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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

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 **(State or other jurisdiction of incorporation or organization)**	**94-3292913** **(I.R.S. Employer Identification Number)**
3401 Hillview Avenue **Palo Alto, CA** **(Address of principal executive offices)**	**94304** **(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 ☒ 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 ☐ 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 ☒

As of October 29, 2008, the number of shares of common stock, par value $.01 per share, of the registrant outstanding was 389,602,066, of which 89,602,066 shares were Class A common stock and 300,000,000 were Class B common stock.

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PART I
FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

VMware, Inc.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)
(unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$1,691,372	$1,231,168
Accounts receivable, less allowance for doubtful accounts of $2,351 and $1,603	287,943	283,824
Deferred tax asset, current portion	44,004	54,386
Income taxes receivable, net	82,228	—
Other current assets	49,120	33,956
Total current assets	2,154,667	1,603,334
Property and equipment, net	370,613	276,983
Other assets, net	97,665	71,695
Deferred tax asset, net of current portion	56,980	72,249
Intangible assets, net	48,513	32,073
Goodwill	730,276	639,366
Total assets	$3,458,714	$2,695,700
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 80,263	$ 61,503
Accrued expenses	160,129	173,610
Due to EMC, net	36,249	2,759
Income taxes payable, current portion	—	68,823
Deferred revenue, current portion	482,366	363,317
Total current liabilities	759,007	670,012
Note payable to EMC	450,000	450,000
Deferred revenue, net of current portion	297,997	189,479
Deferred tax liability	42,026	27,327
Income taxes payable, net of current portion	28,419	18,265
Total liabilities	1,577,449	1,355,083
Commitments and contingencies (see Note J)		
Stockholders' equity:		
Class A common stock, par value $.01; authorized 2,500,000 shares; issued and outstanding 89,452 and 82,924 shares	895	829
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	1,756,638	1,352,788
Retained earnings (accumulated deficit)	120,732	(16,000)
Total stockholders' equity	1,881,265	1,340,617
Total liabilities and stockholders' equity	$3,458,714	$2,695,700

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

VMware, Inc.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)
(unaudited)

	For the Three Months Ended September 30, 2008	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007
Revenues:				
License	$ 285,086	$ 247,481	$ 863,299	$ 621,086
Services	187,035	110,335	503,125	292,250
	472,121	357,816	1,366,424	913,336
Operating expenses:				
Cost of license revenues	21,535	19,158	66,033	60,546
Cost of services revenues	52,919	39,493	166,122	90,946
Research and development	85,315	67,840	318,698	194,379
Sales and marketing	167,914	125,736	475,478	311,432
General and administrative	43,418	39,839	129,682	97,166
Operating income	101,020	65,750	210,411	158,867
Investment income	7,654	7,300	21,968	11,718
Interest expense with EMC, net	(3,823)	(6,743)	(13,221)	(13,261)
Other expense, net	(1,321)	(19)	(497)	(106)
Income before income taxes	103,530	66,288	218,661	157,218
Income tax provision	20,242	1,610	39,982	17,236
Net income	$ 83,288	$ 64,678	$ 178,679	$ 139,982
Net income per weighted-average share, basic for Class A and Class B	$ 0.21	$ 0.18	$ 0.47	$ 0.41
Net income per weighted-average share, diluted for Class A and Class B	$ 0.21	$ 0.18	$ 0.45	$ 0.41
Weighted-average shares, basic for Class A and Class B	387,621	356,431	383,876	340,565
Weighted-average shares, diluted for Class A and Class B	394,232	368,567	397,093	344,736

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

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VMware, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	For the Three Months Ended September 30, 2008	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007
Cash flows from operating activities:				
Net income	$ 83,288	$ 64,678	$ 178,679	$ 139,982
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	40,644	27,643	117,537	72,462
Stock-based compensation, excluding amounts capitalized	35,317	31,737	119,550	59,354
Excess tax benefits from stock-based compensation	(5,844)	—	(85,271)	—
Other adjustments	1,242	(528)	2,300	(394)
Changes in assets and liabilities, net of acquisitions:				
Accounts receivable	20,803	37,062	(3,483)	30,972
Other assets	(2,369)	5,994	(15,650)	(2,666)
Due to/from EMC, net	2,904	15,644	43,190	(74,436)
Accounts payable	10,880	8,578	(250)	20,959
Accrued expenses	(21,309)	(667)	(25,265)	10,801
Income taxes payable/receivable	28,013	22,888	(68,995)	60,397
Deferred income taxes, net	(8,876)	(22,446)	37,843	(45,074)
Deferred revenue	58,812	7,750	227,134	116,505
Net cash provided by operating activities	243,505	198,333	527,319	388,862
Cash flows from investing activities:				
Additions to property and equipment	(32,664)	(42,375)	(133,585)	(91,294)
Purchase of headquarters facilities from EMC	—	(132,564)	—	(132,564)
Capitalized software development costs	(37,961)	(22,314)	(53,895)	(32,858)
Purchase of long-term investment	—	—	(1,750)	—
Business acquisitions, net of cash acquired	(57,363)	(54,108)	(90,652)	(75,518)
Decrease (increase) in restricted cash	—	555	896	(5,139)
Net cash used in investing activities	(127,988)	(250,806)	(278,986)	(337,373)
Cash flows from financing activities:				
Proceeds from issuance of common stock	34,090	1,256,293	167,417	1,256,293
Excess tax benefits from stock-based compensation	5,844	—	85,271	—
Shares repurchased for tax withholdings on vesting of restricted stock	(4,339)	—	(40,817)	—
Repayment of note payable to EMC	—	(350,000)	—	(350,000)
Net cash provided by financing activities	35,595	906,293	211,871	906,293
Net increase in cash and cash equivalents	151,112	853,820	460,204	957,782
Cash and cash equivalents at beginning of the period	1,540,260	280,096	1,231,168	176,134
Cash and cash equivalents at end of the period	$1,691,372	$1,133,916	$1,691,372	$1,133,916
Non-cash items:				
Changes in capital additions, accrued but not paid	$ 11,919	$ —	$ 24,115	$ —

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

A. Overview and Basis of Presentation

Company and Background

VMware, Inc. ("VMware" or the "Company") is the leading provider of virtual infrastructure software solutions from the desktop to the datacenter. VMware's virtual infrastructure software solutions run on industry-standard desktops 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. These consolidated financial statements are unaudited and, in the opinion of management, include all adjustments, consisting of normal recurring adjustments and accruals, for a fair statement of VMware's consolidated financial condition, results of operations and cash flows for the periods presented. Results of operations are not necessarily indicative of the results that may be expected for the full year 2008. 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 2007 Annual Report on Form 10-K.

VMware historically has received, and continues to receive, certain administrative services from EMC Corporation ("EMC"), and VMware and EMC engage in certain intercompany transactions. The consolidated financial statements include expense allocations for certain corporate functions provided to VMware by EMC, including general corporate expenses. Additionally, certain other costs incurred by EMC for the direct benefit of VMware, such as rent and salaries and benefits, have been included in VMware's financial statements. Management believes the assumptions underlying the financial statements and the above allocations are reasonable. However, given these intercompany transactions did not arise from transactions negotiated at arm's length with an unrelated third party, the financial statements included herein may not necessarily reflect the financial condition, results of operations and cash flows had VMware engaged in such transactions with an unrelated third party during all periods presented. Accordingly, historical results of VMware should not be relied upon as an indicator of the future performance of VMware. VMware's future results of operations, which will include costs and expenses for it to operate as an independent company, including payments to EMC for administrative services provided to VMware pursuant to a master transaction agreement and ancillary agreements entered into with EMC in connection with VMware's initial public offering ("IPO") in August 2007, may be materially different than VMware's historical financial position, results of operations and cash flows.

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 are expected to 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 assets and liabilities at the date of the financial statements. Estimates are used for, but not limited to, receivable valuation, useful lives of fixed assets, valuation of acquired intangibles, income taxes, stock-based compensation, amortization of capitalized software development costs and contingencies. Actual results could differ from those estimates.

New Accounting Pronouncements

VMware adopted Financial Accounting Standards ("FAS") FAS No. 157, "Fair Value Measurements" ("FAS No. 157") on January 1, 2008. FAS No. 157 defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements. During 2008, the Financial Accounting Standards Board ("FASB") issued the following amendments to FAS No. 157:

- FASB Staff Position No. 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" amends FAS No. 157 to remove certain leasing transactions from its scope.

- FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" delays the effective date of FAS No. 157 from 2008 to 2009 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).
- FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP FAS No. 157-3") clarifies the application of FAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS No. 157-3 is effective October 2008, including prior periods for which financial statements have not been issued.

The adoption of FAS No. 157 for financial assets and liabilities and its amendments did not have an impact on VMware's consolidated financial position and results of operations. VMware is currently evaluating the potential impact of FAS No. 157-2 for non-financial assets and non-financial liabilities on VMware's financial position and results of operations. See Note D to VMware's consolidated financial statements.

In April 2008, the FASB issued a FASB Staff Position on FAS No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS No. 142-3"). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS No. 142, "Goodwill and Other Intangible Assets" ("FAS No. 142"). The intent of FSP FAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141 (revised 2007), "Business Combinations" , and other U.S. generally accepted accounting principles. This FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. VMware is currently evaluating the potential impact of FSP FAS No. 142-3 on the Company's financial position and results of operations.

B. Significant Accounting Policies

Revenue Recognition

VMware derives revenue from the licensing of software and related services. VMware recognizes revenue for software products and related services in accordance with the American Institute of Certified Public Accountants' Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended. VMware recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable.

License revenue

VMware recognizes revenue from the sale of software when risk of loss transfers, which is generally upon electronic shipment.

VMware licenses its software under perpetual licenses through its direct sales force and through its channel of distributors, resellers, x86 system vendors and systems integrators. VMware defers revenue relating to products that have shipped into its channel until its products are sold through the channel. VMware obtains sell-through information from distributors and certain resellers on a monthly basis. For VMware's channel partners who do not report sell-through data, VMware determines sell-through based on payment of such distributors' and certain resellers' accounts receivable balances and other relevant factors. For software sold by x86 system vendors and bundled with their hardware, revenue is recognized in arrears upon the receipt of binding royalty reports.

For all sales, VMware uses a purchase order, a license agreement and a purchase order, or a master agreement and a binding royalty report as evidence of an arrangement. Sales through distributors and resellers are evidenced by a master distribution agreement, together with purchase orders, on a transaction-by-transaction basis.

VMware's return policy does not allow end-users to return products for a refund. Certain distributors and resellers may rotate stock when new versions of a product are released. VMware estimates future product returns at the time of sale. VMware's estimate is based on historical return rates, levels of inventory held by distributors and resellers and other relevant factors.

VMware offers rebates to certain of its channel partners. When rebates are based on a set percentage of actual sales, VMware recognizes the cost of the rebates as a reduction of revenues when the underlying revenue is recognized. When rebates are earned only if a cumulative level of sales is achieved, VMware recognizes the cost of the rebates as a reduction of revenues proportionally for each sale that is required to achieve the target.

VMware also offers marketing development funds to its channel partners. VMware records the cost of the marketing development funds, based on the maximum potential liability, as a reduction of revenues at the time the underlying revenue is recognized.

Services revenue

Services revenue consists of software maintenance and professional services. VMware recognizes software maintenance revenues ratably over the contract period. Professional services include design, implementation and training. Professional services are not considered essential to the functionality of VMware's products as these services do not alter the product capabilities and may be performed by customers or other vendors. Professional services engagements for which VMware is able to make reasonably dependable estimates of progress toward completion are recognized on a proportional performance basis based upon the hours incurred. Revenue on all other professional services engagements is recognized upon completion.

Multiple element arrangements

VMware's software products are typically sold with software maintenance and/or professional services. Vendor-specific objective evidence ("VSOE") of fair value for professional services is based upon the standard rates VMware charges for such services when sold separately. 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. 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.

Customers under software maintenance agreements are entitled to receive updates and upgrades on a when-and-if-available basis. In the event an upgrade or new product has been announced but not delivered, and customers will receive that upgrade or new product as part of a current software maintenance contract, product revenues are deferred on purchases made after the announcement date until delivery of the upgrade or new product. The amount and elements to be deferred are dependent on whether the company has established VSOE of fair value for the upgrade or new product. VSOE of fair value of these upgrades or new products is established based upon the price set by management. VMware has a history of selling these upgrades or new products on a stand-alone basis.

Deferred revenue includes unearned software maintenance fees, professional services fees and license fees.

