and product enhancements, which has frequently been longer than we originally expected;
- managing customers transitions to new products, which can result in delays in their purchasing decisions;
- adapting to emerging and evolving industry standards and to technological developments by our competitors and customers;
- entering into new or unproven markets with which we have limited experience;

tailoring our business and pricing models appropriately as we enter new markets and respond to competitive pressures and technological changes;

incorporating and integrating acquired products and technologies; and

developing or expanding efficient sales channels.

In addition, if we cannot adapt our business models to keep pace with industry trends, our revenues could be negatively impacted. For example, if we increase our adoption of subscription-based pricing models for our products, we may fail to set pricing at levels appropriate to maintain our revenue streams or our customers may choose to deploy products from our competitors that they believe are priced more favorably.

Our ability to sell our products is dependent on the quality of our support and services offerings, and our failure to offer high-quality support and services could have a material adverse effect on our sales and results of operations.

Once our products are integrated within our customers hardware and software systems, our customers may depend on our support organization to resolve any issues relating to our products. A high level of support is critical for the successful marketing and sale of our products. If we or our channel partners do not effectively assist our customers in deploying our products, succeed in helping our customers quickly resolve post-deployment issues, and provide effective ongoing support, our ability to sell our products to existing customers would be adversely affected, and our reputation with potential customers could be harmed. If our customers with ELAs have a poor perception of our support and services offerings, they may choose not to renew their ELAs when they expire. In addition, as we expand our operations internationally, our support organization will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. As a result, our failure to maintain high-quality support and services, or to adequately assist our channel partners in providing high-quality support and services, could result in customers choosing to use our competitors products instead of ours in the future.

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Acquisitions could disrupt our business, cause dilution to our stockholders and harm our business, financial condition and results of operations.

We have acquired in the past and plan to acquire in the future other businesses, products or technologies. For example, since September 2009 we have completed a number of acquisitions, including acquisitions of SpringSource, Zimbra, certain assets from EMC s Ionix division and Integrien. We may not be able to find suitable acquisition candidates, and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or they may be viewed negatively by customers, financial markets or investors.

Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses and adversely impact our business, financial condition and results of operations. An acquired business may not deliver the expected results. For example, an acquisition may not further our strategies or results in expected benefits, which may include benefits relating to enhanced revenues, technology, human resources, cost savings, operating efficiencies and other synergies. Acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable intangible assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt.

Additionally, we have limited historical experience with the integration of acquired companies. There can be no assurance that we will be able to manage the integration of acquired businesses effectively or be able to retain and motivate key personnel from these businesses. Any difficulties we encounter in the integration process could divert management from day-to-day responsibilities, increase our expenses and have a material adverse effect on our business, financial condition and results of operations. We may also face difficulties due to the lack of experience in new markets, products or technologies or the initial dependence on unfamiliar supply or distribution partners. Other risks related to acquisitions include the assumption of the liabilities of the acquired business, including litigation-related liabilities.

In addition, we review our amortizable intangible assets annually for impairment, or more frequently, when events or changes in circumstances indicate the carrying value may not be recoverable, and we are required to test goodwill for impairment at least annually. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets resulting from an acquisition or otherwise is determined, resulting in an adverse impact on our results of operations. In addition to the risks commonly encountered in the acquisition of a business as described above, we may also experience risks relating to the challenges and costs of closing a transaction. Further, the risks described above may be exacerbated as a result of managing multiple acquisitions at the same time. We also seek to invest in businesses that offer complementary products, services or technologies. These investments are accompanied by risks similar to those encountered in an acquisition of a business.

Operating in foreign countries subjects us to additional risks that may harm our ability to increase or maintain our international sales operations and investments.

Revenues from customers outside the United States comprised approximately 53% of our total revenues in the first nine months of 2011 and 49% in the fiscal year 2010. We have sales, administrative, research and development and technical support personnel in numerous countries worldwide. We expect to continue to add personnel in additional countries. Additionally, our investment portfolio includes investments in non-U.S. financial instruments and holdings in non-U.S. financial institutions. Our international operations subject us to a variety of risks, including:

- the difficulty of managing and staffing international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- increased exposure to foreign currency exchange rate risk;
- difficulties in enforcing contracts and collecting accounts receivable, and longer payment cycles, especially in emerging markets;
- difficulties in delivering support, training and documentation in certain foreign markets;

tariffs and trade barriers and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;

economic or political instability and security concerns in countries that are important to our international sales and operations;

macroeconomic disruptions, such as monetary and credit crises, that can threaten the stability of local and regional financial institutions and decrease the value of our international investments;

the overlap of different tax structures or changes in international tax laws;

reduced protection for intellectual property rights, including reduced protection from software piracy in some countries;

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difficulties in transferring funds from certain countries; and

difficulties in maintaining appropriate controls relating to revenue recognition practices.

