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 March 31, 2013

OR

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

For transition period from to

Commission File Number 001-33622

VMWARE, INC.
(Exact name of registrant as specified in its charter)

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

(650) 427-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ 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 April 26, 2013, the number of shares of common stock, par value $0.01 per share, of the registrant outstanding was 428,177,477 of which 128,177,477 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 STATEMENTS OF INCOME
(in thousands, except per share amounts)
(unaudited)

	For the Three Months Ended March 31,	
	2013	2012
Revenues:		
License	$ 488,227	$ 481,927
Services	703,239	573,255
Total revenues	1,191,466	1,055,182
Operating expenses (1):		
Cost of license revenues	57,344	56,743
Cost of services revenues	124,596	114,172
Research and development	270,558	222,390
Sales and marketing	417,418	363,412
General and administrative	98,466	81,300
Realignment charges	62,882	—
Operating income	160,202	217,165
Investment income	7,720	5,743
Interest expense with EMC	(965)	(1,287)
Other income (expense), net	(2,874)	2,285
Income before income taxes	164,083	223,906
Income tax provision (benefit)	(9,486)	32,470
Net income	$ 173,569	$ 191,436
Net income per weighted-average share, basic for Class A and Class B	$ 0.41	$ 0.45
Net income per weighted-average share, diluted for Class A and Class B	$ 0.40	$ 0.44
Weighted-average shares, basic for Class A and Class B	428,005	424,989
Weighted-average shares, diluted for Class A and Class B	432,631	433,213

(1) Includes stock-based compensation as follows:

	2013	2012
Cost of license revenues	$ 523	$ 440
Cost of services revenues	7,278	5,819
Research and development	62,355	39,377
Sales and marketing	36,092	25,234
General and administrative	13,969	10,936
Realignment charges	5,433	—

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

VMware, Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	For the Three Months Ended March 31, 2013	For the Three Months Ended March 31, 2012
Net income	$ 173,569	$ 191,436
Other comprehensive income:		
Changes in market value of available-for-sale securities:		
Unrealized gains, net of taxes of $628 and $1,430	1,026	2,333
Reclassification of (gains) losses realized during the period, net of taxes of $(398) and $36	(650)	58
Net change in market value of available-for-sale securities	376	2,391
Changes in market value of effective foreign currency forward exchange contracts:		
Unrealized gains (losses), net of taxes of $(27) and $40	(528)	768
Reclassification of losses realized during the period, net of taxes of $(1) and $0	(23)	—
Net change in market value of effective foreign currency forward exchange contracts	(551)	768
Total other comprehensive income (loss)	(175)	3,159
Total comprehensive income, net of taxes	$ 173,394	$ 194,595

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

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

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,840,149	$ 1,609,322
Short-term investments	3,096,531	3,021,512
Accounts receivable, net of allowance for doubtful accounts of $1,585 and $4,267	773,204	1,150,906
Due from EMC, net	8,485	67,934
Deferred tax assets	200,904	179,430
Other current assets	138,510	90,935
Total current assets	6,057,783	6,120,039
Property and equipment, net	693,993	664,669
Other assets, net	117,165	128,701
Deferred tax assets	107,846	103,001
Intangible assets, net	701,375	731,852
Goodwill	3,003,068	2,848,130
Total assets	$ 10,681,230	$ 10,596,392
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 58,830	$ 89,562
Accrued expenses and other	577,785	674,746
Unearned revenues	2,191,159	2,195,926
Total current liabilities	2,827,774	2,960,234
Note payable to EMC	450,000	450,000
Unearned revenues	1,299,049	1,264,639
Other liabilities	191,482	181,538
Total liabilities	4,768,305	4,856,411
Contingencies (see Note L)		
Stockholders' equity:		
Class A common stock, par value $.01; authorized 2,500,000 shares; issued and outstanding 128,376 and 128,688 shares	1,284	1,287
Class B convertible common stock, par value $.01; authorized 1,000,000 shares; issued and outstanding 300,000 shares	3,000	3,000
Additional paid-in capital	3,431,263	3,431,710
Accumulated other comprehensive income	5,501	5,676
Retained earnings	2,471,877	2,298,308
Total stockholders' equity	5,912,925	5,739,981
Total liabilities and stockholders' equity	$ 10,681,230	$ 10,596,392

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

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

	For the Three Months Ended March 31, 2013	For the Three Months Ended March 31, 2012
Operating activities:		
Net income	$ 173,569	$ 191,436
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	91,243	85,766
Stock-based compensation	115,925	81,806
Excess tax benefits from stock-based compensation	(22,215)	(53,682)
Non-cash realignment charges	14,468	—
Other	(2,236)	(928)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	380,259	226,550
Other assets	(40,807)	(47,706)
Due to/from EMC, net	59,449	55,548
Accounts payable	(8,310)	12,525
Accrued expenses	(115,308)	(94,817)
Income taxes payable	1,783	55,366
Deferred income taxes, net	(28,121)	(34,955)
Unearned revenues	56,723	99,695
Net cash provided by operating activities	676,422	576,604
Investing activities:		
Additions to property and equipment	(77,843)	(33,671)
Purchases of available-for-sale securities	(736,927)	(701,463)
Sales of available-for-sale securities	485,560	422,317
Maturities of available-for-sale securities	181,978	256,977
Business acquisitions, net of cash acquired	(184,486)	—
Other investing	48	(1,497)
Net cash used in investing activities	(331,670)	(57,337)
Financing activities:		
Proceeds from issuance of common stock	67,889	111,041
Repurchase of common stock	(181,961)	—
Excess tax benefits from stock-based compensation	22,215	53,682
Shares repurchased for tax withholdings on vesting of restricted stock	(22,068)	(13,637)
Net cash provided by (used in) financing activities	(113,925)	151,086
Net increase in cash and cash equivalents	230,827	670,353
Cash and cash equivalents at beginning of the period	1,609,322	1,955,756
Cash and cash equivalents at end of the period	$ 1,840,149	$ 2,626,109
Non-cash items:		
Changes in capital additions, accrued but not paid	$ (12,921)	$ (2,650)
Changes in tax withholdings on vesting of restricted stock, accrued but not paid	(2,042)	808

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

VMware, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

A. Overview and Basis of Presentation

Company and Background

VMware, Inc. (“VMware” or the “Company”) is the leader in virtualization infrastructure solutions utilized by organizations to help them transform the way they build, deliver and consume information technology (“IT”) resources. VMware’s virtualization infrastructure solutions, which include a suite of products designed to deliver a software-defined data center, run on industry-standard desktop computers and servers and support a wide range of operating system and application environments, as well as networking and storage infrastructures.

Accounting Principles

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

Unaudited Interim Financial Information

These accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial reporting. In the opinion of management, these unaudited consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, for a fair statement of VMware’s consolidated results of operations, financial position 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 2013. 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 2012 Annual Report on Form 10-K.

As of March 31, 2013 , EMC Corporation (“EMC”) holds approximately 80.0% of VMware’s outstanding common stock, including 42.5 million shares of VMware’s Class A common stock and all of VMware’s Class B common stock. VMware is a majority-owned and controlled subsidiary of EMC, and its results of operations and financial position are consolidated with EMC’s financial statements. VMware and EMC engage in intercompany transactions, including agreements regarding the use of EMC’s and VMware’s intellectual property and real estate, agreements regarding the sale of goods and services to one another, and an agreement for EMC to resell VMware’s products and services to third party customers. In geographic areas where VMware has not established its own subsidiaries, VMware contracts with EMC subsidiaries for support services and for personnel who are managed by VMware. See Note N for further information regarding intercompany transactions between VMware and EMC.

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

Principles of Consolidation

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

Use of Accounting Estimates

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

VMware, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 2013-02”). ASU 2013-02 requires companies to present information about reclassification adjustments from accumulated other comprehensive income in their financial statements or footnotes. ASU 2013-02 is effective for fiscal periods beginning after December 15, 2012. VMware adopted this accounting standard update on January 1, 2013, and presents accumulated other comprehensive income in accordance with the requirements of the standard in this Quarterly Report on Form 10-Q.

In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. ASU 2013-01 clarifies that the scope of ASU 2011-11 applies to derivatives, including bifurcated embedded derivatives, repurchase agreements, and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. ASU 2013-01 is required to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. VMware adopted this accounting standard update, as amended, on January 1, 2013, but determined that there was no material impact to its consolidated financial statements.

B. Business Combinations and Goodwill

Business Combinations

On February 15, 2013, VMware acquired Virsto Software (“Virsto”), a provider of software that optimizes storage performance and utilization in virtual environments. The consideration paid for this acquisition was $184.5 million , net of cash acquired.

The following table summarizes the allocation of the consideration to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date (table in thousands):

Intangible assets	$	32,400
Goodwill		162,334
Total intangible assets acquired		194,734
Deferred tax liabilities, net		(135)
Other acquired liabilities, net of acquired assets		(10,113)
Total net liabilities assumed		(10,248)
Fair value of intangible assets acquired and net liabilities assumed	$	184,486

The excess of the consideration for Virsto over the fair values assigned to the assets acquired and liabilities assumed, which represents the goodwill resulting from the acquisition, was allocated to VMware’s one operating segment. Management believes that the goodwill represents the synergies expected from combining the technologies of VMware with those of Virsto, including complementary products that will enhance the Company’s overall product portfolio.

The following table summarizes the fair value of the intangible assets acquired by VMware in conjunction with the acquisition of Virsto (amounts in table in thousands):

	Weighted-Average Useful Lives (in years)		Fair Value Amount
Purchased technology	5.0	$	23,800
In-process research and development			8,600
Total intangible assets, net, excluding goodwill		$	32,400

The results of operations of Virsto described above have been included in VMware’s consolidated financial statements from the date of purchase. Pro forma results of operations have not been presented as the results of the acquired business were not material to VMware’s consolidated results of operations in the three months ended March 31, 2013 .

In the third quarter of 2012, VMware acquired all of the outstanding capital stock of Nicira, Inc. (“Nicira”). The accounting for the Nicira acquisition has not been finalized due to pending items related to open tax returns which are to be filed in the third quarter of 2013. Additionally, the accounting has not been finalized for certain other business combinations made within the last year. These business combinations were not material to VMware's financial statements. For all business combinations where the accounting has not been finalized, VMware has recorded provisional amounts in its consolidated financial statements. During the measurement period, VMware may record adjustments to the provisional amounts recorded.

Goodwill

The following table summarizes the changes in the carrying amount of goodwill for the three months ended March 31, 2013 (table in thousands):

Balance, January 1, 2013	$	2,848,130
Increase in goodwill related to business combination		162,334
Reductions related to business realignment plan		(3,094)
Deferred tax adjustments to purchase price allocations on prior year acquisitions		(3,912)
Other adjustments to purchase price allocations on prior year acquisitions		(390)
Balance, March 31, 2013	$	3,003,068

C. Realignment Charges

In January 2013, VMware approved a business realignment plan to streamline its operations. The plan is expected to be completed by the end of 2013. The total charge resulting from this plan is expected to be between $75.0 million and $90.0 million , with total cash expenditures associated with the plan expected to be in the range of $60.0 million to $75.0 million . The associated cash payments are expected to be paid out primarily through the end of 2013.

The plan includes the elimination of approximately 800 positions and personnel across all major functional groups and geographies, which is expected to result in a charge in the range of $60.0 million to $65.0 million . As of March 31, 2013 , approximately 700 of the employees had been terminated. Of the total expected charge for workforce reductions, $53.9 million was recorded to the consolidated statement of income for the three months ended March 31, 2013 . The remainder of the workforce reduction charge relates to employees in foreign jurisdictions and will be recognized in future periods as the expected severance amounts are finalized. Additionally, VMware exited and is planning to exit certain lines of business and consolidate facilities, which VMware expects to result in a total charge, including asset impairments, in the range of $15.0 million to $25.0 million , of which $9.0 million was recorded to the consolidated statement of income for the three months ended March 31, 2013 .

The following table summarizes the activity for the accrued realignment charge for the three months ended March 31, 2013 (table in thousands):

	Realignment Charges		Utilization		Balance as of March 31, 2013		Non-Cash Portion of Utilization	
Workforce reductions	$	53,847	$	(28,062)	$	25,785	$	(5,433)
Asset impairments		9,035		(9,035)		—		(9,035)
Total	$	62,882	$	(37,097)	$	25,785	$	(14,468)

The non-cash portion of utilization for the workforce reduction relates to equity compensation. The non-cash portion for asset impairment primarily relates to the write-off of intangible assets due to disposition.

Additionally, as of March 31, 2013 , VMware had reclassified assets of $26.9 million , primarily related to intangible assets for a line of business it plans to exit, to assets held for sale. Additionally, $27.2 million in unearned revenues was reclassified to liabilities held for sale. Assets held for sale are reported in other current assets, while liabilities held for sale are reported in accrued expenses and other on the consolidated balance sheet as of March 31, 2013 .

D. Earnings per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted-average number of common shares outstanding and potentially dilutive securities outstanding during the period, as calculated using the treasury stock method. Potentially dilutive securities primarily include unvested restricted stock units, stock options and purchase options under VMware’s employee stock purchase plan. Securities are excluded from the computations of diluted net income per share if their effect would be anti-dilutive. VMware uses the two-class method to calculate earnings per share as both classes share the same rights in dividends, therefore basic and diluted earnings per share are the same for both classes.

VMware, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following table sets forth the computations of basic and diluted net income per share for the three months ended March 31, 2013 and 2012 (table in thousands, except per share data):

	For the Three Months Ended March 31, 2013	2012
Net income	$ 173,569	$ 191,436
Weighted-average shares, basic for Class A and Class B	428,005	424,989
Effect of dilutive securities	4,626	8,224
Weighted-average shares, diluted for Class A and Class B	432,631	433,213
Net income per weighted-average share, basic for Class A and Class B	$ 0.41	$ 0.45
Net income per weighted-average share, diluted for Class A and Class B	$ 0.40	$ 0.44

For the three months ended March 31, 2013 and 2012 , stock options to purchase 0.8 million and 0.4 million , respectively, of VMware Class A common stock were excluded from the diluted earnings per share calculations because their effect would have been anti-dilutive. For the three months ended March 31, 2013 and 2012 , 2.1 million and 0.1 million shares of restricted stock were excluded from the diluted earnings per share calculations because their effect would have been anti-dilutive.

E. Investments

Investments as of March 31, 2013 and December 31, 2012 consisted of the following (tables in thousands):

	March 31, 2013			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. Government and agency obligations	$ 359,369	$ 845	$ (15)	$ 360,199
U.S. and foreign corporate debt securities	1,637,942	5,482	(864)	1,642,560
Foreign governments and multi-national agency obligations	39,907	84	(26)	39,965
Municipal obligations	919,152	4,490	(33)	923,609
Asset-backed securities	2,670	—	(4)	2,666
Mortgage-backed securities	127,680	413	(561)	127,532
Total investments	$ 3,086,720	$ 11,314	$ (1,503)	$ 3,096,531

	December 31, 2012			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. Government and agency obligations	$ 373,863	$ 1,093	$ (11)	$ 374,945
U.S. and foreign corporate debt securities	1,545,397	6,122	(537)	1,550,982
Foreign governments and multi-national agency obligations	40,594	31	(6)	40,619
Municipal obligations	972,867	2,653	(504)	975,016
Asset-backed securities	1,000	—	—	1,000
Mortgage-backed securities	78,674	358	(82)	78,950
Total investments	$ 3,012,395	$ 10,257	$ (1,140)	$ 3,021,512

In addition, VMware evaluated its investments as of March 31, 2013 and 2012 and determined that there were no unrealized losses that indicated an other-than-temporary impairment.

VMware, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

As of March 31, 2013 and December 31, 2012 , VMware did not have investments in a material continuous unrealized loss position for twelve months or greater. Unrealized losses on investments as of March 31, 2013 and December 31, 2012 , which have been in a net loss position for less than twelve months, were classified by investment category as follows (table in thousands):

	March 31, 2013		December 31, 2012	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and agency obligations	$ 73,798	$ (15)	$ 34,852	$ (11)
U.S. and foreign corporate debt securities	428,227	(864)	315,609	(537)
Foreign governments and multi-national agency obligations	7,977	(26)	5,493	(5)
Municipal obligations	24,624	(33)	259,402	(501)
Asset-backed securities	2,666	(4)	—	—
Mortgage-backed securities	82,915	(561)	27,425	(82)
Total	$ 620,207	$ (1,503)	$ 642,781	$ (1,136)

Contractual Maturities

The contractual maturities of investments held at March 31, 2013 consisted of the following (table in thousands):

	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$ 761,343	$ 762,514
Due after 1 year through 5 years	2,200,816	2,209,594
Due after 5 years	124,561	124,423
Total investments	$ 3,086,720	$ 3,096,531

F. Fair Value Measurements

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

VMware’s Level 1 classification of the fair value hierarchy includes money market funds and certain available-for-sale fixed income securities because these securities are valued using quoted prices in active markets for identical assets.

VMware’s Level 2 classification includes the remainder of the available-for-sale fixed income securities because these securities are priced using quoted market prices for similar instruments and non-binding market prices that are corroborated by observable market data. VMware obtains the fair values of its Level 2 financial instruments based upon fair values obtained from its custody bank. In addition, VMware obtains fair values of its Level 2 financial instruments from the asset manager of each of its portfolios. VMware validates the fair value provided by its custody bank by comparing it against the independent pricing information obtained from the asset managers. Independently, the custody bank and the asset managers use professional pricing services to gather pricing data which may include quoted market prices for identical or comparable instruments, or inputs other than quoted prices that are observable either directly or indirectly. VMware is ultimately responsible for the financial statements and underlying estimates.

Additionally, VMware’s Level 2 classification includes foreign currency forward contracts as the valuation inputs for these are based upon quoted prices and quoted pricing intervals from public data sources. The fair value of these contracts was not material for any period presented. VMware does not have any material assets or liabilities that fall into Level 3 of the fair value hierarchy as of March 31, 2013 and December 31, 2012 .

VMware, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following tables set forth the fair value hierarchy of VMware's money market funds and available-for-sale securities, including those securities classified within cash and cash equivalents on the consolidated balance sheets, that were required to be measured at fair value as of March 31, 2013 and December 31, 2012 (tables in thousands):

	March 31, 2013		
	Level 1	Level 2	Total
Money-market funds	$ 1,382,248	$ —	$ 1,382,248
U.S. Government and agency obligations	217,077	143,122	360,199
U.S. and foreign corporate debt securities	—	1,652,855	1,652,855
Foreign governments and multi-national agency obligations	—	39,965	39,965
Municipal obligations	—	923,609	923,609
Asset-backed securities	—	2,666	2,666
Mortgage-backed securities	—	127,532	127,532
Total	$ 1,599,325	$ 2,889,749	$ 4,489,074

	December 31, 2012		
	Level 1	Level 2	Total
Money-market funds	$ 1,125,240	$ —	$ 1,125,240
U.S. Government and agency obligations	249,771	155,173	404,944
U.S. and foreign corporate debt securities	—	1,568,579	1,568,579
Foreign governments and multi-national agency obligations	—	40,619	40,619
Municipal obligations	—	975,016	975,016
Asset-backed securities	—	1,000	1,000
Mortgage-backed securities	—	78,950	78,950
Total	$ 1,375,011	$ 2,819,337	$ 4,194,348

G. Derivative Instruments

VMware conducts business in several foreign currencies and has international sales and expenses denominated in foreign currencies, subjecting the Company to foreign currency risk. To mitigate this risk, VMware enters into hedging activities as described below. The counterparties to VMware's foreign currency forward contracts are multi-national commercial banks considered to be credit-worthy. VMware does not enter into speculative foreign exchange contracts for trading purposes.