Research and Development and Capitalized Software Development Costs

Costs incurred in the research and development of new software products are expensed as incurred until technological feasibility is established. Technological feasibility is defined as the earlier of the completion of a detailed program design or a working model. Such costs include salaries and benefits, including stock-based compensation, consultants, facilities-related costs, equipment costs and depreciation. Software development costs incurred subsequent to establishing technological feasibility through the general release of the software products are capitalized. Upon general release of the products, capitalized costs are amortized over periods ranging from 18 to 24 months, which represent the products' estimated useful lives. The determination of estimates relating to technological feasibility and useful lives requires the exercise of judgment. Changes in judgment as to when technological feasibility is reached and the determination of useful lives could materially impact the amount of costs capitalized and VMware's results of operations.

Unamortized software development costs were $92.2 million and $66.8 million at September 30, 2008 and December 31, 2007, respectively, and are included in other assets, net.

In the three months ended September 30, 2008 and 2007, VMware capitalized $45.8 million (including $7.8 million of stock-based compensation) and $27.6 million (including $5.3 million of stock-based compensation), respectively, of costs incurred for the development of software products. In the nine months ended September 30, 2008 and 2007, VMware capitalized $65.6 million (including $11.7 million of stock-based compensation) and $39.6 million (including $6.7 million of stock-based compensation), respectively, of costs incurred for the development of software products. Amortization expense from capitalized amounts was $11.0 million and $9.2 million in the three months ended September 30, 2008 and 2007, respectively. Amortization expense from capitalized amounts was $40.2 million and $25.9 million in the nine months ended September 30, 2008 and 2007, respectively.

Long-Lived Assets

Intangible assets, other than goodwill, are amortized over their estimated useful lives, during which the assets are expected to contribute directly or indirectly to future cash flows, and which range from one to nine years. In the three months ended September 30, 2008 and 2007, VMware amortized $5.1 million and $6.6 million, respectively, for purchased intangible assets. The amortization expense for the nine months ended September 30, 2008 and 2007 was $12.8 million and $19.2 million, respectively.

VMware reviews long-lived assets for impairment in accordance with FAS No. 144 "Accounting for Impairment or Disposal of Long-Lived Assets." VMware initiates reviews for impairment whenever events or changes in business circumstances indicate that the carrying amounts of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate.

Goodwill is carried at its historical cost. VMware tests goodwill for impairment in accordance with FAS No. 142 “Goodwill and Other Intangible Assets,” in the fourth quarter of each year or more frequently if events or changes in circumstances indicate that the asset might be impaired.

To date, there have been no impairments of goodwill or other intangible assets.

Comprehensive Income

Comprehensive income is equal to net income.

C. Net Income 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. For purposes of computing basic net income per share, the weighted-average number of outstanding shares of common stock excludes potentially dilutive securities. 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. Potentially dilutive securities include stock options, unvested restricted stock units, unvested restricted stock awards and other unvested restricted stock, using the treasury stock method. Securities are excluded from the computations of diluted net income per share if their effect would be anti-dilutive. As of September 30, 2008, VMware had 88.3 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. For purposes of calculating earnings per share, VMware uses the two-class method. As both classes share the same rights in dividends, basic and diluted earnings per share are the same for both classes.

The following table sets forth the computations of basic and diluted net income per share (in thousands, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	$ 83,288	$ 64,678	$ 178,679	$ 139,982
Weighted-average shares, basic for Class A and Class B	387,621	356,431	383,876	340,565
Effect of dilutive securities	6,611	12,136	13,217	4,171
Weighted-average shares, diluted for Class A and Class B	394,232	368,567	397,093	344,736
Net income per weighted-average share, basic for Class A and Class B	$ 0.21	$ 0.18	$ 0.47	$ 0.41
Net income per weighted-average share, diluted for Class A and Class B	$ 0.21	$ 0.18	$ 0.45	$ 0.41

The following shares attributable to outstanding stock options and restricted stock were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Shares of stock options excluded from calculation of diluted EPS	12,631	255	7,151	255
Shares of restricted stock excluded from calculation of diluted EPS	5,956	—	5,491	—

D. Fair Value Measurements

FAS No. 157 clarifies 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 should be determined based on assumptions that market participants would use in pricing an asset or liability.

VMware’s cash and cash equivalents as of September 30, 2008 were $1,691.4 million and included $1,029.8 million of money market securities, which are classified within Level 1 of the fair value hierarchy because the securities are valued using quoted prices in active markets for identical assets. There were no other financial assets or liabilities carried at fair value as of September 30, 2008.

E. Business Acquisitions, Goodwill and Intangible Assets

Business Acquisitions

VMware acquired two companies during the first three months of 2008 for aggregate cash consideration of $33.3 million, net of cash acquired and including transaction costs. Acquired intangibles totaled $9.4 million and have estimated useful lives of between one and eight years. The excess of the purchase price over the fair value of the net assets acquired was $38.7 million and is classified as goodwill on the consolidated balance sheet as of September 30, 2008.

On July 1, 2008, VMware acquired all of the outstanding capital stock of a privately-held application performance management software company with headquarters in San Mateo, California, and principal R&D facilities in Herzliya, Israel. The results of this company's operations have been included in VMware's consolidated financial statements since that date. VMware will leverage this company's technology to enhance VMware's portfolio of application and infrastructure management products. In addition, the Company's R&D facility and team will form the core of VMware's new development center in Israel. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of this acquisition (in thousands):

Cash	$ 216
Intangible assets	19,804
Goodwill	48,143
Assets acquired	1,740
Total liabilities assumed	(9,079)
Total purchase price	$60,824
Cash consideration	$58,436
Value of options assumed	2,388
Total consideration	$60,824

The purchase prices for the companies acquired in the nine months ended September 30, 2008 have been allocated to the assets acquired and the liabilities assumed based on estimated fair values as of the respective acquisition dates. The purchase price allocations are preliminary and may be adjusted. A final determination of required purchase accounting adjustments will be made upon finalization of integration activities and resolution of certain tax contingencies. The results of operations of the acquired companies have been included in VMware's consolidated results from the respective closing dates forward. Pro forma results of operations have not been presented for the aforementioned acquisitions as the results of the acquired companies, either individually or in the aggregate, were not material to VMware's consolidated results of operations.

Goodwill

Changes in the carrying amount of goodwill for the nine months ended September 30, 2008 consist of the following (table in thousands):

Balance, January 1, 2008	$639,366
Goodwill acquired	86,655
Adjustments to purchase price allocations	4,255
Balance, September 30, 2008	$730,276

As of September 30, 2008, $519.2 million of goodwill consisted of EMC's purchase accounting for VMware.

F. Property and Equipment, net

Property and equipment, net, as of September 30, 2008 and December 31, 2007 consist of the following (table in thousands):

	September 30, 2008	December 31, 2007
Furniture and fixtures	$ 45,555	$ 30,678
Equipment and software	258,856	156,641
Buildings and improvements	179,372	129,752
Construction in progress	23,369	32,097
	507,152	349,168
Accumulated depreciation	(136,539)	(72,185)
	$ 370,613	$ 276,983

Depreciation expense was $24.5 million and $64.6 million for the three and nine months ended September 30, 2008, respectively, and $11.8 million and $27.4 million for the three and nine months ended September 30, 2007, respectively.

During the second quarter of 2008, VMware reviewed and revised the estimated useful lives of certain assets after considering (i) the estimated future benefits the Company expects to receive from those assets, (ii) the pattern of consumption of those benefits and (iii) the information available regarding those benefits, and prospectively increased the estimated useful lives of computers and other related equipment from 2 years to 3 years to match the length of the related warranty contracts. For the three months ended September 30, 2008, these changes in estimates reduced depreciation expense by $3.9 million and increased diluted earnings per share by $0.01, from what would have been reported otherwise in the three months ended September 30, 2008. There was no impact on basic earnings per share for the three months ended September 30, 2008. For the nine months ended September 30, 2008, these changes in estimates reduced depreciation expense by $8.7 million and increased both basic and diluted earnings per share by $0.02 from what would have been reported otherwise in the nine months ended September 30, 2008.

G. Accrued Expenses

Accrued expenses as of September 30, 2008 and December 31, 2007 consist of (table in thousands):

	September 30, 2008	December 31, 2007
Salaries, commissions, and benefits	$ 81,511	$ 93,678
Accrued partner liabilities	49,229	42,852
Other	29,389	37,080
	$ 160,129	$ 173,610

H. Income Taxes

Although VMware files a federal consolidated tax return with EMC, VMware has calculated its income tax provision on a stand-alone basis. VMware'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 provision for income taxes differs from the tax computed at the U.S. federal statutory income tax rate due primarily to earnings considered as indefinitely reinvested in foreign operations.

VMware's effective income tax rate was 19.6% and 18.3% for the three and nine months ended September 30, 2008, respectively. The effective income tax rate was 2.4% and 11.0% for the three and nine months ended September 30, 2007, respectively. The effective tax rate for the three months ended September 30, 2007 reflects a benefit of $5.5 million related to the adjustments to the expected annual effective income tax rate from 17.2% for the six months ended June 30, 2007 to 11.0% for the nine months ended September 30, 2007. The increase in the effective rates for the three and nine months ended September 30, 2008 compared to the three and nine months ended September 30, 2007, respectively, were primarily attributable to the expiration of the federal research tax credit, an increase in transfer pricing adjustments relative to VMware's forecasted annual pre-tax income, an increase in state taxes, and a change in the mix of income from international sources to U.S. sources. Income earned abroad 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, 2008, VMware had $31.7 million of gross unrecognized tax benefits and $29.4 million of unrecognized tax benefits, net of federal tax benefit. The gross and net unrecognized tax benefits included interest and penalties of $1.2 million and $0.9 million, respectively. VMware reports interest and penalties related to unrecognized tax benefits in income tax expense. If the total amount of net unrecognized tax benefits had been recognized, $7.6 million would have been recorded to goodwill and the remaining $21.8 million would have adjusted VMware's effective tax rate. The $29.4 million of net unrecognized tax benefits are not expected to be paid within the next 12 months. $28.4 million of net unrecognized tax benefits were classified in non-current income taxes payable. VMware does not expect significant changes to its unrecognized tax benefits within the next 12 months.

As of September 30, 2008, VMware had a net income tax receivable of $82.2 million, which was principally comprised of amounts due from EMC; however, this amount was net of approximately $14.8 million of current income taxes payable due to various governmental authorities. The receivable arose because VMware had a stand-alone taxable loss for the nine months ended September 30, 2008, which was primarily attributable to tax deductions arising from both non-qualified stock option exercises and from restricted stock when the restrictions lapse. Under the tax sharing agreement with EMC, EMC is obligated to pay to VMware an amount equal to the tax benefit that EMC will recognize on its consolidated tax return.

The "Emergency Economic Stabilization Act of 2008," which contains the "Tax Extenders and Alternative Minimum Tax Relief Act of 2008," was signed into law on October 3, 2008. Under the Act, the research credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The effects of the change in the tax law will be recognized in VMware's fourth quarter, which is the quarter in which the law was enacted. VMware is currently in the process of analyzing the impact of the new law.

I. 401(k) Savings Plan

Prior to March 2008, VMware employees participated in the EMC Corporation 401(k) Savings Plan (the "EMC Plan"), and EMC cross-charged VMware for the costs associated with VMware employees who participated in the EMC Plan.

In 2008, VMware established a defined contribution retirement savings program, the VMware Inc. 401(k) Savings Plan (the "VMware Plan"), which is qualified under Section 401(k) of the Internal Revenue Code of 1986 (the "Code"). This plan is available solely to employees of VMware. In March 2008, VMware employees began participating in the VMware Plan and ceased participation in the EMC Plan. In March 2008, $96.4 million of assets and $1.1 million of participant loans were transferred from the EMC Plan into the VMware Plan.

VMware matches pre-tax employee contributions up to 6% of eligible compensation during each pay period, subject to a $750 maximum match each quarter per employee. Matching contributions are immediately 100% vested. During the three and nine months ended September 30, 2008, VMware contributions for employees were $2.4 million and $6.7 million, respectively. Employees may elect to invest their contributions in a variety of funds. VMware's matching contribution mirrors the investment allocation of the employee's contribution.

J. Commitments and Contingencies

Litigation

VMware is named from time to time as a party to lawsuits in the normal course of its business. In such cases it is the Company's policy to defend against such claims, or if considered appropriate, negotiate a settlement on commercially reasonable terms. However, no assurance can be given that the Company will be able to negotiate settlements on commercially reasonable terms, or at all, or that any litigation resulting from such claims would not have a material adverse effect on the Company's consolidated financial position, liquidity, operating results, or consolidated financial statements taken as a whole.