Additionally, as we continue to expand our business globally, we will need to maintain compliance with legal and regulatory requirements covering the foreign activities of U.S. corporations, such as export control requirements and the Foreign Corrupt Practices Act. Our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. We expect a significant portion of our growth to occur in foreign countries, which can add to the difficulties in maintaining adequate management and compliance systems and internal controls over financial reporting and increase challenges in managing an organization operating in various countries.

Our failure to manage any of these risks successfully could negatively affect our reputation, harm our operations and reduce our international sales.

Our products are highly technical and may contain errors, defects or security vulnerabilities which could cause harm to our reputation and adversely affect our business.

Our products are highly technical and complex and, when deployed, have contained and may contain errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by customers. Any errors, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business, financial condition and results of operations. Undiscovered vulnerabilities in our products could expose them to hackers or other unscrupulous third parties who develop and deploy viruses, worms, and other malicious software programs that could attack our products. Actual or perceived security vulnerabilities in our products could harm our reputation and lead some customers to return products, to reduce or delay future purchases or use competitive products. End-users, who rely on our products and services for the interoperability of enterprise servers and applications that are critical to their information systems, may have a greater sensitivity to product errors and security vulnerabilities than customers for software products generally. Any security breaches could lead to interruptions, delays and data loss and protection concerns. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our channel partners. Our contracts with customers contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld and customers and channel partners may seek indemnification from us for their losses and those of their customers. Defending a lawsuit, regardless of its merit, is costly and time-consuming and may divert management s attention and adversely affect the market s perception of us and our products. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all; our business, financial condition and results of operations could be adversely impacted.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. As a result, our stockholders could lose confidence in our financial reporting, which could harm our business and the trading price of our Class A common stock.

We have complied with Section 404 of the Sarbanes-Oxley Act of 2002 by assessing, strengthening and testing our system of internal controls. Even though we concluded our system of internal controls was effective as of December 31, 2010, we need to continue to maintain our processes and systems and adapt them to changes as our business changes and we rearrange management responsibilities and reorganize our business accordingly. We may seek to automate certain processes to improve efficiencies and better ensure ongoing compliance but such automation may itself disrupt existing internal controls and introduce unintended vulnerability to error or fraud. This continuous process of maintaining and adapting our internal controls and complying with Section 404 is expensive and time-consuming, and requires significant management attention. We cannot be certain that our internal control measures will continue to provide adequate control over our financial processes and reporting and ensure compliance with Section 404. Furthermore, as our business changes and as we expand through acquisitions of other companies, our internal controls may become more complex and we will require significantly more resources to ensure our internal controls overall remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm identify material weaknesses, the disclosure of that fact, even if quickly remedied, could reduce the market s confidence in our financial statements and harm our stock price. In addition, if we are unable to continue to comply with Section 404, our non-compliance could subject us to a variety of administrative sanctions, including the suspension or delisting of our Class A common stock from the New York Stock Exchange and the inability of registered broker-dealers to make a market in our Class A common stock, which could reduce our stock price.

Problems with our information systems could interfere with our business, and our data centers may be subject to intentional disruption that could adversely impact our operations.

We rely on our information systems and those of third parties for processing customer orders, delivery of products, providing services and support to our customers, billing and tracking our customers, fulfilling contractual obligations, and otherwise running our business. Any disruption in our information systems and those of the third parties upon whom we rely could have a significant impact on our business. In addition, we continuously work to enhance our information systems. The implementation of these types of enhancements is frequently disruptive to the underlying business of an enterprise, which may especially be the case for us due to the size and complexity of our business. Any disruptions relating to our systems enhancements, particularly any disruptions impacting our operations during the implementation period, could adversely affect our business in a number of respects. Even if we do not encounter these adverse effects, the implementation of these enhancements may be much more costly than we anticipated. If we are unable to successfully implement the information systems enhancements as planned, our financial position, results of operations, and cash flows could be negatively impacted.

Additionally, experienced computer programmers may attempt to penetrate our network security or the security of our website and misappropriate our proprietary information and information confidential to our customers and/or cause interruptions of our services. Because the techniques used by such computer programmers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. The theft and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an event could adversely affect our competitive position, reputation, brand and future sales of our products and our customers may assert claims against us related to resulting losses of confidential or proprietary information. Our business could be subject to significant disruption, and we could suffer monetary and other losses and reputational harm, in the event of such incidents and claims.

If we fail to manage future growth effectively, we may not be able to meet our customers needs or be able to meet our future reporting obligations.