Cash Flow Hedging Activities

To mitigate its exposure to foreign currency fluctuations resulting from operating expenses denominated in certain foreign currencies, VMware enters into foreign currency forward contracts. The Company designates these forward contracts as cash flow hedging instruments as the accounting criteria for such designation has been met. Therefore, the effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported in accumulated other comprehensive income on the consolidated balance sheet and is subsequently reclassified to the related operating expense line item in the consolidated statements of income in the same period that the underlying expenses are incurred. Interest charges or "forward points" on VMware's forward contracts are excluded from the assessment of hedge effectiveness and are recorded in other income (expense), net in the consolidated statements of income as incurred.

VMware generally enters into cash flow hedges semi-annually with maturities of six months or less. As of March 31, 2013 and December 31, 2012 , VMware had forward contracts to purchase foreign currency designated as cash flow hedges with a total notional value of $36.2 million and $9.3 million , respectively. The fair value of these forward contracts was immaterial as of March 31, 2013 and December 31, 2012 , and therefore excluded from the fair value tables above. For the three months ended March 31, 2013 , all cash flow hedges were considered effective.

Balance Sheet Hedging Activities

In order to manage exposure to foreign currency fluctuations, VMware enters into foreign currency forward contracts to hedge a portion of its net outstanding monetary assets and liabilities against movements in certain foreign exchange rates. These forward contracts are not designated as hedging instruments under applicable accounting guidance, and therefore all changes in the fair value of the forward contracts are reported in other income (expense), net in the consolidated statements of income. The

gains and losses on VMware’s foreign currency forward contracts generally offset the majority of the gains and losses associated with the underlying foreign-currency denominated assets and liabilities that VMware hedges.

VMware’s foreign currency forward contracts are generally traded on a monthly basis with a typical contractual term of one month. As of March 31, 2013 and December 31, 2012 , VMware had outstanding forward contracts with a total notional value of $292.9 million and $439.8 million , respectively. The fair value of these forward contracts was immaterial as of March 31, 2013 and December 31, 2012 and therefore excluded from the fair value tables above. In the three months ended March 31, 2013 and 2012, VMware recognized a gain of $11.0 million and a loss of $4.5 million , respectively, on its consolidated statements of income for its foreign currency forward contracts. The net impact of the gains and losses on VMware's foreign currency forward contracts and the gains and losses associated with the underlying foreign-currency denominated assets and liabilities resulted in a net loss of $2.5 million in the three months ended March 31, 2013 and a net gain of $1.3 million in the three months ended March 31, 2012 .

H. Property and Equipment, Net

Property and equipment, net, as of March 31, 2013 and December 31, 2012 consisted of the following (table in thousands):

	March 31, 2013	December 31, 2012
Equipment and software	$ 654,427	$ 636,495
Buildings and improvements	453,091	438,340
Furniture and fixtures	68,612	67,175
Construction in progress	126,881	97,016
Total property and equipment	1,303,011	1,239,026
Accumulated depreciation	(609,018)	(574,357)
Total property and equipment, net	$ 693,993	$ 664,669

Depreciation expense was $35.3 million and $32.8 million in the three months ended March 31, 2013 and 2012 , respectively.

As of March 31, 2013 and December 31, 2012 , construction in progress primarily represented buildings and site improvements related to VMware’s Palo Alto campus expansion that had not yet been placed into service.

I. Accrued Expenses and Other

Accrued expenses and other as of March 31, 2013 and December 31, 2012 consisted of the following (table in thousands):

	March 31, 2013	December 31, 2012
Salaries, commissions, bonuses, and benefits	$ 205,077	$ 292,243
Accrued partner liabilities	104,767	128,866
Other	267,941	253,637
Total	$ 577,785	$ 674,746

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

J. Unearned Revenues

Unearned revenues as of March 31, 2013 and December 31, 2012 consisted of the following (table in thousands):

	March 31, 2013	December 31, 2012
Unearned license revenues	$ 446,215	$ 462,655
Unearned software maintenance revenues	2,796,502	2,755,013
Unearned professional services revenues	247,491	242,897
Total unearned revenues	$ 3,490,208	$ 3,460,565

Unearned license revenues are either recognized ratably, recognized upon delivery of existing or future products or services, or will be recognized ratably upon delivery of future products or services. Future products include, in some cases, emerging products that are offered as part of product promotions where the purchaser of an existing product is entitled to receive a promotional product at no additional charge. VMware regularly offers product promotions to improve awareness of its emerging products. To the extent promotional products have not been delivered and VSOE of fair value cannot be established, the revenue for the entire order is deferred until such time as all product delivery obligations have been fulfilled. Unearned license revenue may also be recognized ratably, which is generally due to a right to receive unspecified future products or a lack of VSOE of fair value on the software maintenance element of the arrangement. At March 31, 2013 , the ratable component represented over half of the total unearned license revenue balance. Unearned software maintenance revenues are attributable to VMware's maintenance contracts and are recognized ratably, typically over terms of one to five years with a weighted-average remaining term at March 31, 2013 of approximately 1.9 years. Unearned professional services revenues result primarily from prepaid professional services, including training, and are recognized as the services are delivered.

K. Income Taxes

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

VMware's effective income tax rate was (5.8)% and 14.5% for the three months ended March 31, 2013 and 2012 , respectively. The lower effective rate for the three months ended March 31, 2013 compared with the three months ended March 31, 2012 was primarily attributable to the discrete tax benefits recognized in the three months ended March 31, 2013 due to the retroactive enactment of the federal R&D tax credit by the United States Congress in January 2013 and the favorable tax impact of charges under VMware's realignment plan. See Note C to the consolidated financial statements for further information. The federal R&D tax credit applicable to 2012 benefited the effective income tax rate in the three months ended March 31, 2013 by $39.1 million . Additionally, the federal R&D credit applicable to 2013 favorably impacted the effective tax rate for the three months ended March 31, 2013 , which was partially offset by a jurisdictional shift of income from lower-tax non-U.S. jurisdictions to the United States.

VMware's rate of taxation in foreign jurisdictions is lower than the U.S. tax rate. VMware's international income is primarily earned by VMware's subsidiaries in Ireland, where the statutory tax rate is 12.5% . Management does not believe that any recent or currently expected developments in non-U.S. tax jurisdictions are reasonably likely to have a material impact on VMware's effective tax rate. As of March 31, 2013 , VMware's total cash, cash equivalents, and short-term investments were $4,936.7 million , of which $3,385.9 million were held outside the U.S. VMware's intent is to indefinitely reinvest its non-U.S. funds in its foreign operations, and VMware's current plans do not demonstrate a need to repatriate them to fund its U.S. operations. VMware plans to meet its U.S. liquidity needs through cash flows from operations, external borrowings, or both. VMware utilizes a variety of tax planning strategies in an effort to ensure that its worldwide cash is available in the locations in which it is needed. If VMware determines these overseas funds are needed for its operations in the U.S., the Company would be required to accrue U.S. taxes on the related undistributed earnings in the period VMware determines the earnings will no longer be indefinitely invested outside the U.S. in order to repatriate these funds. At this time, it is not practicable to estimate the amount of tax that may be payable were VMware to repatriate these funds.

As of March 31, 2013 , VMware had gross unrecognized tax benefits totaling $157.6 million , which excludes $7.2 million of offsetting tax benefits. Approximately $145.2 million of VMware's net unrecognized tax benefits, not including interest and penalties, if recognized, would reduce income tax expense and lower VMware's effective tax rate in the period or periods recognized. In total, there were $162.4 million of net unrecognized tax benefits, including interest and penalties, which were classified as a non-current liability on the consolidated balance sheet as of March 31, 2013 . It is reasonably possible that within the next 12 months audit resolutions could potentially reduce total unrecognized tax benefits by approximately $7.3 million . Due to the closure of a tax audit approximately $2.2 million of uncertain tax benefits were reversed as of March 31, 2013 . Audit outcomes and the timing of audit settlements are subject to significant uncertainty.

VMware recognizes interest expense and penalties related to income tax matters in the income tax provision. VMware recognized approximately $3.6 million in interest and penalties for the three months ended March 31, 2013 . As of March 31, 2013 , there were $11.6 million of interest and penalties accrued for unrecognized tax benefits. These amounts are included as components of the $162.4 million of net unrecognized tax benefits as of March 31, 2013 .

VMware, Inc.
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L. Contingencies

Litigation

From time to time, VMware is subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to commercial, product liability, intellectual property, employment, class action, whistleblower and other matters. From time to time, VMware also receives inquiries from government entities regarding the compliance of its contracting and sales practices with applicable regulations. VMware accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. These accruals are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. As of March 31, 2013 and December 31, 2012 , the amounts accrued were not material. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, management believes that the amount of any such additional loss would also be immaterial to VMware's consolidated financial position and results of operations.

M. Stockholders' Equity

VMware Stock Repurchase Programs

The following table summarizes stock repurchase authorizations that remain open as of March 31, 2013 (amounts in table in thousands):

Month Authorized	Amount Authorized	Expiration Date
November 2012	$250,000	End of 2014
February 2012	600,000	End of 2013

Previously, in February 2011, VMware's Board of Directors authorized the repurchase of up to $550.0 million of VMware's Class A common stock, which was completed in the second quarter of 2012.

From time to time, future stock repurchases may be made pursuant to the November 2012 and February 2012 authorizations in open market transactions or privately negotiated transactions as permitted by securities laws and other legal requirements. VMware is not obligated to purchase any shares under its stock repurchase programs. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including VMware's stock price, cash requirements for operations and business combinations, corporate and regulatory requirements and other market and economic conditions. Purchases can be discontinued at any time that VMware feels additional purchases are not warranted. All shares repurchased under VMware's stock repurchase programs are retired.

In the three months ended March 31, 2013 , VMware repurchased and retired 2.4 million shares of its Class A common stock at a weighted-average price of $77.05 per share for an aggregate purchase price of $182.0 million . In the three months ended March 31, 2012 , VMware did not repurchase shares of its Class A common stock. The amount of repurchased shares includes commissions and was classified as a reduction to additional paid-in capital. As of March 31, 2013 , the authorized amount remaining for repurchase was $286.1 million .

VMware Restricted Stock

VMware restricted stock primarily consists of restricted stock unit ("RSU") awards granted to employees. RSUs are valued based on the VMware stock price on the date of grant, and shares underlying RSU awards are not issued until the restricted stock units vest. Upon vesting, each RSU converts into one share of VMware Class A common stock.

VMware restricted stock also included performance stock unit ("PSU") awards. Beginning in 2012, VMware granted PSU awards to certain of its executives and employees. The awards will vest through the first quarter of 2015 if certain employee-specific or VMware-designated performance targets are achieved. If minimum performance thresholds are achieved, each PSU award will convert into VMware's Class A common stock at ratios ranging from 0.5 to 3.0 shares per PSU, depending upon the degree of achievement of the performance target designated by each individual award. If minimum performance thresholds are not achieved, then no shares will be issued under that PSU award.

VMware, Inc.
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The following table summarizes restricted stock activity since January 1, 2013 (units in thousands):

	Number of Units	Weighted-Average Grant Date Fair Value (per unit)
Outstanding, January 1, 2013	12,170	$ 91.93
Granted	656	82.07
Vested	(664)	76.94
Forfeited	(424)	91.44
Outstanding, March 31, 2013	11,738	92.24

As of March 31, 2013 , the 11.7 million of units outstanding included 10.7 million of RSUs, 0.6 million of restricted stock and 0.4 million of PSUs. Such PSUs are convertible into a maximum aggregate of 1.1 million shares.

The total fair value of VMware restricted stock, including restricted stock and restricted stock units, that vested in the three months ended March 31, 2013 was $52.7 million . As of March 31, 2013 , restricted stock representing 11.7 million shares of VMware's Class A common stock were outstanding, with an aggregate intrinsic value of $925.9 million based on VMware's closing price as of March 31, 2013 . These awards are scheduled to vest through 2017 .

Accumulated Other Comprehensive Income

The changes in components of accumulated other comprehensive income in the three months ended March 31, 2013 were as follows (table in thousands):

	Unrealized Gains on Available-for-Sale Securities	Losses on Cash Flow Hedges	Total
Balance, January 1, 2013	$ 5,707	$ (31)	$ 5,676
Other comprehensive income (loss) before reclassifications, net of taxes of $628, $(27) and $601	1,026	(528)	498
Amounts reclassified from accumulated other comprehensive income to the consolidated statement of income, net of taxes of $(398), $(1) and $(399)	(650)	(23)	(673)
Other comprehensive income (loss), net	376	(551)	(175)
Balance, March 31, 2013	$ 6,083	$ (582)	$ 5,501

Gains (losses) on VMware's available-for-sale securities are reclassified to investment income on the consolidated statement of income in the same period that they are realized.

The effective portion of gains (losses) resulting from changes in the fair value of forward contracts designated as cash flow hedging instruments is reclassified to its related operating expense line item on the consolidated statement of income in the same period that the underlying expenses are incurred. The amounts recorded to their related operating expense line items on the consolidated statement of income in the three months ended March 31, 2013 were not material.

N. Related Party Transactions

Pursuant to an ongoing reseller arrangement with EMC, EMC bundles VMware's products and services with EMC's products and sells them to end-users. In the three months ended March 31, 2013 and 2012 , VMware recognized revenues of $36.3 million and $35.0 million , respectively, from such contractual arrangement with EMC. As of March 31, 2013 , $148.8 million of revenues from products and services sold under the reseller arrangement were included in unearned revenues.

In the three months ended March 31, 2013 and 2012 , VMware recognized professional services revenues of $15.5 million and $18.7 million , respectively, from such contractual agreements with EMC. As of March 31, 2013 , $3.2 million of revenues from professional services to EMC customers were included in unearned revenues.

In the three months ended March 31, 2013 and 2012 , VMware recognized revenues of $3.1 million and $1.7 million , respectively, from products and services purchased by EMC for internal use pursuant to VMware's contractual agreements with EMC. As of March 31, 2013 , $27.1 million of revenues from products and services purchased by EMC for internal use were included in unearned revenues.

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VMware purchased products and services from EMC for $13.3 million and $17.9 million in the three months ended March 31, 2013 and 2012 , respectively.

Payments between VMware and EMC under the tax sharing agreement primarily relate to VMware's portion of federal income taxes on EMC's consolidated tax return. Payments from VMware to EMC primarily relate to periods for which VMware had stand-alone federal taxable income, while payments from EMC to VMware relate to periods for which VMware had a stand-alone federal taxable loss. In the three months ended March 31, 2013 and 2012 , no payments were made by either VMware or EMC under the tax sharing agreement. Due to the retroactive enactment of the federal R&D tax credit, VMware estimates a 2012 federal tax refund of $15.5 million will be due from EMC and payable in the second quarter of 2013. The amounts that VMware either pays to or receives from EMC for its portion of federal income taxes on EMC's consolidated tax return differ from the amounts VMware would owe on a stand-alone basis and the difference is presented as a component of stockholders' equity. In the three months ended March 31, 2013 and 2012 , 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 not material .

In certain geographic regions where VMware does not have an established legal entity, VMware contracts with EMC subsidiaries for support services and EMC personnel who are managed by VMware. The costs incurred by EMC on VMware's behalf related to these employees are passed on to VMware and VMware is charged a mark-up intended to approximate costs that would have been charged had VMware contracted for such services with an unrelated third party. These costs are included as expenses in VMware's consolidated statements of income and primarily include salaries, benefits, travel and rent. Additionally, EMC incurs certain administrative costs on VMware's behalf in the U.S. that are also recorded as expenses in VMware's consolidated statements of income. The total cost of the services provided to VMware by EMC as described above was $36.1 million and $27.8 million in the three months ended March 31, 2013 and 2012 , respectively.

In the three months ended March 31, 2013 and 2012 , $1.0 million and $1.3 million , respectively, of interest expense was recorded related to the note payable to EMC and included in interest expense with EMC on VMware's consolidated statements of income. VMware's interest expense as a separate, stand-alone company may be higher or lower than the amounts reflected in the consolidated financial statements.

In 2011, VMware acquired certain assets relating to EMC's Mozy cloud-based data storage and data center services, including certain data center assets and a license to certain intellectual property. EMC retained ownership of the Mozy business and its remaining assets and continued to be responsible to Mozy customers for Mozy products and services and to recognize revenue from such products and services. VMware entered into an operational support agreement with EMC through the end of 2012, pursuant to which VMware took over responsibility to operate the Mozy service on behalf of EMC. Pursuant to the support agreement, costs incurred by VMware to support EMC's Mozy services, plus a mark-up intended to approximate third-party costs and a management fee, were reimbursed to VMware by EMC. In the fourth quarter of 2012, the operational support agreement between VMware and EMC was amended such that VMware would no longer operate the Mozy service on behalf of EMC. Under the amendment, VMware transferred substantially all employees that support Mozy services to EMC and EMC purchased certain assets from VMware in relation to transferred employees. The termination of service and related transfer of employees and sale of assets was substantially completed during the three months ended March 31, 2013 . On the consolidated statements of income, such amounts reimbursed by EMC to VMware to operate Mozy were immaterial in the three months ended March 31, 2013 and $14.6 million in the three months ended March 31, 2012 . These amounts were recorded as a reduction to the costs VMware incurred.

From time to time, VMware and EMC enter into agreements to collaborate on technology projects. In the three months ended March 31, 2013 and 2012 , VMware received $2.2 million and $1.1 million , respectively, from EMC for EMC's portion of expenses related to such projects.

Effective September 1, 2012, Pat Gelsinger succeeded Paul Maritz as Chief Executive Officer of VMware. Prior to joining VMware, Pat Gelsinger was the President and Chief Operating Officer of EMC Information Infrastructure Products. Paul Maritz remains a board member of VMware and currently serves as Chief Executive Officer of GoPivotal, Inc. ("Pivotal"), a majority-owned subsidiary of EMC in which we have an ownership interest. With the exception of a long-term incentive performance award from EMC that Pat Gelsinger agreed to cancel in consideration of a new performance stock unit award from VMware, both Paul Maritz and Pat Gelsinger retained and continue to vest in their respective equity awards that they held as of September 1, 2012. Stock-based compensation related to Pat Gelsinger's EMC awards will be recognized on VMware's consolidated statements of income over the awards' remaining requisite service periods. Stock-based compensation related to Paul Maritz's VMware awards will be recognized by EMC and Pivotal.

As of March 31, 2013 , VMware had $8.5 million net due from EMC, which consisted of $60.3 million due from EMC, partially offset by $51.8 million due to EMC. These amounts resulted from the related party transactions described above. Additionally, VMware had a net income tax payable due to EMC of $12.2 million as of March 31, 2013 , which was included in accrued expenses and other on VMware’s consolidated balance sheet. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter-end. The timing of the tax payments due to and from EMC is governed by the tax sharing agreement with EMC.