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, 2008 are as follows (table in thousands):

Remainder of 2008	$ 7,147
2009	29,036
2010	28,155
2011	26,086
2012	16,506
Thereafter	294,757
Total minimum lease payments	$401,687

The amount of the future lease commitments after 2012 is primarily for the ground lease on VMware's Palo Alto, California headquarters facilities, which expires in 2057. As several of VMware's operating leases are payable in foreign currencies, the amount of operating lease commitments 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.

K. Stockholders' Equity

VMware Stock Purchase Plan

In June 2007, VMware adopted its 2007 Employee Stock Purchase Plan (the "ESPP") that is intended to be qualified under Section 423 of the Code. A total of 6.4 million shares of VMware Class A common stock were reserved for issuance under the ESPP. Under the ESPP, eligible VMware employees are granted options to purchase shares at the lower of 85% of the fair market value of the stock at the time of grant or 85% of the fair market value at the time of exercise. Options to purchase shares were first granted under the ESPP on August 13, 2007, the date on which VMware's Form S-1 Registration Statement was declared effective by the SEC, and became exercisable on December 31, 2007. Options to purchase shares are granted twice yearly, on or about January 1 and July 1, and are exercisable on or about the succeeding June 30 or December 31, respectively.

For the purchase period ended December 31, 2007, employees purchased 0.6 million shares under the ESPP at a purchase price per share of $24.65. This purchase was completed in January 2008. For the purchase period ended June 30, 2008, employees purchased 0.4 million shares under the ESPP at a purchase price per share of $45.78. This purchase was completed in June 2008.

VMware Stock Options

In September 2008, VMware completed an offer to exchange certain employee stock options issued under VMware's 2007 Equity and Incentive Plan ("Exchange Offer"). Certain previously granted options were exchanged for new, lower-priced stock options granted on a one-for-one basis. Options for an aggregate of 4,103,975 shares of VMware's Class A common stock were exchanged. Options granted pursuant to the Exchange Offer have an exercise price of $33.95 per share, will vest over a four-year period from September 10, 2008 with no credit for past vesting and will have a new six-year option term. The Exchange Offer will result in incremental stock-based compensation expense of $18.0 million to be recognized over the four-year vesting term.

The following table summarizes option activity since January 1, 2008 for VMware stock options (shares in thousands):

	Number of Shares	Weighted Average Exercise Price
Outstanding, January 1, 2008	45,339	$ 26.76
Granted (1)	10,729	42.12
Forfeited (1)	(7,110)	54.71
Expired	(2)	22.17
Exercised	(6,094)	21.69
Outstanding, September 30, 2008	42,862	26.60

(1) Includes options for 4,103,975 shares exchanged in the Exchange Offer.

Total cash proceeds from the exercise of stock options for the nine months ended September 30, 2008 were $132.9 million. The options exercised during the nine months ended September 30, 2008 had a pre-tax intrinsic value of $216.5 million.

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VMware Restricted Stock

VMware restricted stock includes restricted stock awards, restricted stock units and other restricted stock. Other restricted stock includes options exercised by non-employee directors that were required to be exercised within one year of grant, but are subject to a three-year vesting provision. The exercise of those options prior to vesting results in the outstanding shares being subject to repurchase and hence restricted until such time as the respective options vest.

In September 2008, VMware awarded 5,302,448 restricted stock units to certain employees, including a portion for international employees who were not eligible to participate in the Exchange Offer and a portion for retention purposes. These awards generally will vest over a three-year or four-year period. These awards will result in stock-based compensation expense of $164.5 million to be recognized over the three-year or four-year vesting term.

The following table summarizes restricted stock activity since January 1, 2008 for VMware restricted stock (shares in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted stock at January 1, 2008	3,565	$ 24.64
Granted	5,914	36.77
Vested	(1,947)	22.25
Forfeited	(270)	78.36
Restricted stock at September 30, 2008	7,262	33.17

As of September 30, 2008, the aggregate intrinsic value of VMware restricted stock was $191.6 million. These shares are scheduled to vest through 2012.

Shares Repurchased for Tax Withholdings

During the nine months ended September 30, 2008, VMware repurchased 744,130 shares of Class A common stock, for $40.8 million to cover employee tax withholding obligations. Pursuant to the respective agreements, these shares were repurchased in conjunction with the net share settlement upon the vesting of restricted stock during the quarter. The $40.8 million is recorded as a reduction to retained earnings as of September 30, 2008.

Stock-Based Compensation Expense

The following table summarizes the components of total stock-based compensation expense included in VMware's consolidated income statements for the three and nine months ended September 30, 2008 and 2007 (table in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Cost of license revenues	$ 264	$ 212	$ 803	$ 322
Cost of services revenues	3,660	2,195	10,716	3,608
Research and development	15,331	13,033	55,907	27,677
Sales and marketing	13,138	9,594	36,138	16,778
General and administrative	2,924	6,703	15,986	10,969
Stock-based compensation expense	$ 35,317	$ 31,737	$ 119,550	$ 59,354

For the three and nine months ended September 30, 2008, VMware capitalized $7.8 million and $11.7 million, respectively, of stock-based compensation expense associated with capitalized software development (See Note B to VMware's consolidated financial statements). For the three and nine months ended September 30, 2008, VMware capitalized an additional $0.5 million and $1.3 million, respectively, of stock-based compensation expense associated with software developed for internal use.

For the three and nine months ended September 30, 2007, VMware capitalized $5.3 million and $6.7 million, respectively, of stock-based compensation expense associated with capitalized software development. For the three and nine months ended September 30, 2007, the amount of stock-based compensation expense capitalized for software developed for internal use was not material.

Fair Value of VMware Options

The fair value of each option to acquire VMware Class A common stock granted during the three and nine months ended September 30, 2008 and 2007 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

VMware Stock Options	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Dividend yield	None	None	None	None
Expected volatility	39.2%	39.2%	38.7%	39.2%
Risk-free interest rate	2.6%	4.5%	2.5%	5.0%
Expected term (in years)	3.4	3.4	3.4	3.4
Weighted-average fair value at grant date	$19.40	$13.55	$18.81	$ 8.19

VMware Employee Stock Purchase Plan	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Dividend yield	None	None	None	None
Expected volatility	41.4%	34.8%	39.3%	34.8%
Risk-free interest rate	2.0%	4.8%	2.7%	4.8%
Expected term (in years)	0.5	0.4	0.5	0.4
Weighted-average fair value at grant date	$52.45	$ 6.99	$68.72	$ 6.99

For all options granted in the three and nine months ended September 30, 2008 and 2007, respectively, volatility was based on an analysis of historical and implied volatility of publicly-traded companies with similar characteristics, including industry, size and financial leverage. The expected term was calculated based on the historical experience that VMware employees have had with EMC stock option grants as well as the expected term of similar grants of comparable companies. The risk-free interest rate was based on a treasury instrument whose term is consistent with the expected life of the stock options.

L. Related Party Transactions

VMware recognized professional services revenues of $4.6 million and $11.7 million, for services provided to EMC's customers pursuant to VMware's contractual agreements with EMC for the three and nine months ended September 30, 2008, respectively. VMware recognized $1.8 million and $7.8 million of professional services revenues from such contractual arrangements with EMC for the three and nine months ended September 30, 2007.

VMware recognized revenues from server and desktop products and services purchased by EMC for internal use of $0.3 million and $3.8 million for the three and nine months ended September 30, 2008, respectively, pursuant to VMware's contractual agreements with EMC. As of September 30, 2008, $2.0 million of revenues from server and desktop products and services purchased by EMC for internal use was included in deferred revenue.

VMware purchased storage systems from EMC for $3.8 million, $0.5 million, $19.5 million and $4.2 million, in the three months ended September 30, 2008 and 2007, and the nine months ended September 30, 2008 and 2007, respectively. Through the third quarter of 2007, the systems purchases from EMC were at EMC's cost. Since the fourth quarter of 2007, the systems purchases from EMC are at a discount off of EMC's list price.

For certain corporate functions provided by EMC, $2.2 million and $6.9 million of expenses were allocated to VMware by EMC in the three and nine months ended September 30, 2007, respectively. In the three and nine months ended September 30, 2008, these amounts were not significant.

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 personnel. The costs incurred by EMC on VMware's behalf related to these employees were included as expenses in VMware's financial statements. These costs include expenses for salaries and benefits, travel, rent, insurance and service fees. The total of these costs were $33.2 million and $108.0 million in the three and nine months ended September 30, 2008, respectively, and $33.4 million and $78.1 million in the three and nine months ended September 30, 2007, respectively.

As part of VMware's tax sharing agreement, VMware paid EMC the sum of $62.3 million for VMware's portion of their consolidated federal income taxes in the three months ended March 31, 2008, and no payments were made in the three months ended June 30, 2008 and September 30, 2008, respectively, as VMware had a net income tax receivable due from EMC for these

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periods. This amount differed from the amounts owed on a stand-alone basis and the differences are presented as a component of stockholders' equity. In the three months ended September 30, 2007, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was recorded as a decrease in stockholders' equity of $10.0 million. In the nine months ended September 30, 2007, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was recorded as an increase in stockholders' equity of $1.4 million. In the three and nine months ended September 30, 2008, this difference was not significant.

As of September 30, 2008, VMware had a net income tax receivable of $82.2 million, which was principally comprised of amounts due from EMC; however, this amount was net of approximately $14.8 million of current income taxes payable due to various governmental authorities. Under the tax sharing agreement with EMC, EMC is obligated to pay to VMware an amount equal to the tax benefit that EMC will recognize on its consolidated tax return.

As of September 30, 2008, VMware had $41.0 million due to EMC which was partially offset by $4.8 million due from EMC. The net amount due to EMC of $36.2 million resulted from the related party transactions described above. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter end.

Interest expense with EMC, net, consists of interest expense on a note payable to EMC, offset by interest income that has been earned on VMware's intercompany balance with EMC. In the three months ended September 30, 2008, the $3.8 million of interest expense with EMC, net, recorded on the consolidated income statement consisted primarily of interest expense related to a note payable to EMC. In the nine months ended September 30, 2008, $13.5 million of interest expense was recorded related to a note payable to EMC and was included in the $13.2 million interest expense with EMC, net, recorded on the consolidated income statement. In the three and nine months ended September 30, 2007, VMware incurred $6.7 million and $13.3 million, respectively, of interest expense with EMC, net. VMware's interest income and VMware's expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in the financial statements.

In the nine months ended September 30, 2008, VMware and EMC resolved certain acquisition-related intercompany liabilities due to EMC which resulted from EMC's acquisition of VMware. As a result, intercompany liabilities due to EMC of $9.7 million were eliminated and recorded as an increase in additional paid-in capital without the issuance of additional equity by VMware or remittance of any cash.

Prior to March 2008, VMware employees participated in the EMC 401(k) Savings Plan, and EMC cross-charged VMware for the costs associated with VMware employees who participated in the EMC Plan. In March 2008, VMware employees began participating in VMware's 401(k) Savings Plan and ceased participation in the EMC Plan. See Note I to VMware's consolidated financial statements.

M. Segment Information

VMware operates in one reportable segment in accordance with the provisions of FAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" ("FAS No. 131"). Since VMware operates in one segment, all financial segment information required by FAS No. 131 can be found in the consolidated financial statements.

Revenues by geographic area are as follows (table in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
United States	$ 248,523	$ 200,726	$ 713,604	$505,217
International	223,598	157,090	652,820	408,119
Total	$ 472,121	$ 357,816	$1,366,424	$913,336

Long-lived assets, which include property and equipment, net, and other assets, net, excluding capitalized software and financial instruments, in the United States at September 30, 2008 and December 31, 2007, were $284.2 million and $236.5 million, respectively. Long-lived assets internationally at September 30, 2008 and December 31, 2007 were $43.7 million and $22.8 million, respectively. No country other than the United States accounted for 10% or more of these assets at September 30, 2008 or December 31, 2007.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our interim consolidated financial statements and notes thereto which appear elsewhere in this Quarterly Report on Form 10-Q.

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements, within the meaning of the federal securities laws, about our business and prospects. The forward-looking statements do not include the potential impact of any mergers, acquisitions, divestitures, securities offerings or business combinations or other developments in our business that may be announced or consummated after the date hereof. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "outlook," "believes," "plans," "intends," "expects," "goals," "potential," "continues," "may," "will," "should," "seeks," "predicts," "estimates," "anticipates" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these words. Our future results may differ materially from our past results and from those projected in the forward-looking statements due to various uncertainties and risks, including those described in Item 1A of Part II (Risk Factors). The forward-looking statements speak only as of the date of this Quarterly Report and undue reliance should not be placed on these statements. We disclaim any obligation to update any forward-looking statements contained herein after the date of this Quarterly Report.