We have rapidly expanded our operations since inception and anticipate further expansion in the future. This future growth, if it occurs, will place significant demands on our management, infrastructure and other resources. Additionally, further international growth may occur in regions where we presently have little or no infrastructure. To manage any future growth, we will need to hire, integrate and retain highly skilled and motivated employees. We will also need to continue to improve our financial and management controls, reporting and operational systems and procedures. If we do not effectively manage our growth, we may not be able to meet our customers needs, thereby adversely affecting our sales, or be able to meet our future reporting obligations.

Our financial results may be adversely impacted by higher than expected tax rates, and we may have exposure to additional tax liabilities.

As a multinational corporation, we are subject to income taxes as well as non-income based taxes, in both the United States and various foreign jurisdictions. Our domestic and international tax liabilities are subject to the allocation of revenues and expenses in different jurisdictions and the timing of recognizing revenues and expenses. Additionally, the amount of income taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we file and changes to tax laws. Significant judgment is required in determining our worldwide provision for income taxes and other tax liabilities. From time to time, we are subject to income tax audits. While we believe we have complied with all applicable income tax laws, there can be no assurance that a governing tax authority will not have a different interpretation of the law and assess us with additional taxes. Should we be assessed with additional taxes, there could be a material adverse effect on our financial condition or results of operations.

Our future effective tax rate may be affected by such factors as changes in tax laws, regulations or rates, changing interpretation of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, changes in our international organization, and changes in overall levels of income before tax.

For example, during 2010, the IRS announced and finalized Schedule UTP, Uncertain Tax Positions Statement. This schedule is an annual disclosure of certain federal UTPs, ranked in order of magnitude, to be included in corporate tax filings for U.S. federal income tax purposes. According to the IRS, the disclosure is to include a concise description of the tax position, including a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the Service of the identity of the tax position. As a result of this additional disclosure requirement, the amount of taxes paid could increase.

Also, in December 2010, H.R. 4853, Tax Relief, Unemployment Insurance Reauthorization, and the Job Creation Act of 2010, which included an extension of a number of expired tax provisions, took effect retroactively to 2010 and prospectively through 2011. Among the extended tax provisions was the U.S. federal R&D tax credit, which provides a significant reduction in our effective tax rate. The renewal of this credit beyond 2011 is uncertain.

In addition, in the ordinary course of our global business, there are many intercompany transactions and calculations where the ultimate tax determination is uncertain. Although we believe that our tax estimates are reasonable, we cannot ensure that the final determination of tax audits or tax disputes will not be different from what is reflected in our historical income tax provisions and accruals.

We are also subject to non-income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and various foreign jurisdictions. We are under audit from time to time by tax authorities with respect to these non-income taxes and may have exposure to additional non-income tax liabilities.

Our business is subject to the risks of earthquakes, fire, floods and other natural catastrophic events such as pandemics, and to interruption by man-made problems, such as computer viruses, unanticipated disruptions in local infrastructure or terrorism, which could result in delays or cancellations of customer orders or the deployment of our products.

Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity. A significant natural disaster, such as an earthquake, fire, flood or other act of God, could have a material adverse impact on our business, financial condition and results of operations. As we continue to grow internationally, increasing amounts of our business will be located in foreign countries that may be more subject to political or social instability that could disrupt operations. In addition, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Unanticipated disruptions in services provided through localized physical infrastructure, such as utility or telecommunication outages, can curtail the functioning of local offices as well as critical components of our information systems and adversely affect our ability to process orders, respond to customer requests and maintain local and global business continuity. Furthermore, acts of terrorism or war could cause disruptions in our or our customers business or the economy as a whole and disease pandemics could temporarily sideline a substantial part of our or our customers workforce at any particular time. To the extent that such disruptions result in delays or cancellations of customer orders, or the deployment of our products, our revenues would be adversely affected.

Our business is subject to a variety of U.S. and international laws regarding data protection.

Our business is subject to federal, state and international laws regarding privacy and protection of user data. We post, on our website, our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others which could have a material adverse effect on our business, results of operations and financial condition.

It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines and penalties, a governmental order requiring that we change our data practices could result, which in turn could have a material adverse effect on our business. Compliance with these regulations may involve significant costs or require changes in business practices that result in reduced revenue. Noncompliance could result in penalties being imposed on us or we could be ordered to cease conducting the noncompliant activity.

Additionally, our virtualization technology is used by cloud computing vendors, and we have expanded our involvement in the delivery and provision of cloud computing through business alliances with various providers of cloud computing services and software and expect to continue to do so in the future. For example, in April 2011, we entered into an agreement with EMC to acquire certain assets relating to EMC s Mozy cloud-based data storage and data center services, including certain data center assets and a license to certain intellectual property. We also entered into an operational support agreement with EMC pursuant to which we will take over responsibility for operating the Mozy service on behalf of EMC. The application of U.S. and international data privacy laws to cloud computing vendors is uncertain, and our existing contractual provisions may prove to be inadequate to protect us from claims for data loss or regulatory noncompliance made against cloud computing providers who we may partner with. Accordingly, the failure to comply with data protection laws and regulations by our customers and business partners who provide cloud computing services could have a material adverse effect on our business.