On April 1, 2013, VMware and EMC contributed certain assets to Pivotal and Pivotal assumed certain liabilities from VMware and EMC. In exchange for their contributions, VMware received preferred equity interests in Pivotal equal to approximately 31% of Pivotal's outstanding shares, and EMC received equity interests in Pivotal equal to approximately 69% of Pivotal's outstanding shares. See Note P to the consolidated financial statements for further information.

O. Segment Information

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

Revenues by geographic area for the three months ended March 31, 2013 and 2012 were as follows (table in thousands):

	For the Three Months Ended March 31,	
	2013	2012
United States	$ 568,528	$ 484,974
International	622,938	570,208
Total	$ 1,191,466	$ 1,055,182

No individual country other than the United States had material revenues for the three months ended March 31, 2013 and 2012 .

Long-lived assets by geographic area, which primarily include property and equipment, net, as of March 31, 2013 and December 31, 2012 were as follows (table in thousands):

	March 31, 2013	December 31, 2012
United States	$ 597,913	$ 562,862
International	50,625	51,207
Total	$ 648,538	$ 614,069

No country other than the United States accounted for 10% or more of these assets as of March 31, 2013 and December 31, 2012 , respectively.

P. Subsequent Event

Joint Contribution of Assets with EMC into Pivotal

On April 1, 2013, VMware and EMC contributed certain assets to Pivotal and Pivotal assumed certain liabilities from VMware and EMC. VMware contributed substantially all assets to Pivotal, including intellectual property, and Pivotal assumed substantially all liabilities, related to certain of its Cloud Application Platform products and services, including VMware's Cloud Foundry, VMware vFabric (including Spring and GemFire), and Cetas organizations. VMware expects that approximately 500 VMware employees will transfer to Pivotal during the second quarter of 2013 . EMC contributed substantially all assets, including intellectual property, and Pivotal assumed substantially all liabilities, related to its Greenplum and Pivotal Labs businesses. Additionally, EMC made a capital contribution to Pivotal. Pivotal assumed substantially all of the rights and responsibilities for the respective support arrangements transferred by VMware and EMC.

In exchange for their contributions, VMware received preferred equity interests in Pivotal equal to approximately 31% of Pivotal's outstanding shares, and EMC received equity interests in Pivotal equal to approximately 69% of Pivotal's outstanding shares. Additionally, VMware and Pivotal entered into an agreement with Pivotal pursuant to which VMware will act as the selling agent of the products and services it contributed to Pivotal until at least December 31, 2013 in exchange for a customary agency fee. VMware has also agreed to provide various transition services to Pivotal until at least December 31, 2013, for which VMware will be reimbursed for its costs.

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The book value of all contributed assets and the liabilities assumed by Pivotal, with the exception of intangible assets and goodwill, was based on the book values of those assets and liabilities specific to those particular products and services. For intangible assets and goodwill, the book value contributed was based on the relative fair value of the assets applicable to Pivotal as compared to VMware, excluding the value applicable to Pivotal.

On April 1, 2013, VMware contributed the following assets to Pivotal and Pivotal assumed the following liabilities from VMware, which were included in VMware’s consolidated balance sheet as of March 31, 2013 (table in thousands):

Accounts receivable	$	4,269
Property and equipment		1,370
Intangible assets		27,657
Goodwill		28,445
Total assets		61,741
Accounts payable and accrued liabilities		(5,526)
Unearned revenues		(71,190)
Total liabilities		(76,716)
Total liabilities, net assumed by Pivotal	$	(14,975)

Of the $71.2 million in unearned revenues assumed by Pivotal, $32.0 million related to unearned license revenues and $39.2 million related to unearned services revenues.

VMware will account for its investment in Pivotal on a cost basis as VMware's preferred equity interests have a distribution preference upon dissolution or liquidation of Pivotal. As Pivotal assumed a net liability from VMware, the investment carried by VMware will have a cost basis of zero. The net liability assumed by Pivotal of $15.0 million will be classified to additional paid-in capital on VMware's consolidated balance sheet.

On April 24, 2013, EMC and Pivotal announced that a third-party strategic investor is expected to make an investment of approximately $105 million in Pivotal. Upon closing of the third-party investment, the interests of EMC, VMware and the third party will represent approximately 62% , 28% and 10% , respectively, of Pivotal's outstanding equity.

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

All dollar amounts expressed as numbers in this MD&A (except share and per share amounts) are in millions.

Overview

We are the leader in virtualization infrastructure solutions utilized by organizations to help transform the way they build, deliver and consume information technology ("IT") resources. Our primary source of revenues is from the licensing and support of these solutions to organizations of all sizes and across numerous industries. The benefits of our solutions to our customers include substantially lower IT costs, cost-effective high availability across a wide range of applications and a more automated and resilient systems infrastructure capable of responding dynamically to variable business demands.

We pioneered the development and application of virtualization technologies with x86 server-based computing, separating application software from the underlying hardware. Since then, we have introduced a broad and proven suite of virtualization technologies that address a range of complex IT problems that include cost and operational inefficiencies, facilitating access to cloud computing capacity, business continuity, and corporate end-user computing device management. In 2012, we articulated a vision for the software-defined data center ("SDDC"), where increasingly infrastructure is virtualized and delivered as a service, and the control of this data center is entirely automated by software. To further this vision, in the third quarter of 2012, we released the VMware vCloud Suite, which is the first integrated solution designed to meet the requirements of the SDDC by pooling industry-standard hardware and running compute, networking, storage and management functions in the data center as software-defined services.

Our solutions are based upon our core virtualization technology and are organized into two main product groups: Cloud Infrastructure and Management and End-User Computing. The Cloud Infrastructure and Management product group is based upon our flagship virtualization platform, VMware vSphere. VMware vSphere not only decouples the entire software environment from its underlying hardware infrastructure but also enables the aggregation of multiple servers, storage infrastructures and networks into shared pools of resources that can be delivered dynamically, securely and reliably to applications as needed. The Cloud Infrastructure and Management group also encompasses the VMware vCloud Suite and various Cloud Management solutions that are optimized to work with vSphere environments and are designed to simplify and automate management of dynamic cloud infrastructures that enable enterprises to build, manage and automate their own private clouds. Our End-User Computing product group has solutions designed to enable a user-centric approach to personal computing, including, for example, the VMware Horizon Suite launched in the first quarter of 2013, that enable secure access to applications and data from a variety of devices and locations, and addresses the needs of IT departments by delivering existing end-user assets as a managed service.

We have developed a multi-channel distribution model to expand our presence and reach various segments of the market. We derive a significant majority of our sales from our indirect sales channel, which includes distributors, resellers, system vendors and systems integrators. Sales to our channel partners often involve three tiers of distribution: a distributor, a reseller and an end-user customer. Our sales force works collaboratively with our channel partners to introduce them to end-user customer accounts and new sales opportunities. As we expand geographically, we expect to continue to add additional channel partners.

We expect to grow our business by building long-term relationships with our customers through the adoption of enterprise license agreements ("ELAs"). ELAs are comprehensive volume license offerings offered both directly by us and through certain channel partners that provide for multi-year maintenance and support at discounted prices. Under a typical ELA, a portion of the revenues is attributed to the license revenues and the remainder is primarily attributed to software maintenance revenues. In addition, the initial maintenance period is typically longer for ELAs than for other types of license sales. ELAs enable us to build long-term relationships with our customers as they commit to our virtual infrastructure solutions in their data centers. ELAs also provide a base from which to sell additional products, such as our end-user computing products and our cloud infrastructure and management products. ELAs comprised 29% and 22% of our overall sales during the first quarters of 2013 and 2012 , respectively, with the balance represented by our non-ELA, or transactional business. In 2013, in addition to continuing to increase revenues through the adoption of ELAs, we are focused on driving additional transactional business.

In January 2013, we announced a realignment of our strategy to refocus our resources and investments in support of three growth priorities that focus on our core opportunities as a provider of virtualization technologies that simplify IT infrastructure: the software-defined data center, the hybrid cloud and end-user computing. For the SDDC, we plan to continue to invest in the development and delivery of innovations in networking, security, storage and management as we continue to roll out and enhance the features of our vCloud Suite. For the hybrid cloud we plan to focus on expanding our capabilities with our partners to deliver enterprise-class cloud services that are complementary to private clouds in order to enhance our customers' flexibility to run applications on and off premise, as they choose on a compatible, high-quality, secure and resilient hybrid cloud platform.

For end-user computing, we plan to enhance our offerings to enable a virtual workspace for both existing PC environments and emerging mobile devices in a secure enterprise environment.

In January 2013, we also approved a business realignment plan to streamline our operations and to enhance focus on our three growth priorities. The plan is expected to be completed by the end of 2013. The total charge resulting from this plan is expected to be between $75.0 and $90.0 . The plan includes the elimination of approximately 800 positions and personnel across all major functional groups and geographies, which is expected to result in a charge in the range of $60.0 to $65.0 , of which $53.9 was recorded in the first quarter of 2013. Additionally, we exited and are planning to exit certain lines of business and consolidate facilities, which are expected to result in a charge in the range of $15.0 to $25.0 , of which $9.0 was recorded in the first quarter of 2013. Although we expect that streamlining our operations will have a favorable impact on our operating expenses in future quarters, we expect that operating expenses related to our headcount will increase as we expect our total headcount to increase by approximately 500 during 2013 as we continue to make key investments in support of our long-term growth objectives.

On April 1, 2013, we and EMC contributed certain assets to GoPivotal, Inc. (“Pivotal”) and Pivotal assumed certain liabilities from us and EMC. We contributed substantially all assets to Pivotal, including intellectual property, and Pivotal assumed substantially all liabilities, related to certain of our Cloud Application Platform products and services, including our Cloud Foundry, VMware vFabric (including Spring and GemFire), and Cetas organizations. The net liability assumed by Pivotal was $15.0 . We expect that approximately 500 of our employees will transfer to Pivotal during the second quarter of 2013. EMC contributed substantially all assets, including intellectual property, and Pivotal assumed substantially all liabilities, related to its Greenplum and Pivotal Labs businesses. Additionally, EMC made a capital contribution to Pivotal. Pivotal assumed substantially all of the rights and responsibilities for the respective support arrangements transferred by us and EMC.

In exchange for our and EMC’s contributions, we received preferred equity interests in Pivotal equal to approximately 31% of Pivotal’s outstanding shares, and EMC received equity interests in Pivotal equal to approximately 69% of Pivotal’s outstanding shares. We will account for our investment in Pivotal on a cost basis. Additionally, we and Pivotal entered into an agreement with Pivotal pursuant to which we will act as the selling agent of the products and services we contributed to Pivotal until at least December 31, 2013 in exchange for a customary agency fee. We have also agreed to provide various transition services to Pivotal until at least December 31, 2013, for which we will be reimbursed for our costs.

Starting with the second quarter of 2013, substantially all revenues and costs associated with our contribution to Pivotal will be eliminated from our consolidated statements of income. As a result, we expect this will have a negative impact on our 2013 revenue growth rate as we recognized approximately $125 of revenues during 2012 related to products and services we contributed to Pivotal, compared to only one quarter of revenues for these products and services in 2013. Although we expect that our revenue growth will be negatively impacted, we expect a positive impact on our 2013 operating margin due to the elimination of Pivotal related costs from our consolidated statements of income.

On April 24, 2013, EMC and Pivotal announced that a third party strategic investor is expected to make an investment of approximately $105 in Pivotal. Upon closing of the third party investment, the interests of EMC, us and the third party will represent approximately 62%, 28% and 10% , respectively, of Pivotal’s outstanding equity.

Results of Operations

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

We classify our revenues into two categories, i.e. license revenues and services revenues.

Our current financial focus is on long-term revenue growth to enable us to fund our expansion of industry segment share and to evolve our virtualization-based products for data centers, end-user devices and cloud computing through a combination of internal development and acquisitions. In evaluating our results, we also focus on our free cash flows and operating margin excluding certain expenses which are included in our total operating expenses calculated in accordance with GAAP. The expenses excluded are stock-based compensation, amortization of acquired intangible assets, realignment charges and certain other expenses consisting of the net effect of amortization and capitalization of software development costs, employer payroll taxes on employee stock transactions and acquisition and other-related items. We believe these measures reflect our ongoing business in a manner that allows meaningful period-to-period comparisons. We are not currently focused on short-term operating margin expansion, but rather on investing at appropriate rates to support our growth and priorities in what may be a substantially more competitive environment. See “Non-GAAP Financial Measures” for further information.

Revenues

Our revenues in the first quarter of 2013 and 2012 were as follows:

	For the Three Months Ended March 31, 2013	2012	$ Change	% Change
Revenues:				
License	$ 488.2	$ 481.9	$ 6.3	1%
Services:				
Software maintenance	605.4	492.3	113.1	23
Professional services	97.9	81.0	16.9	21
Total services	703.3	573.3	130.0	23
Total revenues	$ 1,191.5	$ 1,055.2	$ 136.3	13
Revenues:				
United States	$ 568.5	$ 485.0	$ 83.5	17%
International	623.0	570.2	52.8	9
Total revenues	$ 1,191.5	$ 1,055.2	$ 136.3	13

In the first quarter of 2013 , we achieved growth in license and services revenues, and growth in the United States and internationally, as compared with the first quarter of 2012 .

License Revenues

License revenues in the first quarter of 2013 were up 1% compared to the first quarter of 2012 . Our growth rate was lower than our historical growth rate due to a variety of factors, including challenges in the macroeconomic environment, both across the U.S. and internationally in Europe.

Services Revenues

In the first quarter of 2013 , software maintenance revenues benefited from strong renewals, multi-year software maintenance contracts sold in previous periods, and additional maintenance contracts sold in conjunction with new software license sales. In each period presented, customers bought, on average, more than 24 months of support and maintenance with each new license purchased, which we believe illustrates our customers' commitment to VMware as a core element of their data center architecture and hybrid cloud strategy.

In the first quarter of 2013 , professional services revenues increased as growth in our license sales and installed-base led to additional demand for our professional services.

Revenue Growth in Constant Currency

We invoice and collect in the Euro, the British Pound, the Japanese Yen and the Australian Dollar in their respective regions. As a result, our total revenues are affected by changes in the value of the U.S. Dollar against these currencies. In order to provide a comparable framework for assessing how our business performed excluding the effect of foreign currency fluctuations, management analyzes year-over-year revenue growth on a constant currency basis. Since we operate with the U.S. Dollar as our functional currency, unearned revenues for orders booked in currencies other than the U.S. Dollar are converted into U.S. Dollars at the exchange rate in effect for the month in which each order is booked and remain at their historical rate when recognized into revenue. We calculate constant currency on license revenues recognized during the current period that were originally booked in currencies other than U.S. Dollars by comparing the exchange rates used to recognize revenue in the current period against the exchange rates used to recognize revenue in the comparable period. For the first quarter of 2013 , the year-over-year growth in license revenues measured on a constant currency basis was 2% compared with 1% as reported. We do not calculate constant currency on services revenues, which include software maintenance revenues and professional services revenues.

Unearned Revenues

Our unearned revenues as of March 31, 2013 and December 31, 2012 were as follows:

	March 31, 2013	December 31, 2012
Unearned license revenues	$ 446.2	$ 462.7
Unearned software maintenance revenues	2,796.5	2,755.0
Unearned professional services revenues	247.5	242.9
Total unearned revenues	$ 3,490.2	$ 3,460.6

The complexity of our unearned revenues has increased over time as a result of acquisitions, an expanded product portfolio and a broader range of pricing and packaging alternatives. Unearned license revenues are either recognized ratably, recognized upon delivery of existing or future products or services, or will be recognized ratably upon delivery of future products or services. Future products include, in some cases, emerging products that are offered as part of product promotions where the purchaser of an existing product is entitled to receive a promotional product at no additional charge. We regularly offer product promotions to improve awareness of our emerging products. To the extent promotional products have not been delivered and vendor-specific objective evidence (“VSOE”) of fair value cannot be established, the revenue for the entire order is deferred until such time as all product delivery obligations have been fulfilled. Increasingly, unearned license revenue may also be recognized ratably, which is generally due to a right to receive unspecified future products or a lack of VSOE of fair value on the software maintenance element of the arrangement. At March 31, 2013 , the ratable component represented over half of the total unearned license revenue balance. The amount of total unearned license revenues may vary over periods due to the type and level of promotions offered, the portion of license contracts sold with a ratable recognition element, and when promotional products are delivered upon general availability. Unearned software maintenance revenues are attributable to our maintenance contracts and are recognized ratably, typically over terms from one to five years with a weighted-average remaining term at March 31, 2013 of approximately 1.9 years . Unearned professional services revenues result primarily from prepaid professional services, including training, and are recognized as the services are delivered. We believe that our overall unearned revenue balance improves predictability of future revenues and that it is a key indicator of the health and growth of our business. As of March 31, 2013 , 88% of our total unearned revenues are expected to be recognized ratably.

As of March 31, 2013, we reclassified $27.2 of unearned revenues to liabilities held for sale that are related to a line of business that we plan to exit. Liabilities held for sale are reported in accrued expenses and other on the consolidated balance sheet.

In the second quarter of 2013, we expect that approximately $100.0 included in our unearned revenues as of March 31, 2013 will be removed from our total unearned revenue balance. Of this amount, $71.2 will be attributable to the transfer of unearned revenues to Pivotal and the balance of approximately $30.0 will be attributable to the anticipated remaining disposals of businesses under our realignment plan.

Operating Expenses

Information about our operating expenses for the first quarter of 2013 and 2012 is as follows:

	For the Three Months Ended March 31, 2013					
	Core Operating Expenses (1)	Stock-Based Compensation	Intangible Amortization	Realignment Charges	Other Operating Expenses	Total Operating Expenses
Cost of license revenues	$ 20.3	$ 0.5	$ 23.3	$ —	$ 13.2	$ 57.3
Cost of services revenues	116.2	7.3	1.0	—	0.1	124.6
Research and development	206.3	62.3	1.0	—	0.9	270.5
Sales and marketing	378.1	36.1	2.6	—	0.7	417.5
General and administrative	83.0	14.0	—	—	1.5	98.5
Realignment charges	—	—	—	62.9	—	62.9
Total operating expenses	$ 803.9	$ 120.2	$ 27.9	$ 62.9	$ 16.4	$ 1,031.3
Operating income						$ 160.2
Operating margin						13.4%

	For the Three Months Ended March 31, 2012					
	Core Operating Expenses(1)	Stock-Based Compensation	Intangible Amortization	Realignment Charges	Other Operating Expenses	Total Operating Expenses
Cost of license revenues	$ 21.2	$ 0.4	$ 13.3	$ —	$ 21.8	$ 56.7
Cost of services revenues	106.8	5.8	1.1	—	0.5	114.2
Research and development	180.3	39.4	0.8	—	1.9	222.4
Sales and marketing	333.2	25.2	2.9	—	2.1	363.4
General and administrative	70.0	11.0	—	—	0.3	81.3
Total operating expenses	$ 711.5	$ 81.8	$ 18.1	$ —	$ 26.6	$ 838.0
Operating income						$ 217.2
Operating margin						20.6%

(1) Core operating expenses is a non-GAAP financial measure that excludes stock-based compensation, amortization of acquired intangible assets, realignment charges, and certain other expenses from our total operating expenses calculated in accordance with GAAP. The other operating expenses excluded are the net effect of the amortization and capitalization of software development costs, employer payroll taxes on employee stock transactions and acquisition and other-related items. Our core operating expenses reflect our business in a manner that allows meaningful period-to-period comparisons. Our core operating expenses are reconciled to the most comparable GAAP measure, "total operating expenses," in the table above. See "Non-GAAP Financial Measures" for further information.