All dollar amounts expressed as numbers in this MD&A (except per share amounts) are in millions.
Certain tables may not add due to rounding.

Overview

Our primary source of revenue is the licensing of virtual infrastructure software solutions and related support and services through a variety of distribution channels for use by businesses and organizations of all sizes and across numerous industries in their information technology infrastructure. Our virtual infrastructure software solutions run on industry-standard desktops and servers and support a wide range of operating system and application environments, as well as networking and storage infrastructures. We have developed a multi-channel distribution model to expand our presence and to reach various segments of the industry. In the third quarter and first nine months of 2008 we derived over 75% of our revenues from our channel partners, which include distributors, resellers, x86 systems vendors and system integrators. We have also developed a network of more than 19,000 indirect channel partners who fulfill orders through our direct channel partners. The majority of our revenues result from contracts that include both perpetual software licenses and ongoing software maintenance contracts. License revenues are recognized when the elements of revenue recognition are complete. Software maintenance revenues are recognized ratably over the term of the software maintenance period, and include renewals of software maintenance sold after the initial software maintenance period expires. We also recognize revenues from professional services provided to our customers.

We have achieved significant revenue growth to date by focusing on delivering new virtual infrastructure software solutions technology and products, expanding our network of technology and distribution partners, increasing product awareness, promoting the adoption of virtualization and building long-term relationships with our customers through the adoption of enterprise license agreements ("ELAs").

Our current financial focus is on revenue growth to generate cash flows to fund our expansion of industry segment share and our virtual infrastructure solutions. We expect to continue our revenue growth by broadening our virtual infrastructure software solutions technology and product portfolio for more uses to more users. We experienced growth in our channel partner transaction business and in the acquisition of new customers during the first nine months of 2008 as compared to the same period in 2007. However, since the end of the second quarter of 2008 we have observed that customers are subjecting large ELAs to a longer review process and in certain cases are purchasing products through the channel to meet their immediate needs, forgoing larger discounts offered under ELAs. We believe this trend is primarily correlated to the recent global economic uncertainty and will continue throughout 2008 and perhaps longer.

Although we are currently the leading provider of virtual infrastructure solutions, we believe the use of virtual infrastructure solutions is at very early stages by customers. We face competitive threats to our leadership from a number of companies, some of which have significantly greater resources than we do. 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 leadership in providing virtual infrastructure solutions. This investment could result in contracting operating margins as we invest in our future. We believe that we will be able to continue to meet our product development objectives through our current resources, with strategic hires and acquisitions, and from operating cash flows as we continue to sell our existing products and services. We believe this is the appropriate priority for the long-term health of our business.

In evaluating our results, we also focus on operating margin excluding stock-based compensation, employer taxes on employee stock transactions, amortization of intangible assets, the write-off of in-process research and development when applicable and the net effect of the amortization and capitalization of software development costs. A portion of our services revenues is recognized in periods of up to five years subsequent to the initial contract, whereas most of our license revenues are recognized within the first quarter of contract signing. As a result, variability in operating margin can result from differences in when we price our service and when the cost is incurred. Substantially all of our international revenues are for contracts in U.S. dollars to international channel partners. A portion of our operating expenses is in currencies other than the U.S. dollar. This difference may cause variability in operating margins due to fluctuations in the U.S. dollar compared to other currencies. 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 result, our future operating margins may decline from current levels.

Prior to our initial public offering ("IPO") in August 2007, we were a wholly-owned subsidiary of EMC Corporation ("EMC"), and as such we relied on EMC to provide a number of administrative support services and facilities in other countries. Although we continue to operate under an administrative services agreement and continue to receive support from EMC, we expect our administrative costs to continue to increase. We continue to invest in expanding our own administrative functions, including our finance, legal and human resources functions, which may be at a higher cost than the comparable services provided by EMC. We are incurring additional costs as a public company, including audit, investor relations, expanded information systems, stock administration and regulatory compliance costs.

Our Relationship with EMC

As of September 30, 2008, EMC owned 26,500,000 shares of Class A common stock and all 300,000,000 shares of Class B common stock, representing approximately 84% of our total outstanding shares of common stock and 98% of the combined voting power of our outstanding common stock.

We recognized professional services revenues of $4.6 and $11.7, for services provided to EMC's customers pursuant to our contractual agreements with EMC in the third quarter and first nine months of 2008, respectively. We recognized $1.8 and $7.8 of professional services revenues from such contractual arrangements with EMC in the third quarter and first nine months of 2007, respectively.

We recognized revenues from server and desktop products and services purchased by EMC for internal use of $0.3 and $3.8 for the third quarter and first nine months of 2008, respectively, pursuant to our contractual agreements with EMC. As of September 30, 2008, $2.0 of revenues from server and desktop products and services purchased by EMC for internal use was included in deferred revenue.

We purchased storage systems from EMC for $3.8, $0.5, $19.5 and $4.2, in the third quarter of 2008 and 2007, and the first nine months of 2008 and 2007, respectively. Through the third quarter of 2007, the systems purchases from EMC were at EMC's cost. Since the fourth quarter of 2007, the systems purchases from EMC are at a discount off of EMC's list price.

For certain corporate functions provided by EMC, $2.2 and $6.9 of expenses were allocated to us by EMC in the third quarter and first nine months of 2007, respectively. In the third quarter and first nine months of 2008, these amounts were not significant.

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 were included as expenses in our financial statements. These costs include expenses for salaries and benefits, travel, rent, insurance and service fees. The total of these costs were $33.2 and $108.0 in the third quarter and first nine months of 2008, respectively, and $33.4 and $78.1 in the third quarter and first nine months of 2007, respectively.

As part of our tax sharing agreement, we paid EMC the sum of $62.3 for our portion of their consolidated federal income taxes in the first quarter of 2008 and no payments were made in the second and third quarters of 2008, respectively, as we had a net income tax receivable due from EMC for these periods. These amounts differed from the amounts owed on a stand-alone basis and the differences are presented as a component of stockholders' equity. In the third quarter of 2007, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was recorded as an increase in stockholders' equity of $10.0. In the first nine months of 2007, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was recorded as a decrease in stockholders' equity of $1.4. In the third quarter and first nine months of 2008, these differences were not significant.

As of September 30, 2008, we had a net income tax receivable of $82.2, which was principally comprised of amounts due from EMC; however, this amount was net of approximately $14.8 of current income taxes payable due to various governmental authorities. The receivable arose because we had a stand-alone taxable loss for the first nine months of 2008, which was primarily attributable to tax deductions arising from both non-qualified stock option exercises and from restricted stock where the restrictions lapsed. Under the tax sharing agreement with EMC, EMC is obligated to pay to us an amount equal to the tax benefit that EMC will recognize on its consolidated tax return.

As of September 30, 2008, we had $41.0 due to EMC which was partially offset by $4.8 due from EMC. The net amount due to EMC of $36.2 resulted from the related party transactions described above. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter end.

Interest expense with EMC, net, consists of interest expense on a note payable to EMC, offset by interest income that has been earned on our intercompany balance with EMC. In the third quarter of 2008, the $3.8 of interest expense with EMC, net, recorded on the consolidated income statement consisted primarily of interest expense related to a note payable with EMC. In the first nine months of 2008, $13.5 of interest expense was recorded related to a note payable with EMC and was included in the $13.2 interest expense with EMC, net, recorded on the consolidated income statement. In the third quarter and first nine months of 2007, we incurred $6.7 and $13.3, respectively, of interest expense with EMC, net. Our interest income and our expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in the financial statements.

In the first nine months of 2008, we resolved with EMC certain acquisition-related intercompany liabilities due to EMC which resulted from EMC's acquisition of us. As a result, intercompany liabilities due to EMC of $9.7 were eliminated and recorded as an increase in additional paid-in capital without the issuance of additional equity by us or remittance of any cash.

Prior to March 2008, our employees participated in the EMC 401(k) Plan, and EMC cross-charged us for the costs associated with our employees who participated in the EMC Plan. In March 2008, our employees began participating in our 401(k) Savings Plan and ceased participation in the EMC Plan. See Note I to our consolidated financial statements.

Given that the amounts we recorded for our intercompany transactions with EMC did not arise from transactions negotiated at arm's length with an unrelated third party, 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.

Income Statement Presentation

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 and are generally priced based upon the number of physical desktops or server processors on which our software runs.

Software maintenance revenues

Software maintenance revenues are recognized ratably over the contract period. Typically, our contract periods range from one to five years. 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 other vendors. Professional services engagements for which we are able to make reasonably dependable estimates of progress toward completion are recognized on a proportional performance basis based upon the hours incurred. Revenues on all other professional services engagements are recognized upon completion.

Costs of Revenues and Operating Expenses

Cost of license revenues

Our cost of license revenues principally consists of amortization of capitalized software development costs and the cost of fulfillment of our software. This 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.

Cost of services revenues

Our cost of services revenues includes the costs of personnel and related overhead to deliver technical support on 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 research and development of new product offerings, including depreciation expense, and the enhancement of our existing software offerings.

Sales and marketing expenses

Our sales and marketing expenses include personnel costs and related overhead associated with the sale and marketing of our license and service offerings, as well as the cost of certain specific marketing initiatives, including our semi-annual VMworld conference.

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 finance, facilities, human resources, IT infrastructure and legal departments.

Results of Operations

Revenues

Our revenues for the third quarter and first nine months of 2008 and 2007 are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues:				
License	$ 285.1	$ 247.5	$ 863.3	$ 621.1
Services:				
Software maintenance	147.3	86.8	395.4	227.9
Professional services	39.7	23.5	107.7	64.3
Total services	187.0	110.3	503.1	292.2
	$ 472.1	$ 357.8	$ 1,366.4	$ 913.3
Percentage of revenues:				
License	60.4%	69.2%	63.2%	68.0%
Services:				
Software maintenance	31.2	24.3	28.9	25.0
Professional services	8.4	6.5	7.9	7.0
Total services	39.6	30.8	36.8	32.0
	100.0%	100.0%	100.0%	100.0%
Revenues:				
United States	$ 248.5	$ 200.7	$ 713.6	$ 505.2
International	223.6	157.1	652.8	408.1
	$ 472.1	$ 357.8	$ 1,366.4	$ 913.3
Percentage of revenues:				
United States	52.6%	56.1%	52.2%	55.3%
International	47.4	43.9	47.8	44.7
	100.0%	100.0%	100.0%	100.0%

Total revenues increased by $114.3, or 32%, to $472.1 in the third quarter of 2008, compared with $357.8 in the third quarter of 2007. The growth in revenues in the third quarter of 2008 reflected an increase of $37.6 in license revenues and an increase of $76.7 in services revenues as compared to the third quarter of 2007. International revenues as a percentage of total revenues increased to 47% in the third quarter of 2008, from 44% in the third quarter of 2007.

Total revenues increased by $453.1, or 50%, to $1,366.4 in the first nine months of 2008, compared with $913.3 in the first nine months of 2007. The growth in revenues in the first nine months of 2008 reflected an increase of $242.2 in license revenues and an increase of $210.9 in services revenues as compared to the first nine months of 2007. International revenues as a percentage of total revenues increased to 48% in the first nine months of 2008, from 45% in the first nine months of 2007.

Our revenue contracts with international customers are denominated in U.S. dollars. The recent significant strengthening of the U.S. dollar relative to the Euro, British pound and Australian dollar increases the price of our products in markets where customers operate in these currencies. We may need to offer additional discounts, reduce prices or offer other incentives to mitigate the effects of the strengthening dollar on local demand.

License Revenues

Software license revenues increased by $37.6, or 15%, to $285.1 in the third quarter of 2008, compared with $247.5 in the third quarter of 2007. Software license revenues increased by $242.2, or 39%, to $863.3 in the first nine months of 2008, compared with $621.1 in the first nine months of 2007. We believe a significant majority of the revenue growth in the third quarter and first nine months of 2008 compared to the respective prior-year periods in 2007 is the result of greater demand for our virtualization product offerings attributable to wider industry acceptance of virtualization as part of organizations' IT infrastructure, a broadened product portfolio and expansion of our network of indirect channel partners. We expect the rate of growth in our license revenues to decelerate due primarily to the size and scale of our business and lengthened sales cycles attributable to challenges our customers may face in the current uncertain economic environment, such as decreases in IT budgets and difficulties in obtaining financing.

ELAs continue to be a significant component of our revenue growth. ELAs are core to our strategy to build long-term relationships with customers as they commit to our virtual infrastructure solutions in their data centers. ELAs provide a base from which to sell additional products, such as our application and infrastructure management suite and our disaster recovery products. Under a typical ELA, a portion of the revenues is attributed to the license and recognized immediately, but the majority is deferred and recognized as services revenues in future periods.