If we fail to comply with our customer contracts or government contracting regulations, our business could be adversely affected.

Our contracts with our customers may include unique and specialized performance requirements. In particular, our contracts with federal, state, and local and non-U.S. governmental customers are subject to various procurements regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us to comply with provisions in our customer contracts or any violation of government contracting regulations could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business and affect our ability to compete for new contracts. If our customer contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse affect on our business, operating results or financial condition.

Changes in accounting principles and guidance, or their interpretation, could result in unfavorable accounting charges or effects, including changes to our previously-filed financial statements, which could cause our stock price to decline.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results and retroactively affect previously reported results.

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Risks Related to Our Relationship with EMC

As long as EMC controls us, other holders of our Class A common stock will have limited ability to influence matters requiring stockholder approval.

As of September 30, 2011, EMC owned 36,978,000 shares of our Class A common stock and all 300,000,000 shares of our Class B common stock, representing 79.8% of the total outstanding shares of common stock or 97.3% of the voting power of outstanding common stock. The holders of our Class A common stock and our Class B common stock have identical rights, preferences and privileges except with respect to voting and conversion rights, the election of directors, certain actions that require the consent of holders of Class B common stock and other protective provisions as set forth in our certificate of incorporation. Holders of our Class B common stock are entitled to 10 votes per share of Class B common stock on all matters except for the election of our Group II directors, in which case they are entitled to one vote per share, and the holders of our Class A common stock are entitled to one vote per share of Class A common stock. The holders of Class B common stock, voting separately as a class, are entitled to elect 80% of the total number of directors on our board of directors that we would have if there were no vacancies on our board of directors at the time. These are our Group I directors. Subject to any rights of any series of preferred stock to elect directors, the holders of Class A common stock and the holders of Class B common stock, voting together as a single class, are entitled to elect our remaining directors, which at no time will be less than one director our Group II director(s). Accordingly, the holders of our Class B common stock currently are entitled to elect 7 of our 8 directors.

If EMC transfers shares of our Class B common stock to any party other than a successor-in-interest or a subsidiary of EMC prior to a distribution to its stockholders under Section 355 of the Internal Revenue Code of 1986, as amended, (a 355 distribution), those shares will automatically convert into Class A common stock. Additionally, if, prior to a 355 distribution, EMC s ownership falls below 20% of the outstanding shares of our common stock, all outstanding shares of Class B common stock will automatically convert to Class A common stock. Following a 355 distribution, shares of Class B common stock may convert to Class A common stock if such conversion is approved by VMware stockholders after the 355 distribution. For so long as EMC or its successor-in-interest beneficially owns shares of our common stock representing at least a majority of the votes entitled to be cast by the holders of outstanding voting stock, EMC will be able to elect all of the members of our board of directors.

In addition, until such time as EMC or its successor-in-interest beneficially owns shares of our common stock representing less than a majority of the votes entitled to be cast by the holders of outstanding voting stock, EMC will have the ability to take stockholder action without the vote of any other stockholder and without having to call a stockholder meeting, and holders of our Class A common stock will not be able to affect the outcome of any stockholder vote during this period. As a result, EMC will have the ability to control all matters affecting us, including:

- the composition of our board of directors and, through our board of directors, any determination with respect to our business plans and policies;
- any determinations with respect to mergers, acquisitions and other business combinations;
- our acquisition or disposition of assets;
- our financing activities;
- certain changes to our certificate of incorporation;
- changes to the agreements we entered into in connection with our transition to becoming a public company;
- corporate opportunities that may be suitable for us and EMC;

- determinations with respect to enforcement of rights we may have against third parties, including with respect to intellectual property rights;
- the payment of dividends on our common stock; and
- the number of shares available for issuance under our stock plans for our prospective and existing employees.

Our certificate of incorporation and the master transaction agreement entered into between us and EMC in connection with our initial public offering (IPO) also contain provisions that require that as long as EMC beneficially owns at least 20% or more of the outstanding shares of our common stock, the prior affirmative vote or written consent of EMC (or its successor-in-interest) as the holder of the Class B common stock is required (subject in each case to certain exceptions) in order to authorize us to:

- consolidate or merge with any other entity;
- acquire the stock or assets of another entity in excess of $100 million;
- issue any stock or securities except to our subsidiaries or pursuant to our employee benefit plans;
- establish the aggregate annual amount of shares we may issue in equity awards;

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- dissolve, liquidate or wind us up;
- declare dividends on our stock;
- enter into any exclusive or exclusionary arrangement with a third party involving, in whole or in part, products or services that are similar to EMC s; and
- amend, terminate or adopt any provision inconsistent with certain provisions of our certificate of incorporation or bylaws.