Our operating margin on total operating expenses decreased to 13.4% in the first quarter of 2013 from 20.6% in the first quarter of 2012 . The decrease in our operating margin in the first quarter of 2013 compared with the first quarter of 2012 primarily related to the year-over-year increase in realignment charges and stock-based compensation.

Core Operating Expenses

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

Core operating expenses increased by $92.4 or 13% in the first quarter of 2013 compared with the first quarter of 2012 . As quantified below, these increase s were primarily due to increases in employee-related expenses, which include salaries and benefits, bonuses, commissions, and recruiting and training, which increased largely as a result of increases in headcount. Our headcount as of March 31, 2013 was approximately 13,000, compared with approximately 11,800 as of March 31, 2012. This increase in headcount was driven by strategic hiring, business growth and business acquisitions, but also includes the reduction of approximately 700 personnel in the first quarter of 2013 as the result of our realignment efforts. A portion of our core operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, marketing, and research and development, are denominated in foreign currencies and are thus exposed to foreign exchange rate fluctuations. Core operating expenses benefited by $2.1 in the first quarter of 2013 as compared with the first quarter of 2012 due to the effect of fluctuations in the exchange rates between the U.S. Dollar and other currencies.

Cost of License Revenues

Our core operating expenses for cost of license revenues principally consist of the cost of fulfillment of our software and royalty costs in connection with technology licensed from third-party providers. The cost of fulfillment of our software includes IT development efforts, personnel costs, product packaging and related overhead associated with the physical and electronic delivery of our software products.

Core operating expenses for cost of license revenues decreased by $0.8 or 4% in the first quarter of 2013 compared with the first quarter of 2012 .

Cost of Services Revenues

Our core operating expenses for cost of services revenues primarily include the costs of personnel and related overhead to deliver technical support for our products and to provide our professional services.

Core operating expenses for cost of services revenues increased by $9.4 or 9% in the first quarter of 2013 compared with the first quarter of 2012 . The increase in the first quarter of 2013 was primarily due to growth in employee-related expenses of $9.5, which was largely driven by incremental growth in headcount to support increased revenues.

Research and Development Expenses

Our core operating expenses for research and development ("R&D") expenses include the personnel and related overhead associated with the R&D of new product offerings and the enhancement of our existing software offerings.

Core operating expenses for R&D increased by $26.0 or 14% in the first quarter of 2013 compared with the first quarter of 2012 . The increase was primarily due to growth in employee-related expenses of $19.5 in the first quarter of 2013 , which was primarily driven by incremental growth in headcount from strategic hiring and business acquisitions. In the first quarter of 2013 , contractor costs of $4.3 related to product development and security efforts further contributed to the year-over-year increase.

Sales and Marketing Expenses

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

Core operating expenses for sales and marketing increased by $44.8 or 13% in the first quarter of 2013 compared with the first quarter of 2012 . The increase in the first quarter of 2013 was primarily due to growth in employee-related expenses of $40.2, driven by incremental growth in headcount and by higher commission expense due to increased sales volumes.

General and Administrative Expenses

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

Core operating expenses for general and administrative increased by $13.0 or 19% in the first quarter of 2013 compared with the first quarter of 2012 . The increase in the first quarter of 2013 was primarily due to an increase of $4.4 related to employee-related expenses mostly due to incremental growth in headcount, and an increase of $4.5 in corporate expenses, which includes contributions to our charitable foundation. Also contributing to the increase in expenses in the first quarter of 2013 were contractor costs of $2.3 related to IT security initiatives.

Stock-Based Compensation

Stock-based compensation was $120.2 and $81.8 in the first quarter of 2013 and 2012 , respectively, representing a year-over-year increase of $38.4 . The increase in total stock-based compensation expense in the first quarter of 2013 compared with the first quarter of 2012 was primarily due to an increase of $22.3 for new awards issued to our existing employees, as well as an increase of $12.5 for awards made to new employees joining VMware over the last year. Additionally, total stock-based compensation expense increased by $23.5 in the first quarter of 2013 due to business acquisitions, primarily attributable to our acquisition of Nicira in the third quarter of 2012. Partially offsetting these increase s was a decrease of $13.8 related to grants that became fully vested over the past year.

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

As of March 31, 2013 , the total unamortized fair value of our outstanding equity-based awards held by our employees was $826.6 , and is expected to be recognized over a weighted-average period of approximately 1.5 years.

Intangible Amortization

Intangible amortization increased $9.8 or 55% in first quarter of 2013 compared with the first quarter of 2012 as a result of new acquisitions, primarily the acquisition of Nicira in the third quarter of 2012. Intangible amortization was predominantly recorded to cost of license revenues on our accompanying consolidated statement of income.

Realignment Charges

In January 2013, we approved a business realignment plan to streamline our operations and to enhance focus on our three growth priorities. The plan is expected to be completed by the end of 2013. The total charge resulting from this plan is expected to be between $75.0 and $90.0 , with total cash expenditures associated with the plan expected to be in the range of $60.0 to $75.0 . The associated cash payments are expected to be paid out primarily through the end of 2013.

The plan includes the elimination of approximately 800 positions and personnel across all major functional groups and geographies, which is expected to result in a charge in the range of $60.0 to $65.0 . As of March 31, 2013 , approximately 700 of the employees had been terminated. The remainder of the workforce reduction charge relates to employees in foreign jurisdictions and will be recognized in future periods as the expected severance amounts are finalized. Additionally, we exited and are planning to exit certain lines of business and consolidate facilities, which we expect to result in a charge in the range of $15.0 to $25.0 .

In the first quarter of 2013 , we recognized total charges of $62.9 related to our business realignment plan. Of this amount, $53.9 related to workforce reductions and $9.0 related to the impairment of assets for certain lines of business that we exited and plan to exit.

Although we expect that streamlining our operations will have a favorable impact on our operating expenses in future quarters, we expect that core operating expenses related to our headcount will increase as our total headcount is expected to have a net increase of approximately 500 during 2013 as we continue to make key investments in support of our long-term growth objectives. This expected net increase takes into account the reduction of approximately 500 people that will transfer to Pivotal in the second quarter of 2013, as well as the impact of our realignment activities.

Other Operating Expenses

Other operating expenses consist of the net effect of the amortization and capitalization of software development costs and employer payroll tax on employee stock transactions, which are recorded to each individual line of operating expense on our accompanying consolidated statements of income. Additionally, other operating expenses include acquisition and other-related items, which are recorded in general and administrative expense on our income statement.

Other operating expenses decreased $10.3 in the first quarter of 2013 from the first quarter of 2012 . The decrease in the first quarter of 2013 was primarily due to a decrease of $8.7 in the amortization of capitalized software development costs resulting from the timing of the completion of amortization for previous product releases, including previous versions of vSphere. Amortization expense from capitalized software development costs is included in cost of license revenues on our accompanying consolidated statements of income. In future periods, we expect our amortization expense from capitalized software development costs to continue to decline as these costs are expected to be recorded as R&D expense as incurred given our current go-to-market strategy and development process. In addition, employer payroll taxes on employee stock transactions decreased $2.9 , due to the market value of our stock and a decrease in the number of awards exercised, sold or vested.

Investment Income

Investment income increased by $2.0 to $7.7 in the first quarter of 2013 from $5.7 in the first quarter of 2012 . Investment income consists of interest earned on cash, cash equivalents and short-term investment balances partially offset by the amortization of premiums paid on fixed income securities. In the first quarter of 2013 as compared with the first quarter of 2012 , investment income increased due to higher yields on our fixed income portfolio.

Other Income (Expense), Net

Other expense , net of $2.9 in the first quarter of 2013 changed by $5.2 compared with other income , net of $2.3 in the first quarter of 2012 , primarily due to the impact from foreign currency rate movement, net of hedges.

Income Tax Provision

Our effective income tax rate was (5.8)% and 14.5% for the first quarter of 2013 and 2012, respectively. The lower effective rate for the first quarter of 2013 compared with the first quarter of 2012 was primarily attributable to the discrete tax benefits recognized in the first quarter of 2013 due to the retroactive enactment of the federal R&D tax credit by the United States Congress in January 2013 and the favorable tax impact of charges under our realignment plan. The federal R&D tax credit applicable to 2012 benefited the effective income tax rate in the first quarter of 2013 by $39.1 . Additionally, the 2013 federal R&D credit applicable to 2013 favorably impacted the effective tax rate for the first quarter of 2013, which was partially offset by a jurisdictional shift of income from lower-tax non-U.S. jurisdictions to the United States.

Our rate of taxation in foreign jurisdictions is lower than our U.S. tax rate. Our international income is primarily earned by our subsidiaries in Ireland, where the statutory tax rate is 12.5%. We do not believe that any recent or currently expected developments in non-U.S. tax jurisdictions are reasonably likely to have a material impact on our effective tax rate. As of March 31, 2013, our total cash, cash equivalents, and short term investments were $4,936.7 , of which $3,385.9 were held outside the U.S. Our intent is to indefinitely reinvest our non-U.S. funds in our foreign operations, and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. We plan to meet our U.S. liquidity needs through ongoing cash flows generated from our U.S. operations, external borrowings, or both. We utilize a variety of tax planning strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed. If management determines these overseas funds are needed for our operations in the U.S., we would be required to accrue U.S. taxes on the related undistributed earnings in the period management determines the earnings will no longer be indefinitely invested outside the U.S. in order to repatriate these funds.

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

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

Our effective tax rate for the remainder of 2013 may be affected by such factors as changes in tax laws, regulations or rates, changing interpretation of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, changes in our international organization, shifts in the amount of income before tax earned in the U.S. as compared with other regions in the world, and changes in overall levels of income before tax.

Our Relationship with EMC

As of March 31, 2013 , EMC owned 42,536,000 shares of Class A common stock and all 300,000,000 shares of Class B common stock, representing 80.0% of our total outstanding shares of common stock and 97.3% of the combined voting power of our outstanding common stock.

Pursuant to an ongoing reseller arrangement with EMC, EMC bundles our products and services with EMC’s products and sells them to end-users. In the three months ended March 31, 2013 and 2012 , we recognized revenues of $36.3 and $35.0 , respectively, from such contractual arrangement with EMC. As of March 31, 2013 , $148.8 of revenues from products and services sold under the reseller arrangement were included in unearned revenues.

In the three months ended March 31, 2013 and 2012 , we recognized professional services revenues of $15.5 and $18.7 , respectively, from such contractual agreements with EMC. As of March 31, 2013 , $3.2 of revenues from professional services to EMC customers were included in unearned revenues.

In the three months ended March 31, 2013 and 2012 , we recognized revenues of $3.1 and $1.7 , respectively, from products and services purchased by EMC for internal use pursuant to our contractual agreements with EMC. As of March 31, 2013 , $27.1 of revenues from products and services purchased by EMC for internal use were included in unearned revenues.

We purchased products and services from EMC for $13.3 and $17.9 in the three months ended March 31, 2013 and 2012 , respectively.

Payments between us and EMC under the tax sharing agreement primarily relate to our portion of federal income taxes on EMC’s consolidated tax return. Payments from us to EMC primarily relate to periods for which we had stand-alone federal taxable income, while payments from EMC to us relate to periods for which we had a stand-alone federal taxable loss. In the three months ended March 31, 2013 and 2012 , no payments were made by either us or EMC under the tax sharing agreement.

Due to the retroactive enactment of the federal R&D tax credit, we estimate a 2012 federal tax refund of $15.5 will be due from EMC and payable in the second quarter of 2013. The amounts that we either pay to or receive from EMC for our portion of federal income taxes on EMC's consolidated tax return differ from the amounts we would owe on a stand-alone basis and the difference is presented as a component of stockholders' equity. In the three months ended March 31, 2013 and 2012 , 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 not material .

In certain geographic regions where we do not have an established legal entity, we contract with EMC subsidiaries for support services and EMC personnel who are managed by us. The costs incurred by EMC on our behalf related to these employees are passed on to us and we are charged a mark-up intended to approximate costs that would have been charged had we contracted for such services with an unrelated third party. These costs are included as expenses in our consolidated statements of income and primarily include salaries, benefits, travel and rent. Additionally, EMC incurs certain administrative costs on our behalf in the U.S. that are also recorded as expenses in our consolidated statements of income. The total cost of the services provided to us by EMC as described above was $36.1 and $27.8 in the three months ended March 31, 2013 and 2012 , respectively.

In the three months ended March 31, 2013 and 2012 , $1.0 and $1.3 of interest expense was recorded related to the note payable to EMC and included in interest expense with EMC on our consolidated statements of income. Our interest expense as a separate, stand-alone company may be higher or lower than the amounts reflected in the consolidated financial statements.

In 2011, we acquired certain assets relating to EMC's Mozy cloud-based data storage and data center services, including certain data center assets and a license to certain intellectual property. EMC retained ownership of the Mozy business and its remaining assets and continued to be responsible to Mozy customers for Mozy products and services and to recognize revenue from such products and services. We entered into an operational support agreement with EMC through the end of 2012, pursuant to which we took over responsibility to operate the Mozy service on behalf of EMC. Pursuant to the support agreement, costs incurred by us to support EMC's Mozy services, plus a mark-up intended to approximate third-party costs and a management fee, were reimbursed to us by EMC. In the fourth quarter of 2012, the operational support agreement between us and EMC was amended such that we would no longer operate the Mozy service on behalf of EMC. Under the amendment, we transferred substantially all employees that support Mozy services to EMC and EMC purchased certain assets from us in relation to transferred employees. The termination of service and related transfer of employees and sale of assets was substantially completed during the three months ended March 31, 2013 . On the consolidated statements of income, such amounts reimbursed by EMC to us to operate Mozy were immaterial in the three months ended March 31, 2013 and $14.6 in the three months ended March 31, 2012 . These amounts were recorded as a reduction to the costs we incurred.

From time to time, we and EMC enter into agreements to collaborate on technology projects. In the three months ended March 31, 2013 and 2012 , we received $2.2 and $1.1 , respectively, from EMC for EMC's portion of expenses related to such projects.

Effective September 1, 2012, Pat Gelsinger succeeded Paul Maritz as Chief Executive Officer of VMware. Prior to joining VMware, Pat Gelsinger was the President and Chief Operating Officer of EMC Information Infrastructure Products. Paul Maritz remains a board member of VMware and currently serves as Chief Executive Officer of Pivotal, a majority-owned subsidiary of EMC in which we have an ownership interest. With the exception of a long-term incentive performance award from EMC that Pat Gelsinger agreed to cancel in consideration of a new performance stock unit award from us, both Paul Maritz and Pat Gelsinger retained and continue to vest in their respective equity awards that they held as of September 1, 2012. Stock-based compensation related to Pat Gelsinger's EMC awards will be recognized on our consolidated statements of income over the awards' remaining requisite service periods. Stock-based compensation related to Paul Maritz's VMware awards will be recognized by EMC and Pivotal.

As of March 31, 2013 , we had $8.5 net due from EMC, which consisted of $60.3 due from EMC, partially offset by $51.8 due to EMC. These amounts resulted from the related party transactions described above. Additionally, we had a net income tax payable due to EMC of $12.2 as of March 31, 2013 , which was included in accrued expenses and other on our consolidated balance sheet. Balances due to or from EMC which are unrelated to tax obligations are generally settled in cash within 60 days of each quarter-end. The timing of the tax payments due to and from EMC is governed by the tax sharing agreement with EMC.

On April 1, 2013, we and EMC contributed certain assets to Pivotal and Pivotal assumed certain liabilities from us and EMC. In exchange for our and EMC's contributions, we and EMC received equity interests in Pivotal. See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations-Overview" above for further information.

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

Liquidity and Capital Resources

At March 31, 2013 and 2012 , we held cash, cash equivalents and short-term investments as follows:

	March 31,	
	2013	**2012**
Cash and cash equivalents	$ 1,840.2	$ 2,626.1
Short-term investments	3,096.5	2,596.1
Total cash, cash equivalents and short-term investments	$ 4,936.7	$ 5,222.2

As of March 31, 2013 , we held a diversified portfolio of money market funds and fixed income securities totaling $4,489.1 . Our fixed income securities were denominated in U.S. Dollars and consisted of highly liquid debt instruments of the U.S. government and its agencies, U.S. municipal obligations, and U.S. and foreign corporate debt securities. We limit the amount of our domestic and international investments with any single issuer and any single financial institution, and also monitor the diversity of the portfolio, thereby diversifying the credit risk. Within our portfolio, we held $40.0 of foreign government and agencies securities, $10.4 of which was deemed sovereign debt, at March 31, 2013 . These sovereign debt securities had an average credit rating of AAA and were predominantly from Canada. None of the securities deemed sovereign debt were from Greece, Ireland, Italy, Portugal or Spain.

As of March 31, 2013 , our total cash, cash equivalents and short-term investments were $4,936.7 , of which $3,385.9 was held outside the U.S. If these overseas funds were needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes on related undistributed earnings to repatriate these funds. However, our intent is to indefinitely reinvest our non-U.S. earnings in our foreign operations and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

We expect to continue to generate positive cash flows from operations in 2013 and to use cash generated by operations as our primary source of liquidity. We believe that existing cash and cash equivalents, together with any cash generated from operations will be sufficient to meet normal operating requirements for at least the next twelve months. While we believe our existing cash and cash equivalents and cash to be generated by operations will be sufficient to meet our normal operating requirements, our overall level of cash needs may be impacted by the number and size of acquisitions and investments we consummate and the amount of stock we buy back in 2013. Should we require additional liquidity, we may seek to arrange debt financing or enter into credit facilities.

Our cash flows for first quarter of 2013 and 2012 were as follows:

	For the Three Months Ended March 31,	
	2013	**2012**
Net cash provided by (used in):		
Operating activities	$ 676.4	$ 576.6
Investing activities	(331.7)	(57.3)
Financing activities	(113.9)	151.1
Net increase in cash and cash equivalents	$ 230.8	$ 670.4

Operating Activities

Cash provided by operating activities is driven by our net income, adjusted for non-cash items and changes in assets and liabilities. Non-cash adjustments include depreciation and amortization, stock-based compensation, excess tax benefits from stock-based compensation, non-cash realignment charges, and other adjustments.

Cash provided by operating activities increased by $99.8 to $676.4 in the first quarter of 2013 from $576.6 in the first quarter of 2012 . The increase was primarily driven by an increase in cash collections due to growth in our sales to customers and was partially offset by increases in core operating expenses, primarily driven by year-over-year headcount growth and by cash payments for workforce reductions in conjunction with our realignment plan.

In evaluating our liquidity internally, we focus on free cash flows, which we consider to be a relevant measure of our progress. We define free cash flows, a non-GAAP financial measure, as net cash provided by operating activities less capital expenditures. See “Non-GAAP Financial Measures” for additional information.