Although license revenue grew in the third quarter of 2008 when compared to the third quarter of 2007, license revenue remained relatively flat from the second quarter of 2008. At the end of the third quarter of 2008, we continued to observe the lengthening of the sales cycle on ELAs that we believe is primarily correlated to economic uncertainty, especially in the United States. In addition, some customers purchased our solutions in smaller quantities often through the channel to meet their immediate needs, forgoing larger discounts offered under ELAs. We believe this had a negative impact on our revenue and deferred revenue in the third quarter. We expect this trend to continue throughout 2008 and perhaps longer term.

We sell our products through a network of channel partners, which includes distributors, resellers, x86 system vendors and systems integrators. As we expand geographically, we may add additional direct channel partners. The increases in orders in the third quarter of 2008 primarily resulted from increased sales volumes through our existing direct channel partners. These increases were driven by several factors, including greater demand for our virtualization product offerings, wider industry acceptance of virtualization as part of an organization's IT infrastructure, a broadened product portfolio and expansion of our indirect channel partner network which purchase product from our direct partners.

We have more than 19,000 indirect channel partners as of September 30, 2008, an increase of over 9,000 from December 31, 2007. These indirect channel partners obtain software licenses and services from our distributors and x86 system vendors and market and sell them to end-user customers. In the first quarter of 2008, we introduced new programs for these channel partners to assist them to quickly establish and expand their virtualization practices and drive new customer acquisition. We believe these programs encourage channel loyalty and may facilitate our ability to reach additional industry segments and acquire new customers. In addition, we have a direct sales force that complements these efforts. Our sales force works with our channel partners to introduce them to customers and new sales opportunities. Our channel partners also introduce our sales force to their customers.

We experienced an increase in the number of license orders greater than fifty thousand dollars in the third quarter of 2008, compared to the third quarter of 2007, as well as in the first nine months of 2008, compared to the first nine months of 2007. Although we remain a high-volume transaction business, we believe an increase in the number of license orders greater than fifty thousand dollars in the comparative periods is a result of broader acceptance of virtual infrastructure solutions for organizations' IT infrastructure, a trend toward end-user customers using our products broadly across their organizations, and a result of more customers entering into multi-year ELAs, our most comprehensive volume license offering during 2008 as compared to 2007. We also experienced an increase in the number of licenses orders greater than fifty thousand dollars in the third quarter of 2008 compared to the second quarter of 2008. License orders from our distributors and end-user customers which were greater than fifty thousand dollars were approximately 36% and 28% of license revenues in the third quarter of 2008 and 2007, respectively. License orders from our distributors and end-user customers which were greater than fifty thousand dollars were approximately 34% and 29% of license revenues in the first nine months of 2008 and 2007, respectively.

Services Revenues

Services revenues increased by $76.7, or 70%, to $187.0 in the third quarter of 2008, compared with $110.3 in the third quarter of 2007. Services revenues increased by $210.9, or 72%, to $503.1 in the first nine months of 2008, compared with $292.3 in the first nine months of 2007. Given the reasons cited below, we expect that services revenues will compose a larger proportion of our revenue mix and revenue growth in 2008.

The increase in services revenues in the third quarter and the first nine months of 2008 was primarily attributable to growth in our software maintenance revenues. Software maintenance revenues increased by $60.5, or 70%, to $147.3 in the third quarter of 2008, compared with $86.8 in the third quarter of 2007, and by $167.5, or 74%, to $395.4 in the first nine months of 2008, compared with $227.9 in the first nine months of 2007. This growth reflects the increase in our license revenues, as software maintenance services are generally purchased with licenses, the benefit from multi-year software maintenance contracts sold in previous periods and renewals of existing customer software maintenance contracts.

Professional services revenues increased by $16.2, or 69%, to $39.7 in the third quarter of 2008, compared with $23.5 in the third quarter of 2007, and by $43.4, or 67%, to $107.7 in the first nine months of 2008, compared with $64.3 in the first nine months of 2007. Professional services revenues increased due to growing demand for design and implementation services and training programs, as end-user organizations deployed virtualization across their organizations.

Operating Expenses, GAAP and Non-GAAP

Information about our operating expenses with and without stock-based compensation is as follows:

	For the Three Months Ended September 30,					
	2008			2007		
	GAAP	Stock-Based Compensation	Non-GAAP	GAAP	Stock-Based Compensation	Non-GAAP
Operating expenses:						
Cost of license revenues [(1)]	$ 21.5	$ (0.3)	$ 21.2	$ 19.2	$ (0.2)	$ 19.0
Cost of services revenues	52.9	(3.7)	49.2	39.5	(2.2)	37.3
Research and development	85.3	(15.3)	70.0	67.8	(13.0)	54.8
Sales and marketing	167.9	(13.1)	154.8	125.7	(9.6)	116.1
General and administrative	43.4	(2.9)	40.5	39.8	(6.7)	33.1
Total operating expenses	$371.0	$ (35.3)	$ 335.7	$292.0	$ (31.7)	$ 260.3
Percentage of revenues:						
Cost of license revenues	4.6%		4.5%	5.4%		5.3%
Cost of services revenues	11.2		10.4	11.0		10.4
Research and development	18.1		14.8	19.0		15.3
Sales and marketing	35.6		32.8	35.1		32.5
General and administrative	9.2		8.6	11.1		9.3
Total operating expenses	78.6%		71.1%	81.6%		72.8%

	For the Nine Months Ended September 30,					
	2008			2007		
	GAAP	Stock-Based Compensation	Non-GAAP	GAAP	Stock-Based Compensation	Non-GAAP
Operating expenses:						
Cost of license revenues [(1)]	$ 66.0	$ (0.8)	$ 65.2	$ 60.5	$ (0.3)	$ 60.2
Cost of services revenues	166.1	(10.7)	155.4	90.9	(3.6)	87.3
Research and development	318.7	(55.9)	262.8	194.4	(27.7)	166.7
Sales and marketing	475.5	(36.1)	439.4	311.4	(16.8)	294.6
General and administrative	129.7	(16.1)	113.6	97.2	(11.0)	86.2
Total operating expenses	$1,156.0	$ (119.6)	$ 1,036.4	$754.4	$ (59.4)	$ 695.0
Percentage of revenues:						
Cost of license revenues	4.8%		4.8%	6.6%		6.6%
Cost of services revenues	12.2		11.4	10.0		9.6
Research and development	23.3		19.2	21.3		18.3
Sales and marketing	34.8		32.2	34.1		32.3
General and administrative	9.5		8.3	10.6		9.4
Total operating expenses	84.6%		75.8%	82.6%		76.1%

(1) Included in the cost of license revenues is the amortization of capitalized software development costs of $11.0 and $9.2 in the third quarter of 2008 and 2007, respectively. Costs of revenues include the amortization of capitalized software development costs of $40.2 and $25.9 in the first nine months of 2008 and 2007, respectively.

Operating expenses without stock-based compensation are non-GAAP financial measures. See—“Non-GAAP Financial Measures” below.

Cost of License Revenues

Our cost of license revenues increased by $2.4, or 12%, to $21.5 in the third quarter of 2008, compared with $19.2 in the third quarter of 2007. Cost of license revenues increased by $5.5, or 9%, to $66.0 in the first nine months of 2008, compared with $60.5 in the first nine months of 2007. As a percentage of revenues, cost of license revenues were 5% in the third quarter of 2008 and 2007, respectively, and 5% and 7% in the first nine months of 2008 and 2007, respectively. The increases in our costs of license revenues were primarily attributable to increased amortization of capitalized software development costs, which were

$11.0 and $9.2 in the third quarter of 2008 and 2007, respectively and $40.2 and $25.9 in the first nine months of 2008 and 2007, respectively. The increase in the first nine months of 2008 was partially offset by a decrease in amortization of intangible assets of $7.7 from the first nine months of 2007. The cost of fulfillment of our software, which includes product packaging, personnel costs and related overhead associated with the physical and electronic delivery of our software products remained relatively flat.

Cost of Services Revenues

Our cost of services revenues increased by $13.4, or 34%, to $52.9 in the third quarter of 2008, compared with $39.5 in the third quarter of 2007. Cost of services revenues increased by $75.2, or 83%, to $166.1 in the first nine months of 2008, compared with $90.9 in the first nine months of 2007. As a percentage of revenues, cost of services revenues were 11% in the third quarter of 2008 and 2007, respectively, and 12% and 10% in the first nine months of 2008 and 2007, respectively. The increases in our costs of services revenues were primarily attributable to increased costs to support the increased direct support, professional services personnel and third-party professional services costs to support the increased services revenues. In the third quarter of 2008, we also reclassified certain costs that were previously categorized as costs of services revenue to general and administrative expenses, therefore decreasing cost of services revenues.

Research and Development Expenses

Our R&D expenses increased by $17.5, or 26%, to $85.3 in the third quarter of 2008, compared with $67.8 in the third quarter of 2007. R&D expenses increased by $124.3, or 64%, to $318.7 in the first nine months of 2008, compared with $194.4 in the first nine months of 2007. As a percentage of revenues, R&D expenses were 18% and 19% in the third quarter of 2008 and 2007, respectively, and 23% and 21% in the first nine months of 2008 and 2007, respectively. The increase in R&D expenses was primarily attributable to incremental headcount to support the growth of our business, resulting in increased salaries, benefits expense and stock-based compensation expense, resulting from the deployment of additional resources to support new product development. Stock-based compensation expense increased by $2.3 in the third quarter of 2008 as compared with the third quarter of 2007, and by $28.2 in the first nine months of 2008 as compared with the first nine months of 2007. Partially offsetting this increase was an increase in software capitalization, which increased by $18.2 to $45.8 (including $7.8 of stock-based compensation) in the third quarter of 2008, compared with $27.6 (including $5.3 of stock-based compensation) in the third quarter of 2007, and by $26.0 to $65.6 (including $11.7 of stock-based compensation) in the first nine months of 2008, compared with $39.6 (including $6.7 of stock-based compensation) in the first nine months of 2007.

Sales and Marketing Expenses

Our sales and marketing expenses increased by $42.2, or 34%, to $167.9 in the third quarter of 2008 from $125.7 in the third quarter of 2007. Sales and marketing expenses increased by $164.0, or 53%, to $475.5 in the first nine months of 2008 from $311.4 in the first nine months of 2007. As a percentage of revenues, sales and marketing expenses were 36%, 35%, 35% and 34% in the third quarters of 2008 and 2007, and in the first nine months of 2008 and 2007, respectively. The increases in sales and marketing expenses in absolute dollars consisted primarily of higher salaries, benefits expense and stock-based compensation expense due to both increases in sales and marketing personnel and higher commission expense resulting from increased sales volume. Stock-based compensation expense increased by $3.5 in the third quarter of 2008 as compared with the third quarter of 2007, and by $19.4 in the first nine months of 2008 as compared with the first nine months of 2007. Our sales and marketing expenses also increased due to marketing expenses related to our international market expansion and marketing expenses related to our branding initiative. A portion of our sales and marketing expenses is denominated in foreign currencies and thus exposed to foreign exchange rate fluctuations. Upon consolidation, as exchange rates vary, the amount of sales and marketing expenses may fluctuate in response to changes in the exchange rate between the U.S. dollar and the foreign currencies in which the expenses are payable.

General and Administrative Expenses

Our general and administrative expenses increased by $3.6, or 9%, to $43.4 in the third quarter of 2008, compared with $39.8 in the third quarter of 2007. General and administrative expenses increased by $32.5, or 33%, to $129.7 in the first nine months of 2008, compared with $97.2 in the first nine months of 2007. As a percentage of revenues, general and administrative expenses were 9%, 11%, 10% and 11% in the third quarters of 2008 and 2007 and in the first nine months of 2008 and 2007, respectively. These expenses increased in absolute dollars primarily as a result of additional salaries and benefits expense resulting from the additional resources to support the growth of our business and to expand our own administrative functions. In the third quarter of 2008, we also reclassified certain costs that were previously categorized as costs of services revenue to general and administrative expenses, therefore increasing general and administrative expenses. Stock-based compensation expense decreased by $3.8 in the third quarter of 2008 as compared with the third quarter of 2007 and increased by $5.0 in the first nine months of 2008 as compared with the first nine months of 2007.