If EMC does not provide any requisite consent allowing us to conduct such activities when requested, we will not be able to conduct such activities and, as a result, our business and our operating results may be harmed. EMC s voting control and its additional rights described above may discourage transactions involving a change of control of us, including transactions in which holders of our Class A common stock might otherwise receive a premium for their shares over the then-current market price. EMC is not prohibited from selling a controlling interest in us to a third party and may do so without the approval of the holders of our Class A common stock and without providing for a purchase of any shares of Class A common stock held by persons other than EMC. Accordingly, shares of Class A common stock may be worth less than they would be if EMC did not maintain voting control over us nor have the additional rights described above.

In the event EMC is acquired or otherwise undergoes a change of control, any acquirer or successor will be entitled to exercise the voting control and contractual rights of EMC, and may do so in a manner that could vary significantly from EMC s historic practice.

By becoming a stockholder in our company, holders of our Class A common stock are deemed to have notice of and have consented to the provisions of our certificate of incorporation and the master transaction agreement with respect to the limitations that are described above.

Our business and that of EMC overlap, and EMC may compete with us, which could reduce our market share.

EMC and we are both IT infrastructure companies providing products related to storage management, back-up, disaster recovery, security, system management and automation, provisioning and resource management. There can be no assurance that EMC will not engage in increased competition with us in the future. In addition, the intellectual property agreement that we have entered into with EMC provides EMC the ability to use our source code and intellectual property, which, subject to limitations, it may use to produce certain products that compete with ours. EMC s rights in this regard extend to its majority-owned subsidiaries, which could include joint ventures where EMC holds a majority position and one or more of our competitors hold minority positions.

EMC could assert control over us in a manner which could impede our growth or our ability to enter new markets or otherwise adversely affect our business. Further, EMC could utilize its control over us to cause us to take or refrain from taking certain actions, including entering into relationships with channel, technology and other marketing partners, enforcing our intellectual property rights or pursuing corporate opportunities or product development initiatives that could adversely affect our competitive position, including our competitive position relative to that of EMC in markets where we compete with them. In addition, EMC maintains significant partnerships with certain of our competitors, including Microsoft.

EMC s competition in certain markets may affect our ability to build and maintain partnerships.

Our existing and potential partner relationships may be affected by our relationship with EMC. We partner with a number of companies that compete with EMC in certain markets in which EMC participates. EMC s majority ownership in us might affect our ability to effectively partner with these companies. These companies may favor our competitors because of our relationship with EMC.

EMC competes with certain of our significant channel, technology and other marketing partners, including IBM and Hewlett-Packard. Pursuant to our certificate of incorporation and other agreements that we have with EMC, EMC may have the ability to impact our relationship with those of our partners that compete with EMC, which could have a material adverse effect on our results of operations or our ability to pursue opportunities which may otherwise be available to us.

In order to preserve the ability for EMC to distribute its shares of our Class B common stock on a tax-free basis, we may be prevented from pursuing opportunities to raise capital, to effectuate acquisitions or to provide equity incentives to our employees, which could hurt our ability to grow.

Beneficial ownership of at least 80% of the total voting power is required in order for EMC to affect a tax-free spin-off of VMware or certain other tax-free transactions. We have agreed that for so long as EMC or its successor-in-interest continues to own greater than 50% of the voting control of our outstanding common stock, we will not knowingly take or fail to take any action that could reasonably be expected to preclude EMC s or its successor-in-interest s ability to undertake a tax-free spin-off. Additionally, under our certificate of incorporation and the master transaction agreement we entered into with EMC, we must obtain the consent of EMC or its successor-in-interest, as the holder of our Class B common stock, to issue stock or other VMware securities, excluding pursuant to employee benefit plans (provided that we obtain Class B common stockholder approval of the aggregate annual number of shares to be granted under such plans), which could cause us to forgo capital raising or acquisition opportunities that would otherwise be available to us. As a result, we may be precluded from pursuing certain growth initiatives.

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Third parties may seek to hold us responsible for liabilities of EMC, which could result in a decrease in our income.

Third parties may seek to hold us responsible for EMC s liabilities. Under our master transaction agreement with EMC, EMC will indemnify us for claims and losses relating to liabilities related to EMC s business and not related to our business. However, if those liabilities are significant and we are ultimately held liable for them, we cannot be certain that we will be able to recover the full amount of our losses from EMC.

Although we have entered into a tax sharing agreement with EMC under which our tax liabilities effectively will be determined as if we were not part of any consolidated, combined or unitary tax group of EMC Corporation and/or its subsidiaries, we nonetheless could be held liable for the tax liabilities of other members of these groups.