Our free cash flows in the first quarter of 2013 were as follows:

	For the Three Months Ended March 31,	
	2013	2012
Net cash provided by operating activities	$ 676.4	$ 576.6
Capital expenditures	(77.8)	(33.7)
Free cash flows	$ 598.6	$ 542.9

Investing Activities

Cash used in investing activities is generally attributable to the purchase of fixed income securities, business acquisitions, and capital expenditures. Cash provided by investing activities is primarily attributable to the sales or maturities of fixed income securities.

In the first quarter of 2013, we paid $77.8 for capital expenditures, compared with $33.7 in the first quarter of 2012. The increase in capital expenditures in the first quarter of 2013 relates to the renovation of our expanded Palo Alto, California campus. The renovation will be a multi-year project with capital investment extending into future periods.

Total fixed income securities of $736.9 and $701.5 were purchased in the first quarter of 2013 and 2012 , respectively. All purchases of fixed income securities were classified as cash outflows from investing activities. We classified these investments as short-term investments on our consolidated balance sheets based upon the nature of the security and their availability for use in current operations or for other purposes, such as business acquisitions and strategic investments. These cash outflows were partially offset by cash inflows of $667.5 and $679.3 in the first quarter of 2013 and 2012 , respectively, as a result of the sales and maturities of fixed income securities.

In the first quarter of 2013 , we paid $184.5 for business acquisitions, compared with no acquisitions in the first quarter of 2012 . See Note B to the consolidated financial statements for further information. Business acquisitions are an important element of our strategy and we expect to continue to consider additional strategic business acquisitions in the future.

Financing Activities

Proceeds from the issuance of our Class A common stock from the exercise of stock options and the purchase of shares under the VMware Employee Stock Purchase Plan (“ESPP”) were $67.9 and $111.0 in the first quarter of 2013 and 2012 , respectively.

In the first quarter of 2013 , we paid $182.0 , including commissions, to repurchase and retire 2.4 million shares of our Class A common stock at a weighted-average price of $77.05 per share, as part of our share repurchase programs. There were no repurchases of common stock under our share repurchase programs during the first quarter of 2012 . From time-to-time, stock repurchases may be made pursuant to the stock repurchase authorizations in open market transactions or privately negotiated transactions as permitted by securities laws and other legal requirements. We are not obligated to purchase any shares under our stock repurchase programs. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including our stock price, cash requirements for operations and business combinations, corporate and regulatory requirements and other market and economic conditions. Purchases can be discontinued at any time that we feel that additional purchases are not warranted. As of March 31, 2013 , the authorized amount remaining available for repurchase was $286.1 . This amount is authorized for repurchases through the end of 2014.

There were additional cash outflows of $22.1 and $13.6 in the first quarter of 2013 and 2012 , respectively, to cover tax withholding obligations in conjunction with the net share settlement upon the vesting of restricted stock units and restricted stock. Additionally, the excess tax benefit from stock-based compensation was $22.2 and $53.7 in the first quarter of 2013 and 2012 , respectively, and is shown as a reduction to cash flows from operating activities and an increase to cash flows from financing activities. The year-over-year changes in the repurchase of shares to cover tax withholding obligations and the excess tax benefit from stock-based compensation in first quarter of 2013 were primarily due to changes in the market value of our stock and the number of awards exercised, sold or vested.

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

Note Payable to EMC

As of March 31, 2013 , $450.0 remained outstanding on a note payable to EMC, with interest payable quarterly in arrears. The note matures in April 2015. The interest rate continues to reset quarterly and bears an interest rate of the 90-day LIBOR plus 55 basis points.

Non-GAAP Financial Measures

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

Core Operating Expenses

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

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

- *Stock-based compensation.* Stock-based compensation is generally fixed at the time the stock-based instrument is granted and amortized over a period of several years. Although stock-based compensation is an important aspect of the compensation of our employees and executives, the expense for the fair value of the stock-based instruments we utilize may bear little resemblance to the actual value realized upon the vesting or future exercise of the related stock-based awards. Furthermore, unlike cash compensation, the value of stock options is determined using a complex formula that incorporates factors, such as market volatility, that are beyond our control. Additionally, in order to establish the fair value of performance-based stock awards, which are also an element of our ongoing stock-based compensation, we are required to apply judgment to estimate the probability of the extent to which performance objectives will be achieved.

- *Amortization of acquired intangible assets.* We generally allocate a portion of the purchase price of an acquisition to intangible assets, such as intellectual property, which is subject to amortization. Additionally, the amount of an acquisition's purchase price allocated to intangible assets and the term of its related amortization can vary significantly and are unique to each acquisition.

- *Realignment charges.* Realignment charges include workforce reductions, asset impairments and losses on asset disposals. We believe it is useful to exclude these items, when significant, as they are not reflective of ongoing business and operating results.

- *Other operating expenses.* Other expenses excluded are amortization and capitalization of software development costs, employer payroll taxes on employee stock transactions and other acquisition and other-related items. Capitalized software development costs encompass capitalization of development costs and the subsequent amortization of the capitalized costs over the useful life of the product. Amortization and capitalization of software development costs can vary significantly depending upon the timing of products reaching technological feasibility and being made generally available. We did not capitalize software development costs related to product offerings in either the first quarter of 2013 or fiscal year 2012 given our current go-to-market strategy. In future periods, we expect our amortization expense from previously capitalized software development costs to steadily decline as previously capitalized software development costs become fully amortized. The amount of employer payroll taxes on stock-based compensation is dependent on our stock price and other factors that are beyond our control and do not correlate to the operation of the business. Acquisition and other-related items include direct costs of acquisitions and dispositions, such as transaction and advisory fees, which vary significantly and are unique to each transaction. Additionally, VMware does not acquire or dispose of businesses on a predictable cycle.

Free cash flows

In evaluating our liquidity internally, we focus on free cash flows, which we consider to be a relevant measure of our progress. In 2012, we changed our methodology for calculating free cash flows, which is reflected in the amounts presented for all periods, to be defined as GAAP operating cash flows less capital expenditures. We include the impact from capital expenditures on property and equipment because these expenditures are also considered to be a necessary component of our operations and therefore part of our core operating expenses. Management uses free cash flows as a measure of financial progress in our business, as it balances operating results, cash management and capital efficiency. We believe that free cash flows provides useful information to investors and others as it allows for meaningful period-to-period comparisons of our operating cash flows for analysis of trends in our business. Additionally, we believe that it provides investors and others with an important perspective on the amount of cash that we may choose to use for strategic acquisitions and investments, the repurchase of shares, operations and other capital expenditures.

Limitations on the use of Non-GAAP financial measures

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

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

See “Results of Operations—Operating Expenses” for a reconciliation of the non-GAAP financial measure of core operating expenses to the most comparable GAAP measure, “total operating expenses,” for the three months ended March 31, 2013 and 2012.

See “Liquidity and Capital Resources” for a reconciliation of free cash flows to the most comparable GAAP measure, “net cash provided by operating activities,” for the three months ended March 31, 2013 and 2012.

Critical Accounting Policies

Our consolidated financial statements are based on the selection and application of accounting principles generally accepted in the United States of America that require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements. We believe that the critical accounting policies set forth within Item 7 of our 2012 Annual Report on Form 10-K may involve a higher degree of judgment and complexity in their application than our other significant accounting policies and represent the critical accounting policies used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements, including, without limitation, statements regarding expectations of, or our plans for: achieving future business growth by building long-term relationships with our customers through the adoption of enterprise license agreements; macroeconomic conditions; future product offerings; sources of revenues; developing new product capabilities; increasing sales volumes in our transactional business; future acquisitions; funding strategic initiatives through long-term revenue growth; future competition; the competitive landscape; maintaining our industry leadership position; the impact of, costs associated with, and the timetable for streamlining our operations and implementing and completing our realignment plan; completion of a third party strategic investment in GoPivotal, Inc. (“Pivotal”); the impact of our realignment plan and the Pivotal transaction on future revenue, operating margin and unearned revenue balance; expenditures to build out our corporate headquarters; geographic expansion and adding additional channel partners; the recognition of unearned revenue; our relationship with EMC; increasing employee headcount; our revenue outlook and product mix; customer and partner demand for our products and services; synergies from our acquisitions and associated accounting for goodwill; the sufficiency of our liquidity and capital reserves to fund our operations and business strategy; continuation of our stock repurchase program; the effects of potential developments in non-U.S. tax jurisdictions; reinvesting our overseas earnings in our foreign operations and not repatriating them to the U.S.; the timing and amount of capitalized software development costs; the lack of a material adverse effect on us due to the resolution of pending claims, legal proceedings and investigations; and costs associated with foreign currency fluctuation.

These forward-looking statements involve risks and uncertainties and the cautionary statements set forth above and those contained in the section of this report entitled “Risk Factors” identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We assume no obligation to, and do not currently intend to, update these forward-looking statements.

Available Information

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

- our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission (“SEC”);
- announcements of investor conferences, speeches and events at which our executives talk about our products, services and competitive strategies (archives of these events are also available for a limited time);
- additional information on financial metrics, including reconciliations of non-GAAP financial measures discussed in our presentations to the nearest comparable GAAP measure;
- press releases on quarterly earnings, product and service announcements, legal developments and international news;
- corporate governance information including our certificate of incorporation, bylaws, corporate governance guidelines, board committee charters, business conduct guidelines (which constitutes our code of business conduct and ethics) and other governance-related policies;
- other news, blogs and announcements that we may post from time to time that investors might find useful or interesting; and
- opportunities to sign up for email alerts and RSS feeds to have information pushed in real time.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

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

International revenues as a percentage of total revenues were 52.3% and 54.0% in the first quarter of 2013 and 2012 , respectively. We invoice and collect in the Euro, the British Pound, the Japanese Yen and the Australian Dollar in their respective regions. Additionally, a portion of our operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, sales and sales support and research and development, are denominated in foreign currencies, primarily those currencies in which we also invoice and collect. Revenues resulting from selling in local currencies and costs incurred in local currencies are exposed to foreign exchange rate fluctuations which can affect our operating income. As exchange rates vary, operating margins may differ materially from expectations. We calculate the foreign currency impact on our revenues and operating expenses as the difference between amounts translated at current exchange rates and the same amounts translated at prior-period exchange rates.

License revenues were negatively impacted by $4.0 million in the first quarter of 2013 due to fluctuations in the exchange rates between the U.S. Dollar and foreign currencies as compared with the same periods in the prior year. Additionally, core operating expenses benefited by $2.1 million in the first quarter of 2013 due to fluctuations in the exchange rates.

To manage the risk associated with fluctuations in foreign currency exchange rates, we utilize derivative financial instruments, principally foreign currency forward contracts, as described below.

Cash Flow Hedging Activities. To mitigate our exposure to foreign currency fluctuations resulting from operating expenses denominated in certain foreign currencies, we enter into foreign currency forward contracts. We typically enter into cash flow hedges semi-annually with maturities of six months or less. As of March 31, 2013 , we had foreign currency forward contracts to purchase approximately $36.2 million in foreign currency. The fair value of these forward contracts was immaterial as of March 31, 2013 .

Balance Sheet Hedging Activities. We enter into foreign currency forward contracts to hedge a portion of our net outstanding monetary assets and liabilities against movements in certain foreign exchange rates. Our foreign currency forward contracts are traded on a monthly basis with a typical contractual term of one month. As of March 31, 2013 , we had outstanding forward contracts with a total notional value of $292.9 million . The fair value of these forward contracts was immaterial as of March 31, 2013 . In the first quarter of 2013 and 2012 , we recognized a gain of $11.0 million and a loss of $4.5 million , respectively, on our consolidated statements of income for our foreign currency forward contracts. The net impact of the gains and losses on our foreign currency forward contracts and the gains and losses associated with the underlying foreign-currency denominated assets and liabilities resulted in a net loss of $2.5 million in the first quarter of 2013 and a net gain of $1.3 million in the first quarter of 2012.

Sensitivity Analysis. There can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. A hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in a potential loss of $29.9 million in fair value of our foreign currency forward contracts used in both the cash flow hedging and balance sheet hedging activities as of March 31, 2013 . This sensitivity analysis disregards any potentially offsetting gain that may be associated with the underlying foreign-currency denominated assets and liabilities that we hedge.

This analysis also assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. Dollar; however, foreign currency exchange rates do not always move in such a manner and actual results may differ materially. We do not enter into speculative foreign exchange contracts for trading purposes. See Note G to the consolidated financial statements for further information.

Interest Rate Risk

Fixed Income Securities

Our fixed income investment portfolio is denominated in U.S. Dollars and consists of various holdings, types, and maturities.

Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in interest rates or credit spreads could have a material adverse impact on the fair value of our fixed income investment portfolio. Hypothetical changes in interest rates of 50 basis points and 100 basis points would have changed the fair value of our fixed income investment portfolio as of March 31, 2013 by $24.7 million and $49.4 million , respectively. This sensitivity analysis assumes a parallel shift of all interest rates; however, interest rates do not always move in such a manner and actual results may differ materially. We monitor our interest rate and credit risk, including our credit exposures to specific rating categories and to individual issuers. There were no impairment charges on our cash equivalents and fixed income securities during the first quarter of 2013 . These instruments are not leveraged and we do not enter into speculative securities for trading purposes. See Notes E and F to the consolidated financial statements for further information.

Note Payable to EMC

As of March 31, 2013 , $450.0 million was outstanding on our consolidated balance sheet for the note payable to EMC. The interest rate on the note payable was 0.86% as of March 31, 2013 and 1.13% as of March 31, 2012 . In the first quarter of 2013 and 2012 , $1.0 million and $1.3 million , respectively, of interest expense was recorded related to the note payable.

The note may be repaid, without penalty, at any time. In the second quarter of 2011, we and EMC amended and restated the note to extend the maturity date of the note to April 16, 2015 and to modify the principal amount of the note to reflect the outstanding balance of $450.0 million . The amended agreement continues to bear an interest rate of the 90 -day LIBOR plus 55 basis points, with interest payable quarterly in arrears. The interest rate on the note resets quarterly and is determined on the two business days prior to the first day of each fiscal quarter. If the interest rate on the note payable were to change 100 basis points from the March 31, 2013 rate, and assuming no additional repayments on the principal were made, our annual interest expense would change by $4.5 million.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Controls Over Financial Reporting

There were no changes in our internal control over financial reporting during the most recent fiscal quarter ended March 31, 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Controls

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

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business

As the market for our computer virtualization products has matured, we have been increasingly developing and marketing products and services targeted toward the delivery, management and automation of information technology (“IT”) infrastructure, platforms and services through cloud-based solutions. If businesses do not find our cloud computing solutions compelling, our revenue growth and operating margins may decline.

Our products and services are based on computer virtualization and related technologies that have primarily been used for virtualizing on-premises data centers. As the market for data center virtualization has matured, we have increasingly directed our product development and marketing toward products and services that enable businesses to utilize virtualization as the foundation for cloud-based computing, management and automation of the delivery of IT resources, end-user computing and Infrastructure as a service (“IaaS”) offerings including hybrid cloud services. Our success depends on organizations and customers perceiving technological and operational benefits and cost savings associated with the increasing adoption of virtualization-based infrastructure and management solutions for cloud computing, hybrid cloud services and end-user computing. As the market for our data center virtualization products mature and the scale of our business increases, it may be difficult to maintain previous rates of growth in our product sales and we expect our annual revenue growth rate in 2013 to decline from the growth rate of 22% experienced in 2012. In addition, to the extent that our newer cloud computing infrastructure management and automation, or software-defined data center (“SDDC”), solutions, end-user computing, and hybrid cloud solutions are adopted more slowly or less comprehensively than we expect, our revenue growth rates may slow materially or our revenue may decline substantially.

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

In fiscal year 2012, approximately 90% of our license revenues were from our cloud infrastructure and management solutions with the balance from our other solutions. Although we continue to develop other applications for our virtualization technology such as our end-user computing products, we expect that our data center virtualization products and related enhancements and upgrades will constitute a majority of our revenue for the foreseeable future. Declines and variability in demand for our data center virtualization products could occur as a result of:

- improved products or product versions being offered by competitors in our markets;
- competitive pricing pressures;
- failure to release new or enhanced versions of our data center virtualization products on a timely basis, or at all;
- technological change that we are unable to address with our data center virtualization products or that changes the way enterprises utilize our products; and
- general economic conditions.

Also, as more and more businesses achieve the virtualization of their data centers and other IT functions, the market for our VMware vSphere product line may become saturated. If we fail to introduce compelling new features in future upgrades to our VMware vSphere product line, develop new applications for our virtualization technology or provide product suites based on the VMware vSphere platform that address customer requirements for integration, automation and management of their IT systems, demand for VMware vSphere may decline.

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

Additionally, in connection with the announcement in August 2012 of our latest product suite centered upon vSphere, we announced the elimination of the virtualization-based entitlement to use vSphere that was based upon virtual memory, or vRAM. We had introduced the vRAM-based entitlement with the release of our prior version of vSphere in the third quarter of 2011 but eliminated the entitlement in the third quarter of 2012. Instead, when sold on a perpetual basis, vSphere will continue to license on a per-processor basis but without core, vRAM or number of virtual machine limits. Although we currently do not expect the elimination of the vRAM entitlement to have a material impact upon our revenues, there can be no assurance that revenues in future periods will not be materially and adversely affected due to the elimination of the vRAM-based entitlement.

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

Over the last several years, we have introduced new product and technology initiatives that aim to leverage our virtualization infrastructure software products into the emerging areas of cloud computing and end-user computing as alternatives to the provisioning of physical computing resources.

VMware's strategy for the data center is to deliver the software-defined data center. In 2010, we introduced the first of our vCenter and vCloud products, which we combined in 2011 with our vShield security product line to create our new Cloud Infrastructure and Management ("CIM") Suite offering. In 2012, we delivered the vCloud Suite, which delivers a comprehensive suite for cloud computing in a single SKU with simplified licensing.

In 2012, we acquired two companies that furthered VMware's SDDC strategy; we acquired Dynamic Ops, a provider of cloud automation solutions that enable provisioning and management of IT services across heterogeneous environments, and Nicira, a developer of software-defined networking and a leader in network virtualization for open source initiatives. In 2013, we acquired Virsto Software, a developer of software that optimizes storage performance and utilization in virtual environments.

We also continue to expand and enhance our end-user computing offerings, such as VMware View, and Horizon Suite, a solution that provides end users with a single place to get access to their apps, data and desktops and give IT a single management console to manage entitlements, policies and security. In 2012, we also acquired Wanova, a leading provider of intelligent desktop solutions that centralize and simplify the management of physical desktop images while enabling users to take advantage of the native performance of a PC.

In first quarter of 2013, we announced plans to develop a hybrid cloud solely developed by VMware. This cloud will be developed and managed by internal VMware employees and hosted by a third party. The target market for the hybrid cloud will initially be current VMware customers that have the desire to use an outsourced version of the cloud in a controlled and trusted manner.

The expansion of our offerings to deliver the SDDC and address IT management and automation and hybrid cloud offerings subjects us to additional risks, such as the following:

- These initiatives may present new and difficult technological challenges. Significant investments will be required to acquire and develop solutions to those challenges. End users may choose not to adopt our new product or service offerings and we may be unable to recoup or realize a reasonable return on our investments.

- Some of our new initiatives are hosted by third parties whom we do not control but whose failure to prevent service disruptions, or other failures or breaches may require us to issue credits or refunds or indemnify or otherwise be liable to customers or third parties for damages that may occur. Any transition of our services from a third party hosting service to our own data centers would also entail a risk of service disruption during a transition. We may be subject to claims if customers of these service offerings experience service disruptions or failures, security breaches, data losses or other quality issues.