Stock-Based Compensation Expense

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Stock-based compensation, excluding amounts capitalized	$ 35.3	$ 31.7	$ 119.6	$ 59.4
Stock-based compensation capitalized under FAS 86	7.8	5.3	11.7	6.7
Stock-based compensation, including amounts capitalized	$ 43.1	$ 37.0	$ 131.3	$ 66.1

Stock-based compensation expense increased in both the third quarter and the first nine months of 2008 as compared with the same periods of 2007, due primarily to broad-based stock option and restricted stock unit grants made under the VMware 2007 Equity and Incentive Plan beginning in the second quarter of 2007. Between the time of our acquisition by EMC in January 2004 and June 2007, we did not issue equity awards in our stock to our employees. During this period, employees received stock-based compensation in the form of EMC stock options and restricted stock awards and units as a result of grants made by EMC's Board of Directors. Beginning in June 2007, we granted equity incentive awards under our 2007 Equity and Incentive Plan in anticipation of our IPO. In connection with the IPO in August 2007, we conducted an exchange offer pursuant to which we offered our eligible employees the ability to exchange their existing EMC options and restricted stock awards for options to purchase our Class A common stock and restricted stock awards of our Class A common stock, respectively.

In September 2008, we completed an offer to exchange certain employee stock options issued under the VMware 2007 Equity and Incentive Plan ("Exchange Offer"). Certain previously granted options were exchanged for new, lower-priced stock options granted on a one-for-one basis. Options for an aggregate of 4,103,975 shares of our Class A common stock were exchanged. Options granted pursuant to the Exchange Offer have an exercise price of $33.95 per share, will vest over a four-year period from September 2008 with no credit for past vesting and will have a new six-year option term. The Exchange Offer will result in incremental stock-based compensation expense of $18.0 to be recognized over the four-year vesting term.

In September 2008, we awarded 5,302,448 restricted stock units to certain employees, including a portion for international employees who were not eligible to participate in the Exchange Offer and a portion for retention purposes. These awards generally will vest over a three-year or four-year period. These awards will result in incremental stock-based compensation expense of $164.5 to be recognized over the three-year or four-year vesting term.

As of September 30, 2008, the total unamortized fair value of outstanding VMware equity-based awards and EMC equity-based awards held by VMware employees was approximately $577. This amount will be recognized over the awards' requisite service periods, and is expected to result in stock-based compensation expense of approximately $61, $201, $180, $110 and $25 for the years ended 2008, 2009, 2010, 2011 and 2012, respectively.

In future quarters, our stock-based compensation expense is expected to increase as a result of these and any additional equity grants in future periods. The stock-based compensation expense is subject to the amount of stock-based compensation that may be capitalized as costs incurred with the development of new software products and also software developed for internal use, the amount of awards that ultimately vest and also the timing and ultimate recognition of expense related to restricted stock units and restricted stock awards if certain performance goals are achieved.

Intangible Assets

In the third quarters of 2008 and 2007, we amortized $5.1 and $6.6, respectively, for purchased intangible assets. The amortization expense for the first nine months of 2008 and 2007 was $12.8 and $19.2, respectively. Amortization expense was lower in the third quarter of 2008 as compared to the third quarter of 2007, as well as in the first nine months of 2008 as compared to the first nine months of 2007, due to decreasing amortization for historical acquisitions offset in part by additional amortization for new acquisitions. The amortization expense was classified as follows in the consolidated income statements:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Costs of license revenues	$ 3.5	$ 5.4	$ 8.1	$ 15.8
Sales and marketing	0.9	0.8	2.7	1.9
General and administrative	0.7	0.4	2.0	1.5
	$ 5.1	$ 6.6	$ 12.8	$ 19.2

Operating Income

Our operating income increased by $35.3, or 54%, to $101.0 in the third quarter of 2008, compared with $65.8 in the third quarter of 2007. Operating margins were 21% and 18% in the third quarter of 2008 and 2007, respectively. The third quarter operating margin increased primarily as a result of an increase of $16.4 in capitalization of software development costs, net of amortization, partially offset by the increase in stock-based compensation of $3.6.

Our operating income increased by $51.5, or 32%, to $210.4 in the first nine months of 2008, compared with $158.9 in the first nine months of 2007. Operating margins were 15% and 17% in the first nine months of 2008 and 2007, respectively. Operating margin decreased primarily as a result of the increase in the first nine months of 2008 of stock-based compensation of $60.2 and partially offset by a decrease in expense of $11.8 from the net effect of capitalizing and amortizing software development costs.

A portion of our costs of revenues, primarily the costs of personnel to deliver technical support on our products and professional services, and a portion of our operating expenses mainly related to sales, sales support and research and development, are denominated in foreign currencies, primarily the Euro, the British pound, the Japanese yen, the Indian rupee, the Australian dollar and the Canadian dollar. These costs and the resulting effect on operating income are exposed to foreign exchange rate fluctuations. As a result of fluctuations in the exchange rates between the U.S. dollar and foreign currencies, operating income decreased by $4.4 in the third quarter of 2008, as compared with the third quarter of 2007, as well as decreased by $22.7 in the first nine months of 2008, as compared with the first nine months of 2007. If the dollar weakens in relation to other currencies, such as the Euro, we expect this to continue to have a negative effect on our operating margins.

We continue to expect that our operating expenses will increase in absolute terms and could increase as a percentage of revenues. In the fourth quarter of 2008, we anticipate that our operating margin could decrease as compared to the third quarter due to our continued market expansion investments as well as our exposure to fluctuations in foreign currency rates.

Investment Income

Investment income was $7.7 and $7.3 in the third quarter of 2008 and 2007, respectively. Investment income was $22.0 and $11.7 in the first nine months of 2008 and 2007, respectively. Investment income consists of interest earned on cash and cash equivalent balances. Investment income increased in the third quarter of 2008 compared to the third quarter of 2007 due to higher cash and cash equivalent balances, primarily a result of cash provided by operating activities. Investment income increased in the first nine months of 2008 compared to the first nine months of 2007 due to higher cash and cash equivalent balances, primarily as a result of cash provided by operating activities, as well as a full year of interest earned on proceeds we received in the middle of the third quarter of 2007 from our IPO and the sale of shares of our Class A common stock to Intel Capital.

Interest Expense with EMC, Net

Interest expense with EMC, net, was $3.8, $6.7, $13.2 and $13.3 in the third quarters of 2008 and 2007 and in the first nine months of 2008 and 2007, respectively. In the third quarter of 2008 and first nine months of 2008, interest expense with EMC, net, consisted primarily of $3.8 and $13.5, respectively, in interest expense incurred on the note issued to EMC in April 2007, net of interest income earned on intercompany balances. The decrease in interest expense in 2008 was due to decreases in interest rates through June applicable to the note with EMC. We expect our interest expense on the note payable to increase in the fourth quarter as a result of an increase of the interest rate on the note payable by approximately 100 basis points for the fourth quarter of 2008 because of increases in the 90-day LIBOR.

Income Tax Provision

Our effective income tax rate was 19.6% for the third quarter of 2008 and 2.4% for the third quarter of 2007. The effective income tax rate in the third quarter of 2007 reflects a benefit of $5.5 from the adjustment to the estimated 11.0% tax rate for the year. This adjustment to the expected annual effective tax rate for 2007 arose from changes in the projected mix of income attributable to foreign versus domestic jurisdictions and from the benefit of holding the proceeds from the IPO in tax-exempt money market securities. The increase in the effective rate for the quarter ended September 30, 2008 compared to the quarter ended September 30, 2007 was also attributable to the expiration of the federal research tax credit, an increase in transfer pricing adjustments relative to our forecasted annual pre-tax income, an increase in state taxes and a change in the mix of income from international sources to U.S. sources. Income earned abroad is considered indefinitely reinvested in our foreign operations and no provision for U.S. taxes has been provided with respect thereto.

The effective tax rate was 18.3% for the first nine months of 2008 and 11.0% for the first nine months of 2007. The increase in the effective rate was primarily attributable to the expiration of the federal research tax credit, an increase in transfer pricing adjustments relative to our forecasted annual pre-tax income, an increase in state taxes and a change in the mix of income from international sources to U.S. sources. Income earned abroad is considered indefinitely reinvested in our foreign operations and no provision for U.S. taxes has been provided with respect thereto.

The “Emergency Economic Stabilization Act of 2008,” which contains the “Tax Extenders and Alternative Minimum Tax Relief Act of 2008,” was signed into law on October 3, 2008. Under the Act, the research credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The effects of the change in the tax law will be recognized in our fourth quarter, which is the quarter in which the law was enacted. We are currently in the process of analyzing the impact of the new law.

Non-GAAP Financial Measures

Regulation S-K Item 10(e), “Use of Non-GAAP Financial Measures in Commission Filings,” and other Securities Exchange Commission (“SEC”) regulations define and prescribe the conditions for use of certain non-GAAP financial information. Our measures of costs of revenues and operating expenses without stock-based compensation meet the definition of non-GAAP financial measures. These non-GAAP financial measures, which are used as measures of our performance, should be considered in addition to, not as a substitute for or in isolation from, measures of our financial performance prepared in accordance with GAAP. We provide this information to show the impact of stock-based compensation on our results of operations, as it is excluded from our internal operating plans and measurement of financial performance (although we consider the dilutive impact to our stockholders when awarding stock-based compensation and value such awards accordingly), and because determining the fair value of the related equity awards involves a high degree of judgment and estimation.

Costs of revenues and operating expenses without stock-based compensation have limitations due to the fact that they do not include all expenses related to the compensation of our people. More specifically, if we did not pay out a portion of our compensation in the form of stock-based compensation, the cash salary expense included in our costs of revenues and operating expenses would be higher. We compensate for this limitation by providing supplemental information about outstanding stock-based awards in the footnotes to our financial statements. Stock-based compensation programs are an important element of our compensation structure and all forms of stock-based awards are valued and included as appropriate in results of operations. Management strongly encourages stockholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

Liquidity and Capital Resources

Our cash flows for the third quarter and first nine months of 2008 and 2007, respectively, were as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Net cash provided by operating activities	$ 243.5	$ 198.3	$ 527.3	$ 388.9
Net cash used in investing activities	$ (128.0)	$ (250.8)	$ (279.0)	$ (337.4)
Net cash provided by financing activities	$ 35.6	$ 906.3	$ 211.9	$ 906.3

Cash Flows from Operating Activities

In the third quarter of 2008, our operating cash flows reflected net income generated during the period of $83.3, adjusted for non-cash items such as depreciation and amortization expense of $40.6 and stock-based compensation of $35.3. This was partially offset by excess tax benefits from stock-based compensation of $5.8. FAS No. 123(R), “Accounting for Stock-Based Compensation,” requires excess tax benefits relating to stock-based compensation deductions be presented as financing cash flows, rather than as cash flows from operating activities. The benefits of tax deductions in excess of the tax-affected compensation could fluctuate significantly from period to period based on the number of stock-based awards exercised, sold or vested, the tax benefit realized and the tax-affected compensation recognized.

Additionally, changes in assets and liabilities, net of acquisitions had a net positive impact on cash flow of $88.9 in the third quarter of 2008, primarily as the result of an increase of deferred revenue of $58.8 due to the growth in our business, decrease in income taxes receivable of $28.0, and a decrease in accounts receivable of $20.8. This was partially offset by a decrease in accrued expenses of $21.3. As of September 30, 2008, our deferred revenue balance was $780.4, of which $482.4 was classified as current.

In the third quarter of 2007, our operating cash flow reflected net income generated during the period of $64.7, adjusted for non-cash items such as depreciation and amortization expense of $27.6 and stock-based compensation of $31.7. Additionally, working capital, including short- and long-term deferred revenue, income taxes payable and deferred income taxes, had a net positive impact on cash flow of $74.8, primarily the result of a decrease in accounts receivable of $37.1.

In the first nine months of 2008, our operating cash flows reflected net income generated during the period of $178.7, adjusted for non-cash items such as depreciation and amortization expense of $117.5 and stock-based compensation of $119.6. This was partially offset by excess tax benefits from stock-based compensation of $85.3. Working capital generated cash flow of $194.5 in the first nine months of 2008, primarily as the result of an increase in total deferred revenue of $227.1, increase in amounts due to EMC of $43.2 and deferred income taxes, net of $37.8 due to the growth in our business. This was offset by a decrease in income taxes payable to EMC of $69.0, a decrease in accrued expenses of $25.3, and an increase in other assets of $15.7

In the first nine months of 2007, our operating cash flow reflected net income generated during the period of $140.0, adjusted for non-cash items such as depreciation and amortization expense of $72.5 and stock-based compensation of $59.4. Additionally, changes in working capital, including short- and long-term deferred revenue, income taxes payable and deferred income taxes, had a net positive impact on cash flow of $117.5, primarily the result of increases in total deferred revenue of $116.5 and income taxes payable to EMC of $60.4, offset by an increase in our intercompany balance due from EMC of $74.4. Our deferred revenue balance consisted of deferred license revenues of $45.2 and deferred service revenues of $382.0 at September 30, 2007, of which $290.0 of the total deferred revenue balance was classified as current. Of the $137.2 classified as long-term, $89.3 will be recognized as revenue subsequent to December 31, 2008.