We have historically been included in EMC s consolidated group for U.S. federal income tax purposes, as well as in certain consolidated, combined or unitary groups that include EMC Corporation and/or certain of its subsidiaries for state and local income tax purposes. Pursuant to our tax sharing agreement with EMC, we and EMC generally will make payments to each other such that, with respect to tax returns for any taxable period in which we or any of our subsidiaries are included in EMC s consolidated group for U.S. federal income tax purposes or any other consolidated, combined or unitary group of EMC Corporation and/or its subsidiaries, the amount of taxes to be paid by us will be determined, subject to certain adjustments, as if we and each of our subsidiaries included in such consolidated, combined or unitary group filed our own consolidated, combined or unitary tax return.

We have been included in the EMC consolidated group for U.S. federal income tax purposes since our acquisition by EMC, and expect to continue to be included in such consolidated group for periods in which EMC owns at least 80% of the total voting power and value of our outstanding stock. Each member of a consolidated group during any part of a consolidated return year is jointly and severally liable for tax on the consolidated return of such year and for any subsequently determined deficiency thereon. Similarly, in some jurisdictions, each member of a consolidated, combined or unitary group for state, local or foreign income tax purposes is jointly and severally liable for the state, local or foreign income tax liability of each other member of the consolidated, combined or unitary group. Accordingly, for any period in which we are included in the EMC consolidated group for U.S. federal income tax purposes or any other consolidated, combined or unitary group of EMC Corporation and/or its subsidiaries, we could be liable in the event that any income tax liability was incurred, but not discharged, by any other member of any such group.

Any inability to resolve favorably any disputes that arise between us and EMC with respect to our past and ongoing relationships may result in a significant reduction of our revenues and earnings.

Disputes may arise between EMC and us in a number of areas relating to our ongoing relationships, including:

- labor, tax, employee benefit, indemnification and other matters arising from our separation from EMC;
- employee retention and recruiting;
- business combinations involving us;
- our ability to engage in activities with certain channel, technology or other marketing partners;
- sales or dispositions by EMC of all or any portion of its ownership interest in us;
- the nature, quality and pricing of services EMC has agreed to provide us;
- arrangements with third parties that are exclusionary to EMC;

- business opportunities that may be attractive to both EMC and us; and

- product or technology development or marketing activities or customer agreements which may require the consent of EMC.

We may not be able to resolve any potential conflicts, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party.

The agreements we enter into with EMC may be amended upon agreement between the parties. While we are controlled by EMC, we may not have the leverage to negotiate amendments to these agreements if required on terms as favorable to us as those we would negotiate with an unaffiliated third party.

Some of our directors own EMC common stock, restricted shares of EMC common stock and/ or equity awards to acquire EMC common stock and hold management positions with EMC, which could cause conflicts of interests that result in our not acting on opportunities we otherwise may have.

Some of our directors own EMC common stock and/or equity awards to purchase EMC common stock. In addition, some of our directors are executive officers and/or directors of EMC, and EMC, as the sole holder of our Class B common stock, is entitled to elect 7 of our 8 directors. Ownership of EMC common stock, restricted shares of EMC common stock and equity awards to purchase EMC common stock by our directors and the presence of executive officers or directors of EMC on our board of directors could create, or appear to create, conflicts of interest with respect to matters involving both us and EMC that could have different implications for EMC than they do for us. Provisions of our certificate of incorporation and the master transaction agreement between EMC and us address corporate opportunities that are presented to our directors or officers that are also directors or officers of EMC. There can be no assurance that the provisions in our certificate of incorporation or the master transaction agreement will adequately address potential conflicts of interest or that potential conflicts of interest will be resolved in our favor or that we will be able to take advantage of corporate opportunities presented to individuals who are officers or directors of both us and EMC. As a result, we may be precluded from pursuing certain growth initiatives.

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EMC s ability to control our board of directors may make it difficult for us to recruit independent directors.

So long as EMC beneficially owns shares of our common stock representing at least a majority of the votes entitled to be cast by the holders of outstanding voting stock, EMC can effectively control and direct our board of directors. Further, the interests of EMC and our other stockholders may diverge. Under these circumstances, persons who might otherwise accept our invitation to join our board of directors may decline.

We are a controlled company within the meaning of the New York Stock Exchange rules and, as a result, are relying on exemptions from certain corporate governance requirements that provide protection to stockholders of companies that are not controlled companies.

EMC owns more than 50% of the total voting power of our common shares and, as a result, we are a controlled company under the New York Stock Exchange corporate governance standards. As a controlled company, we are exempt under the New York Stock Exchange standards from the obligation to comply with certain New York Stock Exchange corporate governance requirements, including the requirements:

- that a majority of our board of directors consists of independent directors;
- that we have a corporate governance and nominating committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities;
- that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities; and
- for an annual performance evaluation of the nominating and governance committee and compensation committee.