- The success of these new offerings depends upon the cooperation of hardware, software and cloud hosting vendors to ensure interoperability with our products and offer compatible products and services to end users. If we are unable to obtain such cooperation, it may be difficult and more costly for us to achieve functionality and service levels that would make our new products and services attractive to end users.

- We will need to develop and implement appropriate go-to-market strategies and train our sales force in order to effectively market offerings in product categories in which we may have less experience than our competitors. Accordingly, end users could choose competing products over ours, even if such offerings are less advanced than ours.

- Our increasing focus on developing and marketing IT management and automation and IaaS (including software-defined networking), offerings that enable customers to transform their IT systems will require a greater focus on marketing and selling product suites and more holistic solutions, rather than selling on a product-by-product basis. Consequently, we will need to develop new strategies for marketing and selling our offerings, our customers' purchasing decisions may become more complex and require additional levels of approval and the duration of sales cycles for our offerings may increase.

- We will need to develop appropriate pricing strategies for our new product initiatives. For example, it has frequently been challenging for software companies to derive significant revenue streams from open source projects, such as certain of our offerings. Additionally, in some cases our new product initiatives are predicated on converting free and trial users to paying customers of the premium tiers of these services, and therefore we must maintain a sufficient conversion ratio for such services to be profitable. Also, certain of our new product initiatives have a subscription model. We may not be able to accurately predict subscription renewal rates or their impact on results, and because revenue is recognized for our services over the term of the subscription, downturns or upturns in sales may not be immediately reflected in our results.
- The hybrid cloud initiative will be dependent on the final development and implementation of the offering along with appropriate go to market strategies. Currently, our field sales do not market this type of offering. The hybrid cloud initiative will represent a shift in sales motion that may not prove successful. Further, any focus on this market from the existing sales team may reduce time spent on selling the existing product portfolio that may have a material negative impact on revenues.
- Our new products and services may compete with offerings from companies who are members of our developer and technology partner ecosystem. Consequently, we may find it more difficult to continue to work together productively on other projects, and the advantages we derive from our ecosystem could diminish.
- The cloud computing and virtualized end-user computing markets are in early stages of development. Other companies seeking to enter and develop competing standards for the cloud computing market, such as Microsoft, IBM, Oracle, Google and Amazon, and the end-user computing market, such as Citrix and Microsoft, have introduced or are likely to introduce their own initiatives that may compete with or not be compatible with our cloud and end-user computing initiatives which could limit the degree to which other vendors develop products and services around our offerings and end users adopt our platforms.
- Emerging IT sectors, such as those within IaaS, are frequently subject to a “first mover” effect pursuant to which certain product offerings can rapidly capture a significant portion of market share and developer attention. Therefore, if competitive product offerings in these sectors gain broad adoption before ours, it may be difficult for us to displace such offerings regardless of the comparative technical merit, efficacy or cost of our products.

Additionally, our newer initiatives may be less profitable than those we have achieved in the markets we currently serve, and we may not be successful enough in these newer activities to recoup our investments in them. If any of these risks were to occur, it could damage our reputation, limit our growth and negatively affect our operating results.

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

Our business depends on the overall demand for information technology and on the economic health of our current and prospective customers. The purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Weak economic conditions or significant uncertainty regarding the stability of financial markets could adversely impact our business, financial condition and results of operations in a number of ways, including by lengthening sales cycles, affecting the size of enterprise license agreements (“ELAs”) that customers will commit to, reducing the level of our non-ELA transactional sales, lowering prices for our products and services, reducing unit sales and reducing the rate of adoption of our products by new customers and the willingness of current customers to purchase upgrades to our existing products. The ongoing sovereign debt crisis in Europe threatens to suppress demand and our customers’ access to credit in that region, which is an important market for our products and services. Additionally, in response to sustained economic uncertainty, many national and local governments that are current or prospective customers for our products and services, including the U.S. federal government, have also made, or announced plans to make, significant spending cutbacks which could reduce the amount of government spending on IT and the potential demand for our products and services from the government sector.

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

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

If we are unable to successfully implement our plan to streamline our operations, our business outlook and financial results could be adversely affected.

In January 2013, in order to enable us to focus our business on the most compelling strategic areas, we approved, subject to compliance with all applicable legal obligations, a plan to streamline our operations. The plan includes the elimination of approximately 800 positions and personnel and a planned exit of certain lines of business and consolidation of facilities. Any such proposals in countries outside the United States are subject to a review of efficiency, resources and performance. The plan is expected to be completed by the end of 2013. Finalization of the plan will be subject to local information and consultation processes with employee representatives if required by law.

The changes to our business may be disruptive, and we may not be able to realize the market opportunities that we believe are available to us in the areas of our strategic focus. Additionally, we may not be able to achieve the cost savings we project from this plan. Because the details of our facilities consolidation and divestitures are not yet final, the total amount expected to be incurred in connection with our plan may not be achieved and its timing may be delayed. If we are unable to achieve our plan when planned, the timing of the costs and charges associated with the plan may be delayed or not fully achieved. Our exit from certain lines of business could have a negative impact on sales and marketing strategies and reduce our future revenues and projections and the costs of implementing the plan may outweigh the commensurate benefits. Accordingly, our activities to streamline our operations, including any related charges and the impact of the related headcount reductions, could have a material adverse effect on our business, operating results, and financial condition.

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

The virtualization, cloud computing, and end-user computing markets are inter-related and rapidly evolving. We experienced increased competition during 2012 and expect it to remain intense in 2013. For example, Microsoft continues to make incremental improvements to its virtual infrastructure and virtual management products. In September 2012, Microsoft began shipping Windows Server 2012, which includes a more advanced version of its Hyper-V virtualization product, which continues its push into the virtualization market, and more recently, Microsoft released System Center 2012, its bundle of management products targeted at legacy and virtual environments. Microsoft also has cloud-based computing offerings and recently announced infrastructure as a service (“IaaS”)-like capabilities for Windows Azure. We also face competition from other companies that have announced a number of new product initiatives, alliances and consolidation efforts. For example, Citrix Systems continues to enhance its end-user and server virtualization offerings and now has a client hypervisor in the market. IBM, Google and Amazon have existing cloud computing offerings and announced new cloud computing initiatives. Red Hat has released commercial versions of Linux that have virtualization capabilities as part of the Linux kernel (“KVM”) and has also announced plans for cloud computing products. Other companies have indicated their intention to expand offerings of virtual management and cloud computing solutions as well. Additionally, our vision for hybrid cloud computing in which enterprises pool internal and external IT resources running on a common vSphere infrastructure competes with low-cost public cloud infrastructure offerings such as Amazon EC2 and Google Compute Engine. Enterprises and service providers have also shown significant interest in building their own clouds based on open source projects such as OpenStack.

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

- the level of reliability, security and new functionality of product offerings;
- the ability to provide comprehensive solutions, including management and security capabilities;
- the ability to offer products that support multiple hardware platforms, operating systems, applications and application development frameworks;
- the ability to deliver an intuitive end-user experience for accessing data, applications and services from a wide variety of end-user devices;
- the ability to effectively run traditional IT applications and emerging applications;
- the proven track record of formulating and delivering a roadmap of virtualization and cloud computing capabilities;
- pricing of products, individually and in bundles;
- the ability to attract and preserve a large installed base of customers;
- pricing of products, individually and in bundles;
- the ability to attract and preserve a large number of application developers to develop to a given cloud ecosystem;
- the ability to create and maintain partnering opportunities with hardware vendors, infrastructure software vendors and cloud service providers;

- the ability to develop robust indirect sales channels; and
- the ability to attract and retain cloud, virtualization and systems experts as key employees.

Existing and future competitors may introduce products in the same markets we serve or intend to serve, and competing products may have better performance, lower prices, better functionality and broader acceptance than our products. Our competitors may also add features to their virtualization, end-user and cloud computing products similar to features that presently differentiate our product offerings from theirs. Many of our current or potential competitors also have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we do. This competition could result in increased pricing pressure and sales and marketing expenses, thereby materially reducing our operating margins, and could harm our ability to increase, or cause us to lose, market share. Increased competition also may prevent us from entering into or renewing service contracts on terms similar to those that we currently offer and may cause the length of our sales cycle to increase. Some of our competitors and potential competitors supply a wide variety of products to, and have well-established relationships with, our current and prospective end users. For example, small to medium sized businesses and companies in emerging markets that are evaluating the adoption of virtualization-based technologies and solutions may be inclined to consider Microsoft solutions because of their existing use of Windows and Office products. Some of these competitors have in the past and may in the future take advantage of their existing relationships to engage in business practices that make our products less attractive to our end users. Other competitors have limited or denied support for their applications running in VMware virtualization environments. These distribution, licensing and support restrictions, as well as other business practices that may be adopted in the future by our competitors, could materially impact our prospects regardless of the merits of our products. In addition, competitors with existing relationships with our current or prospective end users could in the future integrate competitive capabilities into their existing products and make them available without additional charge. For example, Oracle provides free server virtualization software intended to support Oracle and non-Oracle applications, and Microsoft offers its own server virtualization software packaged with its Windows Server product and offers built-in virtualization in the client version of Windows. As a result, existing VMware customers may elect to use products that are perceived to be "free" or "very low cost" instead of purchasing VMware products and services for certain applications where they do not believe that more advanced and robust capabilities are required. Competitors may also leverage open source technologies to offer zero or low cost products capable of putting pricing pressure on our own product offerings. By engaging in such business practices, our competitors can diminish competitive advantages we may possess by incentivizing end users to choose products that lack some of the technical advantages of our own offerings. Even if customers find our products to be technically superior, they may choose to employ a 'multiple-vendor' strategy, regardless of the technical merits of VMware's products, where they purposely deploy multiple vendors in their environment in order to prevent any one vendor from gaining too much control over their IT operations.

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.

Industry alliances or consolidation may result in increased competition.

Some of our competitors have made acquisitions and entered into or extended partnerships or other strategic relationships to offer more comprehensive virtualization and cloud computing solutions than they individually had offered. In 2012, Citrix Systems continued to invest in desktop virtualization marketing by continuing its close collaboration with Microsoft and acquired smaller players like Zenprise and Virtual Computer. Moreover, information technology companies are increasingly seeking to deliver top-to-bottom IT solutions to end users that combine enterprise-level hardware and software solutions to provide an alternative to our virtualization platform. For example, in 2011, Oracle brought to market integrated hardware and software solutions that utilized technologies from its 2010 acquisition of Sun Microsystems, and Microsoft and Hewlett-Packard continued their collaboration based on Microsoft's cloud computing and virtualization platforms. In 2011, Citrix announced its acquisition of Cloud.com, which offers an IaaS cloud services solution, and Red Hat continued to invest in the Open Virtualization Alliance ("OVA") to bolster KVM as a direct competitor to VMware vSphere. In 2012, Dell acquired Wyse Technologies to bolster its ability to serve the "cloud client" market and Quest to enhance its management and automation solutions. Software-defined networking is a new frontier, and many companies are active in this space. For example, in 2012, Cisco acquired Cariden and Meraki, and Juniper acquired Contrail Systems. In February 2013, Microsoft committed to participate in the proposed leveraged buyout of Dell. We expect these trends to continue as companies attempt to strengthen or maintain their market positions in the evolving virtualization infrastructure and enterprise IT solutions industry. Many of the companies driving this trend have significantly greater financial, technical and other resources than we do and may be better positioned to acquire and offer complementary products and technologies. The companies and alliances resulting from these possible combinations may create more compelling product offerings and be able to offer greater pricing flexibility than we can or may engage in business practices that make it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs (such as providing greater incentives to our channel partners to sell a competitor's product), technology or product functionality. This competition could result in a substantial loss of customers or a reduction in our revenues.

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. Cloud computing is proving to be a disruptive technology that will alter the way that businesses consume, manage and provide physical IT resources, applications, data and IT services. We may not be able to develop updated products that keep pace with technological developments and emerging industry standards and that address the increasingly sophisticated needs of our customers or that interoperate with new or updated operating systems and hardware devices or certify our products to work with these systems and devices. As a result, we may not be able to accurately predict the lifecycle of our software solutions, and they may become obsolete before we receive the amount of revenues that we anticipate from them. There is no assurance that any of our new offerings would be accepted in the marketplace. Significant reductions in server-related costs or the rise of more efficient infrastructure management software could also affect demand for our software solutions. As hardware and processors become more powerful, we will have to adapt our product and service offerings to take advantage of the increased capabilities. For example, while the introduction of more powerful servers presents an opportunity for us to provide better products for our customers, the migration of servers to microprocessors with an increasing number of multiple cores also allows an end user with a given number of licensed copies of our software to multiply the number of virtualization machines run per server socket without having to purchase additional licenses from us. If we are unable to revise our solutions and offerings in response to new technological developments, our ability to retain or increase market share and revenues in the virtualization software market could be materially adversely affected.

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

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

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

- general economic conditions in our domestic and international markets and the effect that these conditions have on our customers' capital budgets and the availability of funding for software purchases;
- fluctuations in demand, adoption rates, sales cycles and pricing levels for our products and services;
- fluctuations in foreign currency exchange rates;
- changes in customers' budgets for information technology purchases and in the timing of their purchasing decisions;
- the timing of recognizing revenues in any given quarter, which, as a result of software revenue recognition policies, can be affected by a number of factors, including product announcements, beta programs and product promotions that can cause revenue recognition of certain orders to be deferred until future products to which customers are entitled become available;
- the sale of our products in the time frames we anticipate, including the number and size of orders in each quarter;
- our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer demand, certification requirements and technical requirements;
- the introduction of new pricing and packaging models for our product offerings;
- the timing of the announcement or release of upgrades or new products by us or by our competitors;
- our ability to maintain scalable internal systems for reporting, order processing, license fulfillment, product delivery, purchasing, billing and general accounting, among other functions;
- our ability to control costs, including our operating expenses;

- changes to our effective tax rate;
- the increasing scale of our business and its effect on our ability to maintain historical rates of growth;
- our ability to attract and retain highly skilled employees, particularly those with relevant experience in software development and sales;
- our ability to conform to emerging industry standards and to technological developments by our competitors and customers;
- renewal rates and the amounts of the renewals for ELAs as original ELA terms expire;
- the timing and amount of software development costs that may be capitalized beginning when technological feasibility has been established and ending when the product is available for general release;
- unplanned events that could affect market perception of the quality or cost-effectiveness of our products and solutions; and
- the recoverability of benefits from goodwill and acquired intangible assets and the potential impairment of these assets.

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 may generate less revenues, than we anticipate. Our research and development expenses were over 20% of our total revenues in the first three months of 2013 and in the fiscal year 2012, respectively. 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 rely upon a two-tier selling strategy, which may not succeed in driving long-term sales and revenue growth.

We sell our products and services through two primary means, which we refer to as our ELA and our non-ELA, or transactional, sales.

ELAs are comprehensive long-term license agreements that provide for multi-year maintenance and support and constitute one-quarter to one-third of our overall sales. These are generally larger size transactions, typically driven by our direct sales force and are primarily attractive to our larger enterprise customers.

Transactional sales, in contrast, tend to be smaller in scope, shorter in duration with a standard one-year maintenance term, and are principally driven by our sales channel partners. They represent two-thirds to three-quarters of our overall sales.

During 2012, we expanded the sales of product suites, such as our vCloud suite, that integrate advanced management and automation features with our vSphere cloud infrastructure platform and which are primarily sold through ELAs. We believe that ELAs help us grow our business by building long-term relationships with our enterprise customers.

In 2012, our overall sales growth rate declined compared to 2011, with the growth rate in transactional sales lower than the growth rate in ELAs. In 2013, we intend to focus our selling and marketing efforts to improve the growth rate of our transactional business. As we develop and add new product capabilities to our higher-end product offerings, our strategy is also to increase the value of the products sold through the transactional business by enhancing product features and capabilities. We believe that this strategy can increase sales volumes in our transactional business and help attract new customers to our product ecosystem.

However, if our overall selling strategy is not successful, our growth rates may decline further, and our business, financial condition and results of operations could be materially adversely affected.

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

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

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

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

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

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 and timely development and delivery of upgrades and enhancements to our existing products. The market for expert software developers upon whom we rely has become increasingly competitive. 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 on our strategy, we must continue to attract and retain highly qualified personnel. Competition for these personnel is intense, especially for senior sales executives and engineers with high levels of experience in designing and developing software. We may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Many of the companies with which we compete for experienced personnel have greater resources than we have. R&D personnel are also aggressively recruited by startup and emerging growth companies, which are especially active in many of the technical areas and geographic regions in which we conduct product development. In addition, in making employment decisions, particularly in the high-technology industry, job candidates often consider the value of the stock-based compensation they are to receive in connection with their employment. Declines in the value of our stock could adversely affect our ability to attract or retain key employees and result in increased employee compensation expenses. Additionally, the plan to streamline our operations that we announced in January 2013 could have a negative impact on employee morale and make it more difficult for us to retain and attract personnel. 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.

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

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

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

- managing the length of the development cycle for new products and product enhancements, which has frequently been longer than we originally expected;
- managing customers' transitions to new products, which can result in delays in their purchasing decisions;
- adapting to emerging and evolving industry standards and to technological developments by our competitors and customers;
- entering into new or unproven markets with which we have limited experience;
- tailoring our business and pricing models appropriately as we enter new markets and respond to competitive pressures and technological changes;
- incorporating and integrating acquired products and technologies; and
- developing or expanding efficient sales channels.

In addition, if we cannot adapt our business models to keep pace with industry trends, our revenues could be negatively impacted. For example, if we increase our adoption of subscription-based pricing models for our products, we may fail to set pricing at levels appropriate to maintain our revenue streams or our customers may choose to deploy products from our competitors that they believe are priced more favorably. Additionally, we may fail to accurately predict subscription renewal rates or their impact on results, and because revenue from subscriptions is recognized for our services over the term of the subscription, downturns or upturns in sales may not be immediately reflected in our results. As we offer more products that depend on converting users of free services to users of premium services and as such services grow in size, our ability to maintain or improve and to predict conversion rates will become more important.

Breaches of our cybersecurity systems could degrade our ability to conduct our business operations and deliver products and services to our customers, delay our ability to recognize revenue, compromise the integrity of our software products, result in significant data losses and the theft of our intellectual property, damage our reputation, expose us to liability to third parties and require us to incur significant additional costs to maintain the security of our networks and data.