Cash Flows from Investing Activities

Cash used in investing activities during the three and nine months ended September 30, 2008 and 2007 primarily related to capital additions, business acquisitions and capitalized software development costs. During the third quarter of 2007 we purchased our headquarters facilities from EMC for $132.6 which was the cost expended by EMC in the construction. During 2007 and 2008, we purchased furniture and fixtures for our new headquarters facilities, invested cash in the remaining buildings under development and invested in computer and network equipment to support increased personnel and related infrastructure requirements both domestically and internationally. In the third quarter of 2008, we accrued for $11.9 more of capital additions as compared to the second quarter of 2008, for a total of $24.1 in capital additions in the first nine months of 2008 that are reflected as non-cash items in our statement of cash flows as we had not remitted cash for the additions prior to the end of the quarter. We used $57.4 in the third quarter of 2008 and $90.7 in the first nine months of 2008 for business acquisitions, net of cash acquired. Capitalized software development costs, excluding stock-based compensation expenses, were $38.0, $22.3, $53.9 and $32.9 in the third quarters of 2008 and 2007 and the first nine months of 2008 and 2007, respectively. We expect to continue to invest in capital additions and business acquisitions in future periods.

Cash Flows from Financing Activities

Cash provided by financing activities in the third quarter and first nine months of 2008 reflected proceeds from issuances of common stock, including the exercise of options and the issuance of shares under our 2007 Employee Stock Purchase plan of $34.1 and $167.4, respectively, and excess tax benefits from stock-based compensation of $5.8 and $85.3, respectively. These financing cash inflows were partially offset by $4.3 and $40.8, respectively, of shares repurchased to cover tax withholding obligations in conjunction with the net share settlement upon the vesting of restricted stock.

In the third quarter of 2007, we completed our IPO and sold 37,950,000 shares of our Class A common stock. The net proceeds of the IPO to us were $1,035.2 after deducting underwriters' discounts and offering expenses. Also in the third quarter of 2007, Intel Capital purchased 9.5 million shares of our Class A common stock for an aggregate purchase price of $218.3 net of issuance costs. Subsequent to our IPO in August 2007, we used a portion of the proceeds from the IPO to repay $350.0 of principal on the note payable owed to EMC. We expect that cash proceeds from issuances of common stock and the excess tax benefit from stock-based compensation could increase over time as more stock options vest and become exercisable, however, these proceeds 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.

Our cash and cash equivalents balance increased from $1,231.2 at December 31, 2007 to $1,691.4 at September 30, 2008. We are invested in short-term cash and cash equivalents and have not experienced any declines in valuation of our holdings. Based on our current operating and capital expenditure forecasts, we believe that the combination of funds currently available and funds to be generated from operations will be adequate to finance our ongoing operations for at least the next 12 months.

To date, inflation has not had a material impact on our financial results.

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 2008.

Critical Accounting Policies

Our consolidated financial statements are based on the selection and application of generally accepted accounting principles 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 2007 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. Our significant accounting policies are presented within Note A to our consolidated financial statements of our 2007 Annual Report on Form 10-K.

New Accounting Pronouncements

We adopted Financial Accounting Standards ("FAS") FAS No. 157, "Fair Value Measurements" ("FAS No. 157") on January 1, 2008. FAS No. 157 defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements. During 2008, the Financial Accounting Standards Board ("FASB") issued the following amendments to FAS No. 157:

- FASB Staff Position No. 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" amends FAS No. 157 to remove certain leasing transactions from its scope.
- FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" delays the effective date of FAS No. 157 from 2008 to 2009 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).
- FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP FAS No. 157-3") clarifies the application of FAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS No. 157-3 is effective October 2008, including prior periods for which financial statements have not been issued.

The adoption of FAS No. 157 for financial assets and liabilities and its amendments did not have an impact on our consolidated financial position and results of operations. We are currently evaluating the potential impact of FAS No. 157 for non-financial assets and non-financial liabilities on our financial position and results of operations. See Note D to our consolidated financial statements.

In April 2008, the FASB issued a FASB Staff Position on FAS No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS No. 142-3"). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS No. 142, "Goodwill and Other Intangible Assets" ("FAS No. 142"). The intent of FSP FAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141 (revised 2007), "Business Combinations" , and other U.S. generally accepted accounting principles. FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the potential impact of FSP FAS No. 142-3 on our financial position and results of operations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

International revenues as a percentage of total revenues were 47.4% and 43.9% in the third quarter of 2008 and 2007, respectively, and 47.8% and 44.7% in the first nine months of 2008 and 2007, respectively. Our revenue contracts are denominated in U.S. dollars and the vast majority of our purchase contracts are denominated in U.S. dollars. A portion of our cost of revenues, primarily the cost of personnel to deliver technical support on our products and professional services, and a portion of our operating expense related to sales and sales support and research and development, are denominated in foreign currencies, primarily the Euro, the British pound, the Japanese yen, the Indian rupee, the Australian dollar and the Canadian dollar. These costs and the resulting effect on operating income are exposed to foreign exchange rate fluctuations. Upon consolidation, as exchange rates vary, operating expenses may differ materially from expectations. For example, the amount of our operating lease commitments may fluctuate in response to changes in the exchange rate between the U.S. dollar and the foreign currencies as several of our operating leases are payable in foreign currencies.

We do not hedge our exposure to foreign currency fluctuation. As a result of fluctuations in the exchange rates between the U.S. dollar and foreign currencies, operating income was negatively impacted by $4.4 and $22.7 in the third quarter and first nine months of 2008, as compared to the third quarter and the first nine months of 2007, respectively.

Interest Rate Risk

Our exposure to market risk relates primarily to the variable interest obligation on the note we incurred to fund an $800.0 dividend to EMC. The dividend was declared in April 2007, but given retroactive effect as of December 31, 2006. The note may be repaid, without penalty, at any time. Subsequent to receiving the proceeds from our IPO in August 2007, we repaid $350.0 of principal on the note. The note matures in April 2012 and bears an interest rate of the 90-day LIBOR plus 55 basis points, with interest payable quarterly in arrears. The interest rate on the note payable as of September 30, 2008 was 3.34%, but the interest rate on the note payable will increase by approximately 100 basis points for the fourth quarter of 2008 because of increases in the 90-day LIBOR. Therefore, we expect our interest expense on the note payable to increase in the fourth quarter. If our interest rates were to change 100 basis points from the September 30, 2008 rate and assuming no payments on the principal were made during 2008, our annual interest expense would change by $4.5.

Item 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective.

We are required to comply with the internal control reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002 for our fiscal year ending December 31, 2008. The management report and auditor attestation on the effectiveness of the Company’s internal control over financial reporting must be included in our annual report for the fiscal year ending December 31, 2008.

PART II
OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are named from time to time as a party to lawsuits in the normal course of our business. In such cases it is our policy to defend against such claims, or if considered appropriate, negotiate a settlement on commercially reasonable terms. However, no assurance can be given that we will be able to negotiate settlements on commercially reasonable terms, or at all, or that any litigation resulting from such claims would not have a material adverse effect on our consolidated financial position, liquidity, operating results, or our consolidated financial statements taken as a whole.

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 products and services we sell are based on an emerging technology and therefore the potential market for our products remains uncertain.

The virtualization products and services we develop and sell are based on an emerging technology platform and our success depends on organizations and customers perceiving technological and operational benefits and cost savings associated with adopting virtual infrastructure solutions. Our relatively limited operating history and the relatively limited extent to which virtual infrastructure solutions have been currently adopted may make it difficult to evaluate our business because the potential market for our products remains uncertain. The markets for our virtualization products are new and have grown rapidly from a small base. This has resulted in significant percentage increases in our product sales in recent periods. As the markets for our products mature and the scale of our business increases, the rate of growth in our product sales may be lower than those we have experienced in recent periods. In addition, to the extent that the virtualization market develops 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 market for our products is competitive and we expect competition to significantly intensify in the future. For example, Microsoft currently provides products that compete with some of our free offerings, has released virtual infrastructure and virtual management products during 2008 and recently announced a cloud-based computing initiative. Microsoft’s offerings are positioned to compete with our virtual infrastructure and other virtualization product offerings. We also face competition from other companies, including several recent market entrants and there have been a number of announcements of new product initiatives, alliances and consolidation efforts by our competitors. For example, Citrix Systems recently released a new version of the server virtualization product acquired in conjunction with its 2007 XenSource acquisition, RedHat recently acquired Qumranet, a developer of virtual infrastructure solutions software and Sun and Oracle announced enhancements to their Xen-based products. 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 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. 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. For example, Microsoft has implemented distribution arrangements with x86 system vendors and independent software vendors, or ISVs, related to certain of their operating systems that only permit the use of Microsoft’s virtualization format and do not allow the use of our corresponding format. Microsoft has also implemented pricing policies that require customers to pay additional license fees based on certain uses of virtualization technology. These distribution and licensing 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 has started to provide free server virtualization software intended to support Oracle and non-Oracle applications and Microsoft started offering its own server virtualization software packaged with the 2008 release of its Windows server product. Symantec Corporation also announced a competitive Xen-based product. 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.

The current uncertainty in global economic conditions could result in reduced information technology spending and may adversely impact our revenues.

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 a reduction in information technology spending even if economic conditions improve, would likely adversely impact our business, financial condition and results of operations in a number of ways, including by lengthening sales cycles (for example, for ELAs), lowering prices for our products and services reducing unit sales and decreasing or reversing quarterly growth in our revenues.

Current uncertainty in global economic conditions pose a risk to the overall economy as consumers and businesses may defer purchases in response to tighter credit and negative financial news, which could negatively affect information technology budgets and spending. Consequently, customer spending on our products could be different from our expectations due to factors including changes in business and economic conditions, including conditions in the credit market that could affect consumer confidence; customer acceptance of our and competitors' products; changes in customer order and payment patterns; and changes in the willingness of customers to enter into longer term licensing and support arrangements.

Industry alliances or consolidation may result in increased competition.

Some of our competitors have made acquisitions or entered into partnerships or other strategic relationships with one another to offer a more comprehensive virtualization solution than they individually had offered. For example, Red Hat recently acquired Qumranet, a developer of virtual infrastructure solutions and during 2008 Microsoft announced an expansion of its alliance with Citrix. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in the evolving virtualization infrastructure 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 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, technology or product functionality. These pressures 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:

- 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 and beta programs;

- the sale of our products in the timeframes 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 timing of the announcement or release of upgrades or new products by us or by our competitors;
- our ability to implement 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;
- general economic conditions in our domestic and international markets;
- the timing and amount of capitalized software development costs as a result of establishing technological feasibility; 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 protocol interfaces (“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. 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.

We rely on distributors, resellers, x86 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, x86 system vendors and systems integrators. By relying on distributors, resellers, x86 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.

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, x86 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 x86 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 and x86 system vendors 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. One of the Company's distribution agreements is with Ingram Micro, which accounted for 19% and 23% of our revenues in the first nine months of 2008 and fiscal year 2007. The agreement with Ingram Micro under which the Company receives the substantial majority of its Ingram Micro revenues is 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 agreement. The terms of this agreement between Ingram Micro and us are substantially similar to the terms of the agreements we have with other distributors, except for certain differences in shipment and payment terms, indemnification obligations and product return rights. While we believe that we have in place, or would have in place by the date of any such termination, agreements with other distributors sufficient to maintain our revenues from distribution, if we were to lose Ingram Micro's distribution services, 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 increases our potential credit risk and could cause significant fluctuations or declines in our product revenues.

One distributor accounted for 19% and 23% of revenues in the first nine months of 2008 and fiscal year 2007. Additionally, another distributor accounted for 15% and 12% of revenues in the first nine months of 2008 and fiscal year 2007. 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 50% of our total accounts receivable as of September 30, 2008 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. 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.

Our collection of accounts receivable may be adversely impacted by fluctuation of foreign currency exchange rates.

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 due to the recent strengthening of the U.S. dollar. One or more of these distributors could delay payments or default on credit extended to them. 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 any accounts receivable to be uncollectible, we would recognize an increase in bad debt expense, which would have a negative impact on our results of operations.

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.

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 our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel is intense, especially for engineers with high levels of experience in designing and developing software and senior sales executives. 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. The declines in the value of our stock during 2008 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.