While we have voluntarily caused our Compensation and Corporate Governance Committee to currently be composed entirely of independent directors in compliance with the requirements of the New York Stock Exchange, we are not required to maintain the independent composition of the committee. As a result of our use of the controlled company exemptions, holders of our Class A common stock will not have the same protection afforded to stockholders of companies that are subject to all of the New York Stock Exchange corporate governance requirements.

Our historical financial information as a business segment of EMC may not be representative of our results as an independent public company.

The historical financial information covering the periods prior to our IPO in August 2007 included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 does not necessarily reflect what our financial position, results of operations or cash flows would have been had we been an independent entity during those historical periods. The historical costs and expenses reflected in our consolidated financial statements prior to 2008 include an allocation for certain corporate functions historically provided by EMC, including tax, accounting, treasury, legal and human resources services. Although we have transitioned most of these corporate functions to VMware personnel, in certain geographic regions where we do not have an established legal entity, we contract with EMC subsidiaries for support services and EMC employees who are managed by VMware personnel. The costs incurred by EMC on VMware s behalf related to these employees include a mark-up intended to approximate costs that would have been charged had we contracted for such services with an unrelated third party. These costs have been charged by EMC and are included as expenses in our consolidated statements of income. Our historical financial information is not necessarily indicative of what our financial position, results of operations or cash flows will be in the future if and when we contract at arm s-length with independent third parties for the services we have received and currently receive from EMC. For additional information, see Management s Discussion and Analysis of Financial Condition and Results of Operations and our historical consolidated financial statements and notes thereto.

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Risks Related to Owning Our Class A Common Stock

Our Class A common stock has only been publicly traded since August 14, 2007 and the price of our Class A common stock has fluctuated substantially since then and may fluctuate substantially in the future.

Our Class A common stock has only been publicly traded since our IPO on August 14, 2007. The trading price of our Class A common stock has fluctuated significantly since then. For example, between January 1, 2010 and September 30, 2011, the closing trading price of our Class A common stock was very volatile, ranging between $41.58 and $107.75 per share. Our trading price could fluctuate substantially in the future due to the factors discussed in this Risk Factors section and elsewhere in this Quarterly Report on Form 10-Q.

Substantial amounts of Class A common stock are held by our employees, EMC and Cisco, and all of the shares of our Class B common stock, which may be converted to Class A common stock upon request of the holder, are held by EMC. Shares of Class A common stock held by EMC (including shares of Class A common stock that might be issued upon the conversion of Class B common stock) are eligible for sale subject to the volume, manner of sale and other restrictions of Rule 144 of the Securities Act of 1933, as amended (the Securities Act), which allows the holder to sell up to the greater of 1% of our outstanding Class A common stock or our four-week average weekly trading volume during any three-month period and following the expiration of their contractual restrictions. Additionally, EMC possesses registration rights with respect to the shares of our common stock that it holds. If EMC chooses to exercise such rights, its sale of the shares that are registered would not be subject to the Rule 144 limitations. If a significant amount of the shares that become eligible for resale enter the public trading markets in a short period of time, the market price of our Class A common stock may decline.

Additionally, broad market and industry factors may decrease the market price of our Class A common stock, regardless of our actual operating performance. The stock market in general and technology companies in particular, also have often experienced extreme price and volume fluctuations. In addition, in the past, following periods of volatility in the overall market and the market price of a company s securities, securities class action litigation has often been instituted, including against us, and, if not resolved swiftly, can result in substantial costs and a diversion of management s attention and resources.

If securities or industry analysts cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.

The trading market for our Class A common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If any of the analysts who may cover us change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Delaware law and our certificate of incorporation and bylaws contain anti-takeover provisions that could delay or discourage takeover attempts that stockholders may consider favorable.

Provisions in our certificate of incorporation and bylaws will have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

- the division of our board of directors into three classes, with each class serving for a staggered three-year term, which would prevent stockholders from electing an entirely new board of directors at any annual meeting;

- the right of the board of directors to elect a director to fill a vacancy created by the expansion of the board of directors;

- following a 355 distribution of Class B common stock by EMC to its stockholders, the restriction that a beneficial owner of 10% or more of our Class B common stock may not vote in any election of directors unless such person or group also owns at least an equivalent percentage of Class A common stock or obtains approval of our board of directors prior to acquiring beneficial ownership of at least 5% of Class B common stock;

the prohibition of cumulative voting in the election of directors or any other matters, which would otherwise allow less than a majority of stockholders to elect director candidates;

the requirement for advance notice for nominations for election to the board of directors or for proposing matters that can be acted upon at a stockholders meeting;

the ability of the board of directors to issue, without stockholder approval, up to 100,000,000 shares of preferred stock with terms set by the board of directors, which rights could be senior to those of common stock; and

in the event that EMC or its successor-in-interest no longer owns shares of our common stock representing at least a majority of the votes entitled to be cast in the election of directors, stockholders may not act by written consent and may not call special meetings of the stockholders.