We increasingly depend upon our IT systems to conduct virtually all of our business operations, ranging from our internal operations and product development activities to our marketing and sales efforts and communications with our customers and business partners. Unauthorized parties have attempted to penetrate our network security and our website. Such cyberattacks threaten to misappropriate our proprietary information and cause interruptions of our IT services. Because the techniques used by unauthorized persons to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including "bugs" and other problems, that could unexpectedly interfere with the operation of the system. We have also outsourced a number of our business functions to third party contractors, and our business operations also depend, in part, on the success of our contractors' own cybersecurity measures. Similarly, we rely upon distributors, resellers, system vendors and systems integrators to sell our products and our sales operations depend, in part, on the reliability of their cybersecurity measures. Additionally, we depend upon our employees to appropriately handle confidential data and deploy our IT resources in safe and secure fashion that does not expose our network systems to security breaches and the loss of data. Accordingly, if our cybersecurity systems and those of our contractors fail to protect against unauthorized access, sophisticated cyberattacks and the mishandling of data by our employees and contractors, our ability to conduct our business effectively could be damaged in a number of ways, including:

- sensitive data regarding our business, including intellectual property and other proprietary data, could be stolen;
- our electronic communications systems, including email and other methods, could be disrupted, and our ability to conduct our business operations could be seriously damaged until such systems can be restored and secured;
- our ability to process customer orders and electronically deliver products and services could be degraded, and our distribution channels could be disrupted, resulting in delays in revenue recognition;
- defects and security vulnerabilities could be exploited or introduced into our software products, thereby damaging the reputation and perceived reliability and security of our products and potentially making the data systems of our customers vulnerable to further data loss and cyberincidents; and
- personally identifiable data of our customers, employees and business partners could be stolen or lost.

Should any of the above events occur, we could be subject to significant claims for liability from our customers, regulatory actions from governmental agencies, our ability to protect our intellectual property rights could be compromised and our reputation and competitive position could be significantly harmed. Also, the regulatory and contractual actions, litigations, investigations, fines, penalties and liabilities relating to data breaches that result in losses of personally identifiable or credit card information of users of our services can be significant in terms of fines and reputational impact and necessitate changes to our business operations that may be disruptive to us. Additionally, we could incur significant costs in order to upgrade our cybersecurity systems and remediate damages. Consequently, our financial performance and results of operations could be adversely affected.

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

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

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

Revenues from customers outside the United States comprised approximately 52.3% of our total revenues in the first three months ended 2013 and 51.6% in 2012 . We have sales, administrative, research and development and technical support personnel in numerous countries worldwide. We expect to continue to add personnel in additional countries. Additionally, our investment portfolio includes investments in non-U.S. financial instruments and holdings in non-U.S. financial institutions, including European institutions. Our international operations subject us to a variety of risks, including:

- the difficulty of managing and staffing international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- increased exposure to foreign currency exchange rate risk;
- difficulties in enforcing contracts and collecting accounts receivable, and longer payment cycles, especially in emerging markets;
- difficulties in delivering support, training and documentation in certain foreign markets;
- tariffs and trade barriers and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- economic or political instability and security concerns in countries that are important to our international sales and operations;
- macroeconomic disruptions, such as monetary and credit crises, that can threaten the stability of local and regional financial institutions and decrease the value of our international investments;
- the overlap of different tax structures or changes in international tax laws;
- reduced protection for intellectual property rights, including reduced protection from software piracy in some countries;
- difficulties in transferring funds from certain countries; and
- difficulties in maintaining appropriate controls relating to revenue recognition practices.

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

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

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

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

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

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

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

We generally do not have long-term contracts or minimum purchase commitments with our distributors, resellers, system vendors and systems integrators, and our contracts with these channel partners do not prohibit them from offering products or services that compete with ours. Our competitors may be effective in providing incentives to existing and potential channel partners to favor products of our competitors or to prevent or reduce sales of our products. Certain system vendors now offer competing virtualization products preinstalled on their server products. Additionally, our competitors could attempt to require key distributors to enter into exclusivity arrangements with them or otherwise apply their pricing or marketing leverage to discourage distributors from offering our products. Accordingly, our channel partners may choose not to offer our products exclusively or at all. Our failure to maintain and increase the number of relationships with channel partners would likely lead to a loss of end users of our products which would result in us receiving lower revenues from our channel partners. Two of our distributors each accounted for 10% or more of revenues during the first three months of 2013 . Our agreements with distributors are typically terminable by either party upon 30 to 90 days’ prior written notice to the other party, and neither party has any obligation to purchase or sell any products under the agreements. While we believe that we have in place, or would have in place by the date of any such termination, agreements with replacement distributors sufficient to maintain our revenues from distribution, if we were to lose the distribution services of a significant distributor, such loss could have a negative impact on our results of operations until such time as we arrange to replace these distribution services with the services of existing or new distributors.

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

Two of our distributors each accounted for 10% or more of revenues during the first three months of 2013 . 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 46% of our total accounts receivable as of March 31, 2013 was from our three largest distributors. Some of our distributors may experience financial difficulties, which could adversely impact our collection of accounts receivable. One or more of these distributors could delay payments or default on credit extended to them. Our exposure to credit risks of our distributors may increase if our distributors and their customers are adversely affected by global or regional economic conditions. Additionally, we provide credit to distributors, resellers, and certain end-user customers in the normal course of business. Credit is generally extended to new customers based upon a credit evaluation. Credit is extended to existing customers based on ongoing credit evaluations, prior payment history, and demonstrated financial stability. We often allow distributors and customers to purchase and receive shipments of products in excess of their established credit limit. We are unable to recognize revenue from such shipments until the collection of those amounts becomes reasonably assured. 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 and delay our ability to recognize revenue.

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

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

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

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

We may become involved in litigation and regulatory inquiries and proceedings that could negatively affect us.

From time to time, we are involved in various legal, administrative and regulatory proceedings, claims, demands and investigations relating to our business, which may include claims with respect to patent, commercial, product liability, employment, class action, whistleblower and other matters. From time to time, we receive inquiries from government entities regarding the compliance of our contracting and sales practices with applicable regulations. Such matters can be time-consuming, divert management's attention and resources and cause us to incur significant expenses. While no formal legal proceedings that could have a material impact on our financial condition or results of operations have been taken, there can be no assurance that actions will not be taken in the future. Furthermore, because litigation and the outcome of regulatory proceedings are inherently unpredictable, it is possible that our business, financial condition or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims, demands or investigations.

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

Our business is subject to federal, state and international laws and regulations regarding privacy and protection of personal data. We collect contact and other personal or identifying information from our customers. Additionally, in connection with some of our new product initiatives, including the hybrid cloud service offering, our customers may use our services to store and process personal information and other user data. We post, on our websites, our privacy policies and practices concerning our treatment of personal data. We also often include privacy commitments in our contracts. Any failure by us to comply with our posted privacy policies, other federal, state or international privacy-related or data protection laws and regulations, or the privacy commitments contained in our contracts could result in proceedings against us by governmental entities or others which could have a material adverse effect on our business, financial condition and results of operations. In addition, the increased attention focused upon liability issues as a result of lawsuits and legislative proposals could harm our reputation or otherwise impact the growth of our business.

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

In addition to government regulation, privacy advocacy and industry groups or other third parties may propose new and different self-regulatory standards that either legally or contractually apply to our customers or us. Any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy or data protection laws, regulations and standards, could result in additional cost and liability to us, damage our reputation, inhibit sales and harm our business.

Additionally, our virtualization technology is used by cloud computing vendors, and we have expanded our involvement in the delivery and provision of cloud computing through business alliances with various providers of cloud computing services and software and expect to continue to do so in the future. The application of U.S. and international data privacy laws to cloud computing vendors is uncertain, and our existing contractual provisions may prove to be inadequate to protect us from claims for data loss or regulatory noncompliance made against cloud computing providers who we may partner with. Accordingly, the failure to comply with data protection laws and regulations by our customers and business partners who provide cloud computing services could have a material adverse effect on our business.

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

Our contracts with our customers may include unique and specialized performance requirements. In particular, our contracts with federal, state, local and non-U.S. governmental customers and our arrangements with distributors and resellers who may sell directly to governmental customers are subject to various procurement regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us to comply with provisions in our customer contracts or any violation of government contracting regulations could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business and affect our ability to compete for new contracts. From time to time, we receive inquiries from government entities regarding the compliance of our contracting and sales practices with applicable regulations. While no formal legal proceedings that could have a material impact on our financial condition or results of operations have been taken, there can be no assurance that actions will not be taken in the future. If our customer contracts are terminated, if we are suspended from government work or fines or other government sanctions are imposed, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse effect on our business, operating results or financial condition.

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

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

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

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

Our success and ability to compete depend substantially upon our internally developed technology, which is incorporated in the source code for our products. We seek to protect the source code, design code, documentation and other information relating to our software, under trade secret and copyright laws. However, we have chosen to provide access to our hypervisor and other selected source code to several dozen of our partners for co-development, as well as for open APIs, formats and protocols. Though we generally control access to our source code and other intellectual property, and enter into confidentiality or license agreements with such partners, as well as with our employees and consultants, this combination of procedural and contractual 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.

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

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

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

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

If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations. Although we have received inquiries regarding open source license compliance for software used in our products, no formal legal proceedings that would have a material impact on our results of operations or financial condition have been filed. However, there can be no assurance that actions will not be taken in the future. 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 exposes us to risks that differ from the use of third-party commercial software because open source licensors generally do not provide warranties or assurance of title or controls on origin of the software. In addition, many of the risks associated with usage of open source software such as the lack of warranties or assurances of title, cannot be eliminated, and could, if not properly addressed, negatively affect our business. We have established processes to help address these risks, including a review process for screening requests from our development organizations for the use of open source and conducting appropriate due diligence of the use of open source software in the products developed by companies we acquire, but we cannot ensure that all open source software is submitted for approval prior to use in our products or is discovered during due diligence.

We offer a number of products under open source licenses that subject us to additional risks and challenges, which could result in increased development expenses, delays or disruptions to the release or distribution of those software solutions, and increased competition.

Several of our product offerings are distributed under open source licenses. Additionally, in July 2012, we acquired Nicira whose expertise is in software-defined networking and whose principal products contain some open source software. Software solutions that are substantially or mostly based on open source software subject us to a number of risks and challenges:

- If open source software programmers, most of whom we do not employ, do not continue to develop and enhance open source technologies, our development expenses could be increased and our product release and upgrade schedules could be delayed.
- One of the characteristics of open source software is that anyone can modify the existing software or develop new software that competes with existing open source software. As a result, competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is also possible for new competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our solutions.
- It is possible that a court could hold that the licenses under which our open source products and services are developed and licensed are not enforceable or that someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable, or that open source components of our product or services offerings may not be liberally copied, modified or distributed, may have the effect of preventing us from distributing or developing all or a portion of our products or services. In addition, licensors of open source software employed in our offerings may, from time to time, modify the terms of their license agreements in such a manner that those license terms may no longer be compatible with other open source licenses in our offerings or our end-user license agreement or terms of service, and thus could, among other consequences, prevent us from continuing to distribute the software code subject to the modified license or terms of service.
- Actions to protect and maintain ownership and control over our intellectual property could adversely affect our standing in the open source community, which in turn could limit our ability to continue to rely on this community, upon which we are dependent, as a resource to help develop and improve our open source products and services.

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

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

We have acquired in the past and plan to acquire in the future other businesses, products or technologies. For example, in 2012 we completed a number of acquisitions, including acquisitions of Wanova, Dynamic Ops and Nicira and in 2013 we completed the acquisition of Virsto Software. We may not be able to find suitable acquisition candidates, and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or they may be viewed negatively by customers, financial markets or investors.

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

Additionally, we have limited historical experience with the integration of acquired companies. There can be no assurance that we will be able to manage the integration of acquired businesses effectively or be able to retain and motivate key personnel from these businesses. We may also face difficulties due to the lack of experience in new markets, products or technologies or the initial dependence on unfamiliar supply or distribution partners. Other risks related to acquisitions include the assumption of the liabilities of the acquired business, including litigation-related liabilities.

If our acquisitions do not meet our expectations, or if our strategic focus subsequently changes, we may choose to abandon certain acquired product lines and divest from acquired businesses. For example, in January 2013, we announced a plan to streamline our operations that included a planned exit of certain lines of business, including SlideRocket and Shavlik. It is generally difficult for an acquirer to completely recover the cost of an acquisition which is subsequently divested. Accordingly, divestitures of acquired businesses and products may result in us taking charges for impairment of assets and goodwill, and result in cash expenditures in connection with headcount reductions.

In addition to the risks commonly encountered in the acquisition of a business as described above, we may also experience risks relating to the challenges and costs of closing a transaction. Further, the risks described above may be exacerbated as a result of managing multiple acquisitions at the same time. We also seek to invest in businesses that offer complementary products, services or technologies. These investments are accompanied by risks similar to those encountered in an acquisition of a business.

If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.

We may not realize all the economic benefit from our acquisitions of other companies, which could result in an impairment of goodwill or intangibles. During 2012, our goodwill balance increased by $1.1 billion or 62% as a result of acquisitions made during the year, primarily for Nicira. Under GAAP, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be considered a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in stock price and market capitalization or cash flows, reduced future cash flow estimates, and slower growth rates in our industry. We may be required to record a significant charge in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively impacting our results of operations.

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

In order to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we need to maintain our processes and systems and adapt them to changes as our business changes and we rearrange management responsibilities and reorganize our business accordingly. We may seek to automate certain processes to improve efficiencies and better ensure ongoing compliance but such automation may itself disrupt existing internal controls and introduce unintended vulnerability to error or fraud. This continuous process of maintaining and adapting our internal controls and complying with Section 404 is expensive and time-consuming, and requires significant management attention. We cannot be certain that our internal control measures will continue to provide adequate control over our financial processes and reporting and ensure compliance with

Section 404. Furthermore, as our business changes and as we expand through acquisitions of other companies, our internal controls may become more complex and we will require significantly more resources to ensure our internal controls overall remain effective. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm identify material weaknesses, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. In addition, if we are unable to continue to comply with Section 404, our non-compliance could subject us to a variety of administrative sanctions, including the suspension or delisting of our Class A common stock from the New York Stock Exchange and the inability of registered broker-dealers to make a market in our Class A common stock, which could reduce our stock price.

Problems with our information systems could interfere with our business that could adversely impact our operations.

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

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

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

Our future effective tax rate may be affected by such factors as changes in tax laws, regulations or rates, changing interpretation of existing laws or regulations, the impact of accounting for stock-based compensation, the impact of accounting for business combinations, changes in our international organization, and changes in overall levels of income before tax. For example, the U.S. federal research credit, which provided a significant reduction in our effective tax rate, expired on December 31, 2011. Reinstatement of the U.S. federal research credit would have a favorable effect on our effective tax rate. In January 2013, the United States Congress retroactively enacted an extension of the federal research credit through December 31, 2013. As a result, our income tax provision for the first quarter of 2013 includes an estimated discrete tax benefit reflecting the full year 2012 federal research credit, and our 2013 annual estimated effective tax rate also includes the benefit expected for 2013. Accordingly, our 2013 effective tax rate is expected to be lower than the 2012 effective tax rate.

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

Additionally, our rate of taxation in foreign jurisdictions is lower than the U.S. tax rate. Our international income is primarily earned by our subsidiaries in Ireland, where the statutory tax rate is 12.5%. All income earned abroad, except for previously taxed income for U.S. tax purposes, is considered indefinitely reinvested in our foreign operations and no provision for U.S. taxes has been provided with respect to such income. If management determines these overseas funds are needed for our operations in the U.S., we would be required to accrue U.S. taxes on the related undistributed earnings in the period management determines the earnings will no longer be indefinitely invested outside the U.S. to repatriate these funds.

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

Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity. A significant natural disaster, such as an earthquake, fire, flood or other act of God, could have a material adverse impact on our business, financial condition and results of operations. As we continue to grow internationally, increasing amounts of our business will be located in foreign countries that may be more subject to political or social instability that could disrupt operations. Furthermore, some of our new product initiatives and business functions are hosted and carried out by third parties that may be vulnerable to disruptions of these sorts, many of which may be beyond our control. In addition, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Unanticipated disruptions in services provided through localized physical infrastructure, such as utility or telecommunication outages, can curtail the functioning of local offices as well as critical components of our information systems and adversely affect our ability to process orders, provide services, respond to customer requests and maintain local and global business continuity. Natural disasters that affect the manufacture of IT products, such as the 2011 flooding in Thailand, can also delay customer spending on our software, which is often coupled with customer purchases of new servers and IT systems. Furthermore, acts of terrorism or war could cause disruptions in our or our customers' business or the economy as a whole and disease pandemics could temporarily sideline a substantial part of our or our customers' workforce at any particular time. To the extent that such disruptions result in delays or cancellations of customer orders, or the deployment or availability of our products and services, our revenues would be adversely affected. Additionally, we may incur significant costs to repair damages to our facilities and equipment.

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

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

Risks Related to Our Relationship with EMC

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

As of March 31, 2013 , EMC owned 42,536,000 shares of our Class A common stock and all 300,000,000 shares of our Class B common stock, representing 80.0% of the total outstanding shares of common stock or 97.3% of the voting power of outstanding common stock. The holders of our Class A common stock and our Class B common stock have identical rights, preferences and privileges except with respect to voting and conversion rights, the election of directors, certain actions that require the consent of holders of Class B common stock and other protective provisions as set forth in our certificate of incorporation. Holders of our Class B common stock are entitled to 10 votes per share of Class B common stock on all matters except for the election of our Group II directors, in which case they are entitled to one vote per share, and the holders of our Class A common stock are entitled to one vote per share of Class A common stock. The holders of Class B common stock, voting separately as a class, are entitled to elect 80% of the total number of directors on our board of directors that we would have if there were no vacancies on our board of directors at the time. These are our Group I directors. Subject to any rights of any series of preferred stock to elect directors, the holders of Class A common stock and the holders of Class B common stock, voting together as a single class, are entitled to elect our remaining directors, which at no time will be less than one director-our Group II director(s). Accordingly, the holders of our Class B common stock currently are entitled to elect 8 of our 9 directors.

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

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

- the composition of our board of directors and, through our board of directors, any determination with respect to our business plans and policies;
- any determinations with respect to mergers, acquisitions and other business combinations;
- our acquisition or disposition of assets;
- our financing activities;
- certain changes to our certificate of incorporation;
- changes to the agreements we entered into in connection with our transition to becoming a public company;
- corporate opportunities that may be suitable for us and EMC;
- determinations with respect to enforcement of rights we may have against third parties, including with respect to intellectual property rights;
- the payment of dividends on our common stock; and
- the number of shares available for issuance under our stock plans for our prospective and existing employees.

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

- consolidate or merge with any other entity;
- acquire the stock or assets of another entity in excess of $100 million;
- issue any stock or securities except to our subsidiaries or pursuant to our employee benefit plans;
- establish the aggregate annual amount of shares we may issue in equity awards;
- dissolve, liquidate or wind us up;
- declare dividends on our stock;
- enter into any exclusive or exclusionary arrangement with a third party involving, in whole or in part, products or services that are similar to EMC's; and
- amend, terminate or adopt any provision inconsistent with certain provisions of our certificate of incorporation or bylaws.

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

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

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

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

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

EMC could assert control over us in a manner which could impede our growth or our ability to enter new markets or otherwise adversely affect our business. Further, EMC could utilize its control over us to cause us to take or refrain from taking certain actions, including entering into relationships with channel, technology and other marketing partners, enforcing our intellectual property rights or pursuing business combinations, other 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 joint launch of GoPivotal, Inc. (" Pivotal ") with EMC may not prove successful.