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. Even if patents are issued from our patent applications, which is 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 contractual and enterprise license agreements (“ELAs”) 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 do we. 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 written materials for 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 40 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 ELAs 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.

Claims by others that we infringe their proprietary technology could force us to pay damages or prevent us from using certain technology in our products.

Third parties could claim that our products or technology infringe their proprietary rights. This risk may increase as the number of products and competitors in our market increases and overlaps occur. In addition, to the extent that we gain greater visibility and market exposure as a public 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 materially reduce our income.

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 or technologies acquired, licensed or developed by us may incorporate so-called “open source” software, and we may incorporate open source software into other products in the future. 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, “Berkeley Software Distribution,” “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 such that we have not triggered any such conditions, 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 or using the open source software and/or that we license such modifications or derivative works under the terms of the particular open source license.

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. 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, but we cannot be sure that all open source software is submitted for approval prior to use in our products. 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.

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. Additionally, 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. This pattern makes prediction of revenues, earnings and working capital for each financial period especially difficult and uncertain and increases 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.

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.

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 $318.7 million, or 23% of our total revenues, in the nine months ended September 30, 2008, and

$285.9 million, or 22% of our total revenues, in 2007. 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. 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 expected migration of servers from dual-core to quad-core microprocessor technology will also allow an end user with a given number of licensed copies of our software to double the number of virtualization machines run per server socket without having to purchase additional licenses from us. 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. 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.

If we are unable to develop new products and services, or to enhance and improve our products and support services in a timely manner or to position and/or price our products and services to meet market demand, customers may not buy new software licenses 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.

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;
- 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.

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. 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.

We may engage in future acquisitions that could disrupt our business, cause dilution to our stockholders and harm our business, financial condition and results of operations.

In the future we may seek to acquire other businesses, products or technologies. However, 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. Future 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. 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. In addition, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable and 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.

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

In 2007, we derived approximately 46%, and in the nine months ended September 30, 2008, we derived approximately 48%, of our revenues from customers outside the United States. We have sales and technical support personnel in numerous countries worldwide. We expect to continue to add personnel in additional countries. 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;
- 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;
- difficulties in transferring funds from certain countries; and
- difficulties in maintaining appropriate controls relating to revenue recognition practices.

As we continue to expand our business globally, 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 establishing and maintaining adequate management 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 harm our international operations and reduce our international sales.

Our products are highly technical and may contain errors, 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. 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.

Our independent registered public accounting firm identified a material weakness in the design and operation of our internal controls as of December 31, 2006, which we remediated in 2007. We cannot assure you that material weaknesses will not exist or be identified in future periods.

Our independent registered public accounting firm reported to our board of directors a material weakness in the design and operation of our internal controls as of December 31, 2006 related to the capitalization of software development costs. A material weakness is defined by the standards issued by the Public Company Accounting Oversight Board as a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weakness resulted from a lack of adequate internal controls to ensure the timely identification and accumulation of costs once a project reaches technological feasibility under applicable accounting standards. Our historical consolidated financial statements reflect adjustments to properly state our capitalized software development costs for the periods included therein. Our independent registered public accounting firm was not engaged to audit the effectiveness of our internal control over financial reporting as of December 31, 2006. If such an evaluation had been performed, additional material weaknesses may have been identified. Our independent registered public accounting firm was also not engaged to audit the effectiveness of our internal control over financial reporting as of December 31, 2007. If such an evaluation had been performed, material weaknesses may have been identified.

We remediated the material weakness found in our internal controls as of December 31, 2006 by implementing additional formal policies, procedures and processes, hiring additional accounting personnel and increasing management review and oversight over the financial statement close process. Under Section 404 of the Sarbanes-Oxley Act of 2002 and the current rules of the SEC, our management and independent registered public accounting firm will be required to evaluate and report on the effectiveness of our internal control over financial reporting as of December 31, 2008. If additional material weaknesses in our internal controls are discovered in the future, we may fail to meet our future reporting obligations, our financial statements may contain material misstatements and the price of our common stock may decline.

If we fail to implement and 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 common stock.

We are preparing for compliance with Section 404 by remediating the previously identified material weakness in our internal controls and by assessing, strengthening and testing our system of internal controls. In particular, we believe we will need to increase the number of our accounting personnel and improve our processes and systems to ensure timely and accurate reporting of our financial results in accordance with reporting obligations as a stand-alone public company. However, the continuous process of strengthening our internal controls and complying with Section 404 is expensive and time-consuming, and requires significant management attention. We cannot be certain that these measures will provide adequate control over our financial processes and reporting. In addition, we have identified certain processes that need to be automated in order to ensure that we have effective internal control over financial reporting. If we are not able to automate these processes in a timely fashion, we will not be able to ensure compliance. Furthermore, as we grow our business, our internal controls will 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 comply with Section 404, our non-compliance could subject us to a variety of administrative sanctions, including the suspension or delisting of our common stock from the New York Stock Exchange and the inability of registered broker-dealers to make a market in our common stock, which could further reduce our stock price.

Problems with our information systems could interfere with our business and 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 are in the process of enhancing 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 businesses. 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.

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 expanded our operations significantly 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.

We may have exposure to additional income tax liabilities.

We are subject to income 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. 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 business is subject to the risks of earthquakes, fire, floods and other natural catastrophic events, and to interruption by man-made problems, such as computer viruses 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 or a flood, 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. Furthermore, acts of terrorism or war could cause disruptions in our or our customers' business or the economy as a whole. 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.

Risks Related to Our Relationship with EMC

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

As of September 30, 2008, EMC owned 26,500,000 shares of our Class A common stock and all 300,000,000 shares of our Class B common stock, representing approximately 84% of the total outstanding shares of common stock or 98% 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). Shares of Class B common stock are entitled to one vote per share when voting for such remaining directors. 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 (other than in a distribution to its stockholders under Section 355 of the Internal Revenue Code of 1986, as amended, or the Code, or in transfers following such a distribution), those shares will automatically convert into Class A common stock. 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 providing for 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 between us and EMC 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;
- 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 or 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 that of EMC.

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 will provide 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.

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

Our historical financial information we have included in this Quarterly Report on Form 10-Q 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 include an allocation for certain corporate functions historically provided by EMC, including tax, accounting, treasury, legal and human resources services. This historical financial information is not necessarily indicative of what our financial position, results of operations or cash flows will be in the future. We have not made pro forma adjustments to reflect many significant changes that will occur in our cost structure, funding and operations as a result of our becoming a public company, including changes in our employee base, potential increased costs associated with reduced economies of scale and increased costs associated with being a publicly traded, stand-alone company. 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.

Our ability to operate our business effectively may suffer if we are unable to cost-effectively establish our own administrative and other support functions in order to operate as a stand-alone company after the expiration of our transitional services agreements with EMC.

Before the completion of our initial public offering (“IPO”) in August 2007, in which we issued and sold 37,950,000 shares of our Class A common stock, we were a wholly-owned subsidiary of EMC and we relied on administrative and other resources of EMC to operate our business. In connection with our IPO, we entered into various service agreements with EMC to retain the ability for specified periods to use these EMC resources. These services may not be provided at the same level as when we were a wholly-owned subsidiary of EMC, and we may not be able to obtain the same benefits that we received prior to our IPO. These services may not be sufficient to meet our needs, and after our agreements with EMC expire, we may not be able to replace these services at all or obtain these services at prices and on terms as favorable as we currently have with EMC. We will need to create our own administrative and other support systems or contract with third parties to replace EMC's systems. In addition, we have received informal support from EMC which may not be addressed in the agreements we have entered into with EMC; the level of this informal support may diminish as we become a more independent company. Any failure or significant downtime in our own administrative systems or in EMC's administrative systems during the transitional period could result in unexpected costs, impact our results and/or prevent us from paying our suppliers or employees and performing other administrative services on a timely basis.

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 and 80% of each class of nonvoting capital stock is required in order for EMC to effect 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.

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.

Prior to our IPO in August 2007, we were 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 owned 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 entered into with EMC in connection with our IPO 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 and executive officers own EMC common stock, restricted shares of EMC common stock or options 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 and executive officers own EMC common stock and/or options to purchase EMC common stock. In addition, some of our directors are executive officers and/or directors of EMC. Ownership of EMC common stock, restricted shares of EMC common stock and options to purchase EMC common stock by our directors and officers 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.

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 exempted 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.

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 September 30, 2007 and September 30, 2008, the closing trading price of our Class A common stock was very volatile, ranging between $26.00 and $124.83 per share, including single-day increases of up to 13% and declines up to 34%. 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, Intel Corporation ("Intel") and Cisco Systems ("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. Contractual restrictions on the sale of shares held by EMC expired in February 2008 and expired for the shares held by Cisco and Intel in August 2008. 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 Exchange Act of 1933 which allow the holder to sell up to the greater of 1% of our outstanding Class A common stock or our 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 against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

If securities or industry analysts do not publish or 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 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.

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 ownership relationship with us and the membership on our board of individuals 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 has an ownership interest in us and pursuant to Intel's right to designate a director acceptable to our board of directors, 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 that position) proposed by Cisco as one of our directors. 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.

As a public company we incur costs and face demands on our management in addition to the costs and demands we faced prior to our initial public offering.

As a public company, we incur significant legal, accounting and other expenses that we did not directly incur as a private company. In addition, the Sarbanes-Oxley Act of 2002, as well as the rules subsequently implemented by the SEC and the New York Stock Exchange, have required changes in corporate governance practices of public companies. These rules and regulations have increased and will continue to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. For example, in connection with becoming a public company, we have added independent directors and may add more, created additional board committees and adopted certain policies regarding internal controls and disclosure controls and procedures and may expand those procedures. In addition, we will incur additional costs associated with our public company reporting requirements. We are currently evaluating and monitoring developments with respect to these rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs. Furthermore, our management will have increased demands on its time in order to ensure we comply with public company reporting requirements and the compliance requirements of the Sarbanes-Oxley Act of 2002, as well as the rules subsequently implemented by the SEC and the applicable requirements of the New York Stock Exchange.

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

Issuer Purchases of Equity Securities during the quarter ended September 30, 2008:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Publicly Announced Plans or Programs
July 1 – July 31, 2008	27,456	$ 35.85	—	—
August 1 – August 31, 2008	41,745	38.25	—	—
September 1 – September 30, 2008	27,753	26.64	—	—
	96,954	34.24	—	—

We do not have a publicly announced stock repurchase program. All shares referenced in the above table were withheld through net share settlements during the fiscal quarter ending September 30, 2008 upon the vesting of restricted stock under our equity compensation plan to satisfy tax withholding obligations.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held a Special Meeting of Stockholders (the "Special Meeting") on September 9, 2008. At the Special Meeting, our stockholders approved a one-time stock option exchange program under which eligible VMware employees (excluding, among others, our executive officers and members of our Board of Directors) were able to elect to exchange certain outstanding stock options issued under our 2007 Equity and Incentive Plan.

The Class A common stock and Class B common stock voted together as a single class on the stock option exchange proposal. Each share of Class A common stock was entitled to one vote and each share of Class B common stock was entitled to ten votes on the stock option exchange proposal. The result of the votes for the stock option exchange proposal was as follows:

Class	In Favor	Against	Abstain
Class A	38,362,430	25,215,184	39,993
Class B	3,000,000,000	—	—

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

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.

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.

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.

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.

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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 4, 2008

By: /s/ MARK S. PEEK
Mark S. Peek
Chief Financial Officer
(Principal Financial Officer and Duly Authorized Officer)

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EXHIBIT INDEX

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.
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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.

Exhibit 31.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Paul Maritz, certify that:

1. I have reviewed this quarterly report on Form 10-Q of VMware, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. [Paragraph omitted in accordance with SEC Release 34-47986]
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2008

/s/ Paul Maritz

Paul Maritz
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark S. Peek, certify that:

1. I have reviewed this quarterly report on Form 10-Q of VMware, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. [Paragraph omitted in accordance with SEC Release 34-47986]

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2008

/s/ Mark S. Peek
Mark S. Peek
Chief Financial Officer
(Principal Financial Officer)

Exhibit 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

I, Paul Maritz, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of VMware, Inc. on Form 10-Q for the quarterly period ended September 30, 2008 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of VMware, Inc.

Date: November 4, 2008

/s/ Paul Maritz
Paul Maritz
President and Chief Executive Officer
(Principal Executive Officer)

This certification "accompanies" the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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

I, Mark S. Peek, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of VMware, Inc. on Form 10-Q for the quarterly period ended September 30, 2008 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of VMware, Inc.

Date: November 4, 2008

/s/ Mark S. Peek
Mark S. Peek
Chief Financial Officer
(Principal Financial and Accounting Officer)

This certification "accompanies" the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.