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Until such time as EMC or its successor-in-interest ceases to beneficially own 20% or more of the outstanding shares of our common stock, the affirmative vote or written consent of the holders of a majority of the outstanding shares of the Class B common stock will be required to:

- amend certain provisions of our bylaws or certificate of incorporation;
- make certain acquisitions or dispositions;
- declare dividends, or undertake a recapitalization or liquidation;
- adopt any stockholder rights plan, poison pill or other similar arrangement;
- approve any transactions that would involve a merger, consolidation, restructuring, sale of substantially all of our assets or any of our subsidiaries or otherwise result in any person or entity obtaining control of us or any of our subsidiaries; or
- undertake certain other actions.

In addition, we have elected to apply the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us. These provisions in our certificate of incorporation and bylaws and under Delaware law could discourage potential takeover attempts and could reduce the price that investors might be willing to pay for shares of our common stock.

Intel s and Cisco s relationship with us and the membership on our board of individuals initially proposed by Intel and Cisco may create actual or potential conflicts of interest.

As a result of an investment by Intel Capital in our Class A common stock in August 2007, Intel had a one-time right to designate a director acceptable to our board of directors for an initial term of service. Pursuant to that right, we appointed an Intel executive to our board of directors. Cisco, pursuant to its purchase of our Class A common stock from EMC, also has an ownership relationship with us, and we appointed an executive officer of Cisco (since retired from Cisco) proposed by Cisco as one of our directors. Neither Intel nor Cisco has an ongoing right to designate a director for our board. However, each of the directors initially proposed by them continues to serve on our board. These relationships may create actual or potential conflicts of interest and the best interests of Intel or Cisco may not reflect the best interests of other holders of our Class A common stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Sales of Unregistered Securities

None.

(b) Use of Proceeds from Public Offering of Common Stock

None.

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Purchases of equity securities during the three months ended September 30, 2011:

	Total Number of Shares Purchased (1)(2)	Average Price Paid Per Share (1)(2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)(4)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Publicly Announced Plans or Programs (2)(3)(4)
July 1 July 31, 2011	431,627	$ 102.97	427,228	$ 287,127,611
August 1 August 31, 2011	3,647,186	84.89	1,345,488	172,671,699
September 1 September 30, 2011	1,142,315	86.36	597,812	120,653,332
	5,221,128	86.70	2,370,528	

(1) Includes 2,850,600 shares purchased by EMC in open market transactions. In the three months ended March 31, 2010, EMC announced a stock purchase program of VMware s Class A common stock to maintain its approximate level of ownership in VMware over the long term. Inclusion of EMC s purchases in the above table does not indicate that EMC is deemed to be an affiliated purchaser with respect to the VMware stock repurchase program discussed in the following footnote. Shares purchased by EMC remain issued and outstanding.

(2) In February 2011, a committee of our Board of Directors authorized the repurchase of up to $550.0 million of VMware s Class A common stock through the end of 2012 (the VMware 2011 Repurchase Authorization). Stock has, and may in the future be, purchased pursuant to the VMware 2011 Repurchase Authorization, from time to time, in the open market or through private transactions, subject to market conditions. In the three months ended September 30, 2011, we repurchased in open market transactions and retired 2,370,528 shares of our Class A common stock at a weighted-average price of $88.79 per share for an aggregate purchase price of $210,479,640. We are not obligated to purchase any shares under our stock repurchase program. Subject to applicable laws, repurchases under our stock repurchase program may be made at such times and in such amounts as we deem appropriate. Purchases under our stock repurchase program can be discontinued at any time that we feel additional purchases are not warranted.

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(3) Represents the amounts remaining in the 2011 VMware Repurchase Authorization.

(4) Amounts do not include potential purchases by EMC.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

			Incorporated by Reference	
Exhibit Number	**Exhibit Description**	**Filed Herewith**	**Form/ File No.**	**Date**
3.1	Amended and Restated Certificate of Incorporation		S-1/A-2	7/9/2007
3.2	Amended and Restated Bylaws		8-K	3/8/2011
10.9	2007 Equity and Incentive Plan	X		
10.27	Amendment to Letter Agreement between VMware, Inc. and Richard McAniff dated July 19, 2011	X		
31.1	Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
31.2	Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
101.INS	XBRL Instance Document	X		
101.SCH	XBRL Taxonomy Extension Schema	X		
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X		
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X		
101.LAB	XBRL Taxonomy Extension Label Linkbase	X		
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X		

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

		VMWARE, INC.
Dated: November 2, 2011	By:	/S/ ROBYNNE D. SISCO **Robynne D. Sisco** **Chief Accounting Officer and Corporate Controller** **(Principal Accounting Officer and Duly Authorized Officer)**

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