In April 2013, we contributed technology and transferred employees to Pivotal, a subsidiary of EMC, established to focus on Big Data and Cloud Application Platforms. Pivotal is led by Paul Maritz, its Chief Executive Officer and our former Chief Executive Officer, and includes most employees and resources formerly working within EMC's Greenplum and Pivotal Labs organizations, and our vFabric (including Spring and Gemfire), Cloud Foundry and Cetas organizations, as well as related efforts. Pivotal's ability to operate successfully will require, among other factors:

- the ability to successfully integrate technology from both us and EMC;
- the ability to create offerings for which there is suitable demand in the marketplace;
- the ability to have an effective go-to-market practice;
- the ability to differentiate offerings developed by the initiative from competitors;
- the ability to have adequate financial resources to fund its operations.

In the event that Pivotal is unable to operate successfully, we may be asked to contribute capital resources to Pivotal or accept dilution in our ownership interest, and we may be unable to realize any value from the technology and resources that we contributed to Pivotal.

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

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

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

Third parties may seek to hold us responsible for EMC's liabilities. Under our master transaction agreement with EMC, EMC will indemnify us for claims and losses relating to liabilities related to EMC's business and not related to our business.

However, if those liabilities are significant and we are ultimately held liable for them, we cannot be certain that we will be able to recover the full amount of our losses from EMC.

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

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

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

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

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

- labor, tax, employee benefit, indemnification and other matters arising from our separation from EMC;
- employee retention and recruiting;
- business combinations involving us;
- our ability to engage in activities with certain channel, technology or other marketing partners;
- sales or dispositions by EMC of all or any portion of its ownership interest in us;
- the nature, quality and pricing of services EMC has agreed to provide us or we have agreed to provide to EMC;
- arrangements with third parties that are exclusionary to EMC;
- arrangements with EMC for collaborative product or technology development, marketing and sales activities involving our technology, employees and other resources;
- business opportunities that may be attractive to both EMC and us; and
- product or technology development or marketing activities or customer agreements which may require the consent of EMC.

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

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

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

Our CEO and some of our directors own EMC common stock or equity awards to purchase EMC common stock. In addition, some of our directors are executive officers or directors of EMC, and EMC, as the sole holder of our Class B common stock, is entitled to elect 8 of our 9 directors. Ownership of EMC common stock, restricted shares of EMC common stock and equity awards to purchase EMC common stock by our directors and the presence of executive officers or directors of EMC on our board of directors could create, or appear to create, conflicts of interest with respect to matters involving both us and EMC that could have different implications for EMC than they do for us. Provisions of our certificate of incorporation and the master transaction agreement between EMC and us address corporate opportunities that are presented to our directors or officers that are also directors or officers of EMC. There can be no assurance that the provisions in our certificate of incorporation or the master transaction agreement will adequately address potential conflicts of interest or that potential conflicts of interest will be resolved in our favor or that we will be able to take advantage of corporate opportunities presented to individuals who are officers or directors of both us and EMC. As a result, we may be precluded from pursuing certain growth initiatives.

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

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

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

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

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

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

Our historical financial information as a majority-owned subsidiary of EMC may not be representative of the results of a completely independent public company.

The financial information covering the periods included in this Quarterly Report on Form 10-Q does not necessarily reflect what our financial condition, results of operations or cash flows would have been had we been a completely independent entity during those periods. In certain geographic regions where we do not have an established legal entity, we contract with EMC subsidiaries for support services and EMC personnel who are managed by us. The costs incurred by EMC on our behalf related to these employees are passed on to us and we are charged a mark-up intended to approximate costs that would have been charged had we contracted for such services with an unrelated third party. These costs are included as expenses in our consolidated statements of income. Additionally, we and EMC engage in intercompany transactions, including agreements regarding the use of EMC's and our intellectual property and real estate, agreements regarding the sale of goods and services to one another and to Pivotal, and an agreement for EMC to resell our products and services to third party customers. Accordingly, our historical financial information is not necessarily indicative of what our financial condition, results of operations or cash flows will be in the future if and when we contract at arm's length with independent third parties for the services we have received and currently receive from EMC. In the three months ended March 31, 2013 , we recognized revenues of $54.9 million and as of March 31, 2013 , $179.1 million of revenues were included in unearned revenues from such transactions with EMC on our financial statements. For additional information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto.

Risks Related to Owning Our Class A Common Stock

The price of our Class A common stock has fluctuated substantially in recent years and may fluctuate substantially in the future.

The trading price of our Class A common stock has fluctuated significantly since our IPO in August 2007. For example, between January 1, 2012 and March 31, 2013, the closing trading price of our Class A common stock was very volatile, ranging between $70.37 and $114.62 per share. Our trading price could fluctuate substantially in the future due to the factors discussed in this Risk Factors section and elsewhere in this Quarterly Report on Form 10-Q.

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

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

If securities or industry analysts 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.

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

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

- the division of our board of directors into three classes, with each class serving for a staggered three-year term, which would prevent stockholders from electing an entirely new board of directors at any annual meeting;
- the right of the board of directors to elect a director to fill a vacancy created by the expansion of the board of directors;
- following a 355 distribution of Class B common stock by EMC to its stockholders, the restriction that a beneficial owner of 10% or more of our Class B common stock may not vote in any election of directors unless such person or group also owns at least an equivalent percentage of Class A common stock or obtains approval of our board of directors prior to acquiring beneficial ownership of at least 5% of Class B common stock;
- the prohibition of cumulative voting in the election of directors or any other matters, which would otherwise allow less than a majority of stockholders to elect director candidates;
- the requirement for advance notice for nominations for election to the board of directors or for proposing matters that can be acted upon at a stockholders' meeting;
- the ability of the board of directors to issue, without stockholder approval, up to 100,000,000 shares of preferred stock with terms set by the board of directors, which rights could be senior to those of common stock; and
- in the event that EMC or its successor-in-interest no longer owns shares of our common stock representing at least a majority of the votes entitled to be cast in the election of directors, stockholders may not act by written consent and may not call special meetings of the stockholders.

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.

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

- (a) Sales of Unregistered Securities

  None.

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

  None.

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

  Purchases of equity securities during the three months ended March 31, 2013 :

	Total Number of Shares Purchased (1)	Average Price Paid Per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (4)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Publicly Announced Plans or Programs (2)(3)(4)
January 1 – January 31, 2013	417,510	$ 77.79	—	$ 468,054,934
February 1 – February 28, 2013	3,167,536	77.28	2,099,823	305,643,169
March 1 – March 31, 2013	261,673	74.53	261,673	286,141,830
	3,846,719	77.15	2,361,496	286,141,830

(1) Includes 1,485,223 shares repurchased by EMC in open market transactions. In 2010, EMC announced a stock purchase program of VMware’s Class A common stock to maintain its approximate level of ownership in VMware over the long term. Inclusion of EMC’s purchases in the above table does not indicate that EMC is deemed to be an “affiliated purchaser” with respect to the VMware stock repurchase program discussed in the following footnote. Shares purchased by EMC remain issued and outstanding.

(2) In February 2012, VMware’s Board of Directors authorized the repurchase of up to $600.0 million of VMware’s Class A common stock through the end of 2013 . In November 2012, VMware’s Board of Directors authorized the repurchase of up to an additional $250.0 million of VMware’s Class A common stock through the end of 2014 . VMware’s Class A common stock has been, and may in the future be, purchased pursuant to our stock repurchase authorizations, from time to time, in the open market or through private transactions, subject to market conditions. We are not obligated to purchase any shares under our stock repurchase program. Subject to applicable laws, repurchases under our stock repurchase program may be made at such times and in such amounts as we deem appropriate. The timing of any repurchases and the actual number of shares repurchased will depend on a variety of factors, including VMware’s stock price, cash requirements for operations and business combinations, corporate and regulatory requirements and other market and economic conditions. Purchases under our stock repurchase program can be discontinued at any time that we feel additional purchases are not warranted.

(3) Represents the amounts remaining in the VMware stock repurchase authorizations.

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

			Incorporated by Reference	
Exhibit Number	Exhibit Description	Filed Herewith	Form/ File No.	Date
3.1	Amended and Restated Certificate of Incorporation		S-1/A-2	7/9/2007
3.2	Amended and Restated Bylaws		8-K	3/8/2011
10.20+	Executive Bonus Program, amended and restated February 14, 2013	X		
31.1	Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
31.2	Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
101.INS	XBRL Instance Document	X		
101.SCH	XBRL Taxonomy Extension Schema	X		
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X		
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X		
101.LAB	XBRL Taxonomy Extension Label Linkbase	X		
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X		

+ Management contract or compensatory plan or arrangement

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: May 3, 2013	By: /s/ Jonathan C. Chadwick
	Jonathan C. Chadwick **Chief Financial Officer and Executive Vice President** **(Principal Financial Officer and Principal Accounting Officer)**

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference		
		Filed Herewith	Form/ File No.	Date
3.1	Amended and Restated Certificate of Incorporation		S-1/A-2	7/9/2007
3.2	Amended and Restated Bylaws		8-K	3/8/2011
10.20+	Executive Bonus Program, amended and restated February 14, 2013	X		
31.1	Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
31.2	Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
101.INS	XBRL Instance Document	X		
101.SCH	XBRL Taxonomy Extension Schema	X		
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X		
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X		
101.LAB	XBRL Taxonomy Extension Label Linkbase	X		
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X		

VMware, Inc.
Executive Bonus Program

Executive Bonus Program Objectives

Among the objectives of the VMware Bonus Program are to:

- motivate our executives to achieve our strategic, operational and financial goals
- reward superior performance
- attract and retain exceptional executives; and
- reward behaviors that result in long term increased stockholder value

Overview

The Compensation and Corporate Governance Committee has adopted a cash bonus program relating to performance (the “Executive Bonus Program”) under the 2007 Equity and Incentive Plan (the "Plan") providing for possible cash bonuses to specified executives of VMware, Inc. and its consolidated subsidiaries (the "Company"). Unless otherwise indicated herein, provisions of the Plan shall apply to the Executive Bonus Program.

In keeping with VMware’s philosophy of tying a substantial portion of our executive compensation to the achievement of measurable achievements, a goals-based cash bonus program has been developed and implemented. The determination of bonus payouts will be made semiannually after the conclusion of the semi-annual measurement periods ending on June 30 and December 31 based on results achieved by the company, as reported to the Compensation and Corporate Governance Committee by the Chief Financial Officer, Chief Accounting Officer or Corporate Controller. Bonuses will be determined by the Compensation and Corporate Governance Committee of the Board of Directors (the “Administrator”). Bonus payments will only occur if certain predetermined company and individual (“MBO”) objectives are successfully achieved. Bonus amounts will be calculated (“Calculated Bonus Amounts”) based upon the degree of achievement of the predetermined objectives. The Compensation and Corporate Governance Committee shall determine final bonus payouts and, in its discretion, taking into account review and discussion of recommendations made by the Chief Executive Officer, may reduce, but not increase, final bonus payouts from the Calculated Bonus Amounts.

Bonus awards represent an unfunded, unsecured promise by the Company to pay a bonus amount determined by the Compensation and Corporate Governance Committee to each Participant, but only upon satisfaction of the performance criteria determined by the Compensation and Corporate Governance Committee in accordance with the provisions set forth below.

Eligibility

All senior executives are eligible to be considered for participation. However, no person is automatically entitled to participate in the Executive Bonus Program. Participants will be approved solely at the discretion of the Compensation and Corporate Governance Committee and may be amended at any time by the Compensation and Corporate Governance Committee. Additionally, the executive must be an employee of the Company at the time the bonus is paid out in order to vest in right to receive payment.

Participants may include executive officers of the Company as defined under Rule 3b-7 of the 1934 Securities Exchange Act (“Executive Officers”) and other senior executives who are not Executive Officers. At its discretion, the Compensation and Corporate Governance Committee may delegate authority to the Chief Executive Officer to add senior executives who are not Executive Officers to the Executive Bonus Program.

Administration

As Administrator, the Compensation and Corporate Governance Committee is ultimately responsible for administering the Executive Bonus Program. The Administrator has all powers and discretion necessary or appropriate to review and approve the Executive Bonus Program and its operation, including, but not limited to, the power to (a) determine Participants, (b) interpret the provisions of the Executive Bonus Program, (c) adopt rules for the administration, interpretation and application of the Executive Bonus Program consistent with the Plan, and (d) interpret, amend or revoke any such rules. All determinations and decisions made by the Administrator and any decision of the Administrator shall be final, conclusive, and binding on all persons, and shall be given the maximum deference permitted by law.

The Administrator, in its sole discretion, may amend or terminate the Executive Bonus Program, or any part thereof, at any time and for any reason, subject to the limitations set forth in Sections 3, 6(b)(iv) and 7 of the Plan.

The Administrator shall exercise full authority to make final determinations with respect to bonuses granted under the Executive Bonus Program to Executive Officers. The Administrator may, in its discretion, delegate authority over bonuses to Participants who are not Executive Officers to the Chief Executive Officer of the Company.

Target Percentage

The Administrator shall establish target bonuses and bonus formulas for the Executive Bonus Program.

Target bonus amounts will be a percentage of a Participant's actual semi-annual base salary during the course of the Performance Period as of the date the target bonus percentage is established (the "Target Bonus Percentage").

The Calculated Bonus Amount, if any, may range 0% to 200% of the Target Bonus Percentage multiplied by the Participant's actual semi-annual base salary depending upon performance achievement. Minimum bonus thresholds are described below. For purposes of this calculation, Participant's actual semi-annual base salary shall not exceed 200% of the Participant's base salary as of the date that semi-annual performance targets are approved.

Performance Period

Unless otherwise indicated, the performance periods for bonuses granted under the Executive Bonus Program shall run each year from January 1 to June 30 and from July 1 to December 31 . (each, a "Performance Period"). Participants are rewarded during the period that they are actively employed by VMware.

Participants are not eligible to participate in any other Company bonus or incentive plan during a Performance Period. This exclusion does not apply, however, to applicable employee referral bonuses, spot bonuses, equity awards, or Company contributions to qualified retirement or savings plans.

> **New Hires** : Calculated Bonus Amounts will be prorated for newly hired participants based on the number of days they are employed during the Performance Period.
>
> **Leaves of Absence:** Calculated Bonus Amounts will be prorated for any time during the Performance Period that a Participant is on an unpaid leave of absence status. Unpaid leaves of absence exclude those absences for which vacation, sick leave or other compensation is paid directly by the Company. Unpaid absences include those absences for which compensation is received from any source other than directly from the Company.
>
> **Changes in Position** : Participants who move from one bonus-eligible position to a different bonus-eligible position with a different target bonus percentage may earn a target bonus prorated based on base pay and bonus at the start of each period.
>
> **Termination** : In order to vest and the right to receive a bonus under the Executive Bonus Program, an employee must be in an active employment status or on approved leave at the day the bonus is paid out. An employee whose employment ends for any reason prior to that date will not earn and will not be paid any bonus under this Executive Bonus Program.

The Compensation and Corporate Governance Committee shall have the exclusive discretion to determine when a Participant is no longer actively employed for purposes of the Executive Bonus Program. Participants have no right or interest in any bonus and such bonus is not earned unless the Administrator determines a bonus payout is due.

Performance Metrics

The Calculated Bonus Amount will depend on both a company component ("Corporate Financial Metric") and an individual component ("MBO") selected from the performance goals from the 2007 Plan. The Company must meet a minimum performance threshold established within the Corporate Financial Metric in order for any bonus payouts to be made. If the minimum threshold is not achieved, the Executive Bonus Program shall not be funded and no bonus payouts shall be made. The Corporate Financial Metrics and the relative weighting of the Corporate Financial Metrics and the MBOs shall be determined by the Committee within 45 days of the commencement of the performance period. The MBOs shall be determined by the Committee within 45 days of the commencement of the performance period;

provided, however, that if the MBOs are used solely solely as a factor for the Administrator to consider in determining whether to exercise negative discretion, then they can be established or amended at any time during the performance period.

Corporate Financial Metric Component

The Corporate Financial Metric shall be determined by calculating success against company-wide financial metrics and, as applicable, business unit performance metrics, as determined by the Compensation and Corporate Governance Committee.

MBO (Individual) Component

Each Participant will be assigned individual performance goals by the Compensation and Corporate Governance Committee that are appropriate to the Participant's role at the Company. If threshold achievement of 80% of the Corporate Financial Metric is met, then the MBO component is funded at the same percentage as the Corporate Financial Metric. The Compensation and Corporate Governance Committee can exercise negative discretion to reduce the bonus for the MBO component. In making its determination whether to reduce the bonus for the MBO component, the Committee's shall review and discuss the Chief Executive Officer's assessment of each Participant's achievement of his or her individual performance goals.

Bonus Determination and Payment

The Compensation and Corporate Governance Committee shall determine final bonus payouts to Participants based upon achievement of the foregoing metrics and goals. The Committee reserves the right to reduce bonus payouts below Calculated Bonus Amounts or not make any bonus payouts in its sole discretion.

Cancellation, Rescission and Recoupment of Awards

Any bonus granted under this Executive Bonus Program to a Participant shall be subject to cancellation, rescission, repayment or other action at the discretion of the Compensation Committee as set forth in Section 7(d) of the Plan in the event that such Participant engages in "Detrimental Activity" as such term is defined in Section 7(d).

Additionally, the Compensation and Corporate Governance Committee shall have the discretion to require that each Participant reimburse the Company for all or any portion of any bonuses paid under the Executive Bonus Program if –

(a) the payment was predicated upon the achievement of certain financial results that were subsequently the subject of a material financial restatement,

(b) in the Board's view, the Participant engaged in fraud or misconduct that caused or partially caused the need for a material financial restatement by the Company or any substantial affiliate, and

(c) a lower payment, award, or vesting would have occurred based upon the restated financial results.

In each such instance, upon the determination of the Compensation and Corporate Governance Committee to require recoupment of a previously paid bonus awarded under the Executive Bonus Program, the Company will, to the extent practicable and allowable under applicable laws, require reimbursement of any bonus awarded for the relevant period exceeded the lower payment that would have been made based on the restated financial results, provided that the Company will not seek to recover bonuses compensation paid more than three years prior to the date the applicable restatement is disclosed.

At-Will Employment (US Only)

This Plan does not affect the terminable-at-will status of the employment relationship. Neither the attainment of goals nor the continuous service requirement necessary to earn a bonus alters the ability of an employee or the Company to terminate employment at any time, with or without reason and with or without advance notice.

Exhibit 31.1

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

I, Patrick P. Gelsinger, certify that:

1. I have reviewed this annual 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 Rules13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   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:	May 3, 2013	By:	/s/ Patrick P. Gelsinger
			Patrick P. Gelsinger **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, Jonathan C. Chadwick, certify that:

1. I have reviewed this annual 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 Rules13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   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: May 3, 2013

By: /s/ Jonathan C. Chadwick

Jonathan C. Chadwick
Chief Financial Officer and Executive Vice President
(Principal Financial Officer and Principal Accounting 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, Patrick P. Gelsinger, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, the Quarterly Report of VMware, Inc. on Form 10-Q for the fiscal quarter ended March 31, 2013 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:	May 3, 2013	By:	/s/ Patrick P. Gelsinger
			Patrick P. Gelsinger **(Principal Executive Officer)**

Exhibit 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

I, Jonathan C. Chadwick, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, the Quarterly Report of VMware, Inc. on Form 10-Q for the fiscal quarter ended March 31, 2013 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:	May 3, 2013	By:	/s/ Jonathan C. Chadwick
			Jonathan C. Chadwick **Chief Financial Officer and Executive Vice President** **(Principal Financial Officer and Principal Accounting Officer